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**FROM THE CHAIR – RANDOM RANTS AND RAVES**

By: Alan M. Parness
Cadwalader, Wickersham & Taft LLP

A. **Whither the “EFD”?**

For those of us who attended the North American Securities Administrators Association’s (“NASAA”) Annual Conference in Baltimore this past September,
we were provided with an update at the “Corporate Finance Section Forum” on the status of NASAA’s long-awaited “one-stop filing system” (which has now been assigned the acronym “EFD,” for “Electronic Filing of Form D”) for notice filings of offerings complying with Rule 506 (“Rule 506”) of Regulation D (“Regulation D”) promulgated by the U.S. Securities and Exchange Commission (the “SEC”) under the Securities Act of 1933, as amended (the “Securities Act”). According to a presentation by Willie Neumann, the outside consultant to NASAA’s Regulation D Electronic Filing Committee, and a gentleman whose name escapes me, but whom I believe was from the outside firm which will actually run the EFD, it seems that we shouldn’t expect the EFD to be up and running until possibly the summer of 2011.

As I’ve indicated previously, I still question whether all states will have the legal authority to participate in the EFD when NASAA first pushes the button on the system, and whether issuers will still be stuck with idiosyncratic filing requirements in certain states (e.g., the need to submit manually-signed Form D’s and/or separate Form U-2’s directly to the state), which clearly defeat the purpose of an electronic filing system. By analogy, I note that there are still states which insist on receiving documents in addition to those required to be filed on the CRD and IARD systems in connection with broker-dealer, investment adviser, agent, and investment adviser representative registrations, regardless of whether such additional documents are actually necessary (or even reviewed when received). For example, I came across one state rule governing broker-dealer registration applications which requires applicants to not only submit their BD Forms via the CRD, but to separately submit a manually-signed and notarized facing page to Form BD directly to the state. In most cases, however, I believe that a careful reading of the statutes governing Rule 506 notice filings will rarely reveal that the submission of a manually-signed Form D and/or a separate manually-signed Form U-2 is specifically mandated as a matter of law, but that these requirements are actually something simply imposed by means of administrative fiat, premised on antiquated and unnecessary practices.

For those states still beholden to the idea that they need manual signatures on forms, according to the National Conference of State Legislatures, all states, with the exception of Illinois, New York and Washington (which have adopted other statutes on point), as well as the District of Columbia, Puerto Rico and the U.S. Virgin Islands, have adopted a version of the Uniform Electronic Transactions Act (the “UETA”). See http://www.ncsl.org/default.aspx?tabid=13484 for a chart of state adoptions of the UETA; a copy of the UETA is available at http://www.law.upenn.edu/bll/archives/ulp/ecom/ueta_final.pdf. While I will confess to no special expertise with the UETA, nor familiarity with the version of the UETA enacted by any particular state, I note that Section 18 of the UETA, an optional provision titled “Acceptance and Distribution of Electronic Records by Governmental Agencies,” doesn’t mandate that state agencies accept electronic records and electronic signatures, but rather leaves it up to each agency or some designated state officer to determine which records may be received and stored in electronic form, and which electronic records may be required to be signed by electronic means. Nevertheless, it seems to me that any state which has adopted a version of the UETA, including Section 18, has indicated its willingness to move its recalcitrant bureaucracy into the 21st Century and that they should be prepared to accept electronic records and signatures.

Of course, we have yet to be provided with any price list of any additional service or other fees and charges NASAA plans on imposing on EFD users in addition to state filing fees (you can be sure that there will be such additional fees and charges!). In this regard, I’m concerned that these additional fees and charges might cause the EFD to go the way of NASAA’s ill-fated “Securities Registration Depository” (the “SRD”), unless use of the EFD becomes mandatory. For those of you too young to remember the SRD, it was set up by NASAA in those wonderful days of yore, prior to NSMIA and the advent of the Internet, and was intended to serve as an adjunct to the SEC’s then-new EDGAR system, whereby persons could voluntarily make all their state securities registration filings by means of a single filing through the SRD. Unless my memory has failed me in my dotage, it’s my recollection that mutual funds, who were anticipated to be the primary beneficiaries of the SRD, balked at using the system, when they determined that the additional fees and charges which NASAA sought to impose on users would exceed their current costs of simply sending hard copies of documents to the individual states via mail or courier service! Once the mutual funds opted out of using the SRD, the system promptly died. Accordingly, I would hope that any additional fees and charges which NASAA may seek to impose on EFD users are
nominal, given that these are intended to be simple notice filings.

B. The Dodd-Frank Act’s Impact on Investment Advisers

1. Introduction

Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (the “DFA”), is separately titled the “Private Fund Investment Advisers Registration Act of 2010,” and effected significant amendments to the Investment Advisers Act of 1940, as amended (the “Advisers Act”), which will impact investment advisers, whether presently registered, or exempt from registration, with the SEC under the Advisers Act, or registered with one or more states. In accordance with DFA § 419, the relevant amendments are all effective July 21, 2011, and many of the amendments require SEC rulemaking; the SEC has recently proposed certain rules in response to the DFA, which are described below.

2. DFA § 410 and “Mid-Sized Investment Advisers”

Of particular interest to Blue Sky practitioners, because of its potential impact on the current bifurcated jurisdiction over investment advisers between the SEC and the states under Advisers Act § 203A, as added by the National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290 (“NSMIA”), is DFA § 410. Until July 21, 2011, Advisers Act § 203A(a)(1) and SEC rules promulgated thereunder prohibit an investment adviser from registering with the SEC if it is regulated or required to be regulated as an investment adviser in the state in which it maintains its “principal office and place of business” [as defined in SEC Advisers Act Rule 203A-3(c) to mean the executive office of the adviser from which the officers, partners, or managers of the adviser direct, control, and coordinate the adviser’s activities], unless: (i) it has at least $25 million of “assets under management,” a term defined in Advisers Act § 203A(a)(2) to mean securities portfolios with respect to which an investment adviser provides continuous and regular supervisory and management services (“AUM”), or a higher amount set by SEC rule [pursuant to SEC Advisers Act Rule 203A-1, advisers need at least $30 million of AUM to be required to register with the SEC, while those satisfying the $25 million of AUM statutory threshold may register with the SEC]; (ii) it serves as an investment adviser to an investment company registered under the Investment Company Act of 1940, as amended (the “Company Act”); (iii) it satisfies at least one of certain exemptions in SEC Advisers Act Rule 203A-2 (for example, it would be required to be registered as an adviser in 30 or more states); or (iv) it has its principal office and place of business in Wyoming, since that is the only state which currently has no statutory provisions relating to regulation of investment advisers.

In turn, pursuant to Advisers Act § 203A(b), investment advisers registered with the SEC under Advisers Act § 203, or not registered because they satisfy one of the exceptions from the definition of “investment adviser” in Advisers Act § 202(a)(11), are not subject to registration, licensing or qualification as an investment adviser in any state. However, a state may require the registration, licensing or qualification of any “investment adviser representative” of an SEC-registered adviser with a “place of business” in the state [SEC Advisers Act Rule 203A-3(a) and (b) define the terms “investment adviser representative” and “place of business” of such a representative for purposes of Advisers Act § 203A(b)]. States may, however, require SEC-registered advisers to make non-substantive notice filings pursuant to NSMIA § 307, an uncodified provision of that Act. Thus, Advisers Act § 203A created a clear bifurcation of investment adviser registration and regulation between the SEC and the states, essentially giving the SEC authority over larger advisers, while leaving the regulation of smaller advisers to the states.

While DFA § 410 didn’t change the $25 million of AUM threshold in Advisers Act § 203A(a)(1), and renumbered the definition of “AUM” in Advisers Act § 203A(a)(2) as Section 203A(a)(3), it did insert a new Section 203A(a)(2), entitled “Treatment of Mid-sized Investment Advisers” (note that the term “mid-sized investment adviser” is not specifically defined in Advisers Act § 203A(a)(2) or elsewhere in the Advisers Act, nor is it used again after the caption of that paragraph). Under this provision, also effective July 21, 2011, unless an adviser: (a) is an adviser to an investment company registered under the Company Act, (b) is an adviser to a company which
elected to be a business development company pursuant to Company Act § 54, or (c) would be required to register with 15 or more states by reason of this new provision, it will be prohibited from registering with the SEC if: (i) it is required to be registered as an investment adviser with the securities administrator of the state in which it maintains its principal office and place of business; (ii) registered with that state, it would be subject to examination as an investment adviser by the state securities administrator; and (iii) it has AUM between the $25 million threshold in Advisers Act § 203A(a)(1)(A) and $100 million, which amount may also be increased by SEC rule, if deemed “appropriate in accordance with the purposes of this title.”

In sum, unless an adviser: (a) advises a registered investment company or business development company; (b) would be required to register with 15 or more states; (c) has its principal office and place of business in a state where it isn’t subject to investment adviser registration or where, if registered, it wouldn’t be subject to examination as an adviser; (d) qualifies for one of the exceptions in SEC Advisers Act Rule 203A-2; or (e) obtains an exemptive order from the SEC pursuant to Advisers Act § 203A(c), which authorizes the SEC to exempt a person, upon application, from the conditions of Section 203A(a), upon a finding that “the application of subsection (a) would be unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes of this section,” it will have to meet a higher AUM threshold of $100 million in order to qualify for SEC registration as of July 21, 2011.

As many of the Bugle readers are aware, most Blue Sky laws include exceptions from the definition of “investment adviser” in provisions identical or similar to Section 401(f)(6) of the 1956 version of the Uniform Securities Act (the “1956 USA”), or exemptions from registration as an investment adviser in provisions identical or similar to Section 403(b) of the 2002 version of the Uniform Securities Act (the “2002 USA”), in both instances applicable to investment advisers whose only clients in the state are certain institutional investors, plus a de minimis number of other clients (typically no more than five) within any 12-month period. However, these provisions are typically subject to a proviso that the adviser have no place of business in the state. Therefore, except in the case of Wyoming, where there’s no investment adviser registration at all, in most states there will be no definitional exception or exemption from registration available in the state where an adviser has its “principal office and place of business.”

However, since lack of uniformity is the norm for the states, there are a number of states with definitional exceptions or registration exemptions which don’t include a “no place of business in the state” proviso. While these exceptions or exemptions are generally more restrictive than the 1956 USA and 2002 USA provisions cited above (even though some of these states have enacted versions of the 1956 USA or 2002 USA), by my count, an adviser may have its principal office and place of business and provide advisory services to certain types of clients (typically institutional investors) in 22 states, without need for investment adviser registration therein. For example, the definition of “investment adviser” in Section 359-ee(1)(a) of the New York General Business Law (“NYGBL”), 2A Blue Sky L. Rep. (CCH) ¶ 42,130, and 13 NYCCR §§ 11.12 and 11.13, 2A Blue Sky L. Rep. (CCH) ¶¶ 42,517D and 42,517E, the New York Attorney General’s (“NYAG”) rules thereunder, provide fairly liberal definitional exceptions and exemptions from investment adviser registration (including one permitting up to 5 non-institutional clients), none of which is subject to a “no place of business in the state” proviso. Thus, there may be a number of instances in which an adviser may not be subject to the constraints of new Advisers Act § 203A(a)(2), and may be able to register with the SEC, since it won’t be subject to registration in the state where it has its principal office and place of business.

The other exception created by new Advisers Act § 203A(a)(2) raises the issue whether, even if an adviser may be subject to registration as an adviser in the state where it has its principal office and place of business, it “would be subject to examination as an investment adviser” by that state’s securities authority. First, a quick review of the Blue Sky laws of all 50 states (other than Wyoming), as well as of the District of Columbia, Guam, Puerto Rico and the U.S. Virgin Islands, reveals that all 53 of such jurisdictions, with the exception of New York, Ohio, and Virginia, have enacted statutory provisions identical or comparable to 1956 USA § 203(d), 1 Blue Sky L. Rep. (CCH) ¶ 5523, or 2002 USA § 411(d), 1 Blue Sky L. Rep. (CCH) ¶ 5627, providing specific authority to the state securities
In the case of New York, however, there is no apparent statute or rule which would authorize the NYAG to examine, audit, or inspect the books and records of a registered investment adviser in the ordinary course, in the manner contemplated by 1956 USA § 203(d) or 2002 USA § 411(d). Thus, while the NYAG has promulgated rules requiring that certain books and records be maintained by registered investment advisers, 13 NYCRR § 11.9, 2A Blue Sky L. Rep. (CCH) ¶ 359-eee(9)(b)(3). However, 2A Blue Sky L. Rep. (CCH) ¶ 42,517A, presumably adopted pursuant to NYGBL § 352, 2A Blue Sky L. Rep. (CCH) ¶ 42,101, that provision requires, in relevant part, that before conducting such an investigation, “it shall appear to the attorney-general, either upon complaint or otherwise, that . . . any person . . . shall have engaged in or engages in or is about to engage in any practice or transaction or course of business relating to . . . investment advice . . . which is . . . in violation of law . . .” Accordingly, as I read NYGBL § 352, absent a complaint or some other reasonable basis to suspect a violation that would necessitate an inspection of a registered investment adviser’s books and records, there is no authority in the NYGBL for the NYAG to simply drop by an investment adviser’s office (on an announced or unannounced basis) and inspect its books and records to determine whether there’s a violation of any law or rule (i.e., conduct what amounts to a “fishing expedition”). In any event, I’m not aware that the NYAG has ever conducted routine examinations of registered advisers.

Aside from the issue of authority to conduct examinations, inspections, or audits of investment advisers’ books and records in the ordinary course of business, there’s also a question as to how many of the 53 jurisdictions which register investment advisers actually do exercise their examination authority, and whether they will have the staff and budgetary wherewithal to do so going forward. In order to assist the SEC in preparing a study required by DFA § 913, NASAA submitted a report to the SEC, State Securities Regulators Report on Regulatory Effectiveness and Resources with Respect to Broker-Dealers and Investment Advisers (2010), available at http://www.sec.gov/comments/4-606/4606-2789.pdf (the “NASAA Report”), which is stated to be based on information derived from questionnaires and interviews prepared and conducted from August 30 to September 7, 2010 with all 50 states and the District of Columbia (but not Guam, Puerto Rico, or the U.S. Virgin Islands). According to Part II.B of the NASAA Report, at 7-9, titled “Overview of State Broker-Dealer, Broker-Dealer Agent, Investment Adviser, and Investment Adviser Representative Registration and Examination Programs – Investment Adviser Examinations Conducted by State Securities Regulators”: (a) “at least 47 states monitor compliance through examinations or audits of their registered Investment Advisers” (unfortunately, the NASAA Report doesn’t identify the states which don’t conduct such examinations or audits); (b) 94% of such states conduct investment adviser examinations on-site at the investment adviser’s principal place of business on a “routine” or non-cause basis; and (c) 89% of state routine examinations are completed on a formal cyclical basis (ranging from 1 – 6 years), while 11% are performed on a random or ad hoc basis. Thus, it appears that three states (and possibly the District of Columbia) don’t examine investment advisers, while the NASAA Report doesn’t provide any information concerning such examinations by Guam, Puerto Rico, or the U.S. Virgin Islands.

Accordingly, NASAA (or the jurisdictions themselves) must identify those jurisdictions which don’t examine investment advisers, so that investment advisers with their principal office and place of business in one of those jurisdictions and which aren’t otherwise exempt from registration in
such jurisdiction, may determine whether they may register with the SEC, or only with the jurisdiction itself (and other applicable states) pursuant to amended Advisers Act § 203A(a)(2)(B).

3. The SEC’s Rule Proposals under DFA § 410

In SEC Release No. IA-3110 (Nov. 19, 2010), 75 Fed. Reg. 77052 (Dec. 10, 2010) ("Release IA-3110"), available at http://www.sec.gov/rules/proposed/2010/ia-3110fr.pdf, the SEC announced some of its proposed amendments to Advisers Act rules and forms in response to certain provisions of DFA Title IV. As regards DFA § 410, the SEC has proposed to revise a variety of rules, as well as Form ADV and the instructions thereto, to explain how to determine whether a “mid-sized adviser” within the meaning of Advisers Act § 203A(a)(2)(B) is “required to be registered” or is “subject to examination” by the state in which it maintains its principal office and place of business, and how advisers may switch from state to SEC registration, or vice versa.

a. “Required to be Registered” Test

As regards the “required to be registered” test, Release IA-3110 notes that an adviser with its principal office and place of business in Wyoming or in a foreign country must register with the SEC, regardless of its AUM, if not otherwise exempt under the Advisers Act. The Release also notes that certain smaller advisers exempt from state registration aren’t subject to registration with either the SEC or any state, citing Advisers Act § 203A(a)(1) (i.e., the $25 million of AUM threshold) and 2002 USA §§ 102(15) and 403(b). See Part II.A.7.a of Release IA-3110 at 75 Fed. Reg. 77060, text at fn. 99. It’s unclear which particular subsection of 2002 USA § 102(15), the definition of “investment adviser,” the Release is referring to, and since the exemptions from investment adviser registration in 2002 USA § 403(b) are all subject to a “no place of business” proviso, it would appear that an adviser with its principal office and place of business in a state which has enacted a version of the 2002 USA with Section 403(b) intact would be subject to registration therein, regardless of whether its clients are restricted to the institutional investors designated therein, or whether it has not more than 5 other types of clients during any 12 months. See 2002 USA § 403(b)(1) and (2), 1 Blue Sky L. Rep. (CCH) ¶ 5619. As indicated in Part B.2 above, however, 22 states have enacted exceptions or exemptions from investment adviser registration which aren’t subject to a “no place of business” proviso.

As interpreted by the SEC, it was Congress’ intent that a “mid-sized” adviser which isn’t required to register with the state where it maintains its principal office and place of business must register with the SEC, unless an exemption is otherwise available, but would not be eligible for SEC registration if it’s not registered under the state law in contravention of that statute, and an adviser otherwise exempt from state registration cannot avoid SEC registration by voluntarily registering with a state. Thus, the SEC’s proposed changes to Form ADV require a mid-sized adviser to affirm, upon application and annually thereafter, that it isn’t required to be registered with the state securities authority in the state where it maintains its principal office and place of business, and an adviser which can no longer make such an affirmation will have 180 days from its fiscal year end to withdraw its SEC registration. See Part II.A.7.a of Release IA-3110 at 75 Fed. Reg. 77060 – 77061.

b. “Subject to Examination” Test

Citing the NASAA Report, the SEC acknowledges that not all state securities authorities conduct compliance examinations of registered investment advisers. However, the SEC decided not to review or evaluate each state’s examination program, but rather has proposed to correspond with each state securities administrator and request that each advise the SEC whether a registered adviser in that state would be subject to examination, and to promptly advise the SEC if advisers will begin to be subject to examination or will no longer be subject to examination. Using that information, the SEC intends to identify those states which didn’t certify that they examine advisers, for advisers filing on the Investment Advisers Registration Depository (the system used to register advisers with the SEC and the states), and to make that list available on its website, so that only mid-sized advisers with their principal office and place of business in one of those states could rightfully claim that they are entitled to register with the SEC. See Part II.A.7.b of Release IA-3110 at 75 Fed. Reg. 77061.
Two issues are apparent from the SEC’s proposal. First, as reflected in the NASAA Report, 11% of states which reported that they examine investment advisers said that they do so only “on a random or ad hoc basis.” See NASAA Report at 8. I suspect that this means that those examinations are performed only in response to a complaint or some other inquiry which triggers the state administrator’s interest in a particular adviser, and I therefore question whether examinations performed on that basis are truly what the drafters of the DFA had in mind, as contrasted with the examinations performed on “a formal cyclical basis” as reported by the other states. Second, I believe that states should not only be required to promptly report changes in their investment adviser examination programs to the SEC, but should be required to submit an annual affirmation to the SEC as to the status of their examination programs, so as to assure that they review their programs at least once a year.

c. Proposed Amendments to Form ADV


(1) is a “large advisory firm,” i.e., one with AUM of $100 million or more;

(2) is a “mid-sized adviser” with AUM of $25 million or more but less than $100 million, and, if so, whether it’s not required to register with the state where it has its principal office and place of business, or isn’t subject to examination by the state where it has its principal office and place of business (the form would include a list of the non-examination states);

(3) has its principal office and place of business in Wyoming;

(4) has its principal office and place of business outside the United States;

(5) is an investment adviser or sub-adviser to an investment company registered under the Company Act;

(6) is an investment adviser to a company which elected to be a business development company under Company Act § 54;

(7) qualifies for one of the exemptions under SEC Advisers Act Rule 203A-2(a) – (e), as proposed to be amended by Release IA-3110 [a discussion of such proposed changes isn’t germane to this article, except that the current exemption in Rule 203A-2(e) for advisers which would be subject to registration in 30 or more states is proposed to be renumbered as Rule 203A-2(d) and the threshold reduced to 15 or more states, in conformity with DFA § 410; see Part II.A.5 of Release IA-3110 at 75 Fed. Reg. 77058 – 77060, and the text of the proposed amendments to Rule 203A-2 at 75 Fed. Reg. 77098];

(8) has received an SEC order exempting it from the prohibition against SEC registration pursuant to Advisers Act § 203A(c); or

(9) is no longer eligible for SEC registration.

d. New “Regulatory Assets Under Management” Test

Release IA-3110 also proposes revisions to the current explanation of how to calculate an adviser’s AUM for purposes of Advisers Act § 203A, by adopting a new “regulatory assets under management” test, which may be found in proposed Instruction 5.b to Part 1A of Form ADV and in proposed Item 5.F of Part 1A of the Form. See Part II.A.3 of Release IA-3110 at 75 Fed. Reg. 77055 – 77058; Item 5.b of the Instructions to Part 1A of Form ADV, Appendix B to Release IA-3110 at 75 Fed. Reg. 77120 – 77123; and Item 5.F of Part 1A of Form ADV, Appendix D to Release IA-3110 at 75 Fed. Reg. 77142.
Switching Between State and SEC Registration

Release IA-3110 also proposes revisions to SEC Advisers Act Rule 203A-1, whereby the $30 million of AUM threshold for mandatory SEC registration would be deleted (thereby dropping back to the statutory $25 million of AUM threshold in Advisers Act § 203A(a)(1)(A)), and whereby (a) state-registered advisers eligible for SEC registration, other than those exempt under new Advisers Act § 203(1) or (m) (i.e., advisers to “venture capital funds” or solely to “private funds” – see Part II.B.4 below), would have to apply for SEC registration within 90 days of filing an annual updating amendment to Form ADV; and (b) SEC-registered advisers filing an annual updating amendment to Form ADV reporting that they’re no longer eligible for SEC registration and aren’t exempt under Advisers Act § 203(1) or (m), must file a Form ADV-W to withdraw their SEC registration within 180 days after their fiscal year-end. During that period, such advisers will be regulated by both the SEC and any state(s) where they’re registered. See Part II.A.4 of Release IA-3110 at 75 Fed. Reg. 77058, and the text of proposed amended SEC Advisers Act Rule 203A-1 at 75 Fed. Reg. 77098.

Following the July 21, 2011 effectiveness of the DFA amendments to Advisers Act § 203A, however, the SEC has proposed new “Transition Rules,” as Advisers Act Rule 203A-5. Under this proposal, every adviser registered with the SEC as of July 21 will be required to file an “other-than-annual” amendment to its Form ADV by no later than August 20, 2011, including a determination of its AUM as of a date within 30 days prior to the filing of the amendment. If that amended Form ADV reflects that the adviser is prohibited from registering with the SEC under Advisers Act § 203A(a)(2) and isn’t otherwise exempted by Advisers Act Rule 203A-2, the adviser will be required to file a Form ADV-W, withdrawing its SEC registration, by no later than October 19, 2011. If such an adviser has filed one or more state registrations during that period, its SEC and state registrations will be simultaneously effective, and the Advisers Act and applicable state laws will apply to its advisory activities. See Part II.A.1 of Release IA-3010 at 75 Fed. Reg. 77054 - 77055, and proposed SEC Advisers Act Rule 203A-5 at 75 Fed. Reg. 77099.

It is anticipated that many investment advisers will be troubled by the SEC’s proposals in Advisers Act Rules 203A-5 and 203A-1. First, some advisers switching from state to SEC registration for the first time will probably consider the proposed 90-day period from the filing of their annual updating amendments to submit their SEC registration applications pursuant to Rule 203A-1 to be inadequate. Second, it is expected that advisers forced to withdraw from SEC registration and register with one or more states will find the absence of any specific transition period in both rules for effecting their state filings particularly perturbing. Despite NASAA’s efforts in establishing an “IA Switch Resource Center” on its website, purportedly to provide information for such advisers to easily accomplish their state registrations (see http://www.nasaa.org/industry_regulatory_resourc es/investment_advisers/13183.cfm), it is anticipated that, given: (i) the historic failure of states to handle investment adviser filings in a uniform fashion (see pages 5 – 7 of the NASAA Report as regards discrepancies in the state registration process); (ii) the lack of uniformity among the states and between the states and the SEC as regards regulation of registered investment advisers; and (iii) the expectation that the states will be swamped with these filings post-July 21, 2011, and that some states may accordingly be unable to provide adequate staff to process these filings in a timely and efficient manner (particularly in this day and age of governmental budget-cutting), advisers forced to go through the state registration process will no doubt be faced with a time-consuming, cumbersome and expensive process. In light of that, I believe that the SEC must provide for a suitably long transition period during which such advisers may prepare and first submit their state filings, and then maintain their SEC registrations while their state filings are pending, both following July 21, 2011 and for ensuing years.

4. Other DFA Changes of Importance to Investment Advisers

Among other changes to the Advisers Act wrought by the DFA with potential ramifications under state laws:

- The private adviser exemption in Advisers Act § 203(b)(3) has been repealed and replaced by an exemption

- A new exemption from registration has been added for advisers solely to “private funds” with AUM under $150 million. See Advisers Act §§ 203(m) and (n), as added by DFA § 408, and the new defined term “private fund” in Advisers Act § 202(a)(29), as added by DFA § 402, as well as the SEC’s proposed Advisers Act Rule 203(m)-1. See Part II.B of Release IA-3111 at 75 Fed. Reg. 77206 – 77210, and the proposed rule at 75 Fed. Reg. 77226 – 77227.


- A new exception from the definition of “investment adviser” has been added for “family offices.” See Advisers Act § 202(a)(11)(G) [old clause (G) was renumbered as (H)], as added by DFA § 409, and SEC Release No. IA-3098 (Oct. 12, 2010), 75 Fed. Reg. 63753 (Oct. 18, 2010), available at http://www.sec.gov/rules/proposed/2010/ia-3098fr.pdf, which includes proposed Advisers Act Rule 202(a)(11)(G)-1, defining the term “family office.”

Since they will be exempt from SEC registration, foreign private advisers and advisers solely to private funds and venture capital funds qualifying under the DFA amendments and the SEC’s new rules will be fair game for state registration, absent an exception or exemption under state law or Advisers Act § 222(d) (see below). In the case of qualifying family offices, however, since they will be covered by a definitional exception from the Advisers Act, they will not be subject to state registration by reason of Advisers Act § 203A(b)(1)(B), irrespective of state law to the contrary.

5. The Preemptive Effect of Advisers Act § 222

a. The “National De Minimis Standard”

One provision which was thankfully untouched by the DFA is Advisers Act § 222(d), which establishes a “national de minimis standard” before a state can require registration of an adviser. Specifically, states are preempted from requiring the registration of an adviser (but not a notice filing by an SEC-registered adviser), if the adviser doesn’t have a place of business in the state and had fewer than six clients who are residents of that state during the preceding 12-month period. The current version of SEC Advisers Act Rule 222-2 defines the term “client” for the purposes of Section 222(d) by reference to Advisers Act Rule 203(b)(3)-1, whereby an adviser may count as a single “client” any legal organization it advises, so long as the adviser provides advice based on the entity’s investment objectives, rather than the individual investment objectives of the entity’s shareholders, partners, limited partners, members or beneficiaries – i.e., ordinarily, there may be no “look through” to count such persons as separate “clients” of the adviser for purposes of the five-client limit in Advisers Act § 222(d). Thus, an adviser otherwise subject to state registration may avoid such registration by having no place of business in the state [see SEC Advisers Act Rule 222-1 in that regard] and not more than 5 clients in the state, irrespective of any exceptions or exemptions in the state law.

By reason of the rewrite of Advisers Act § 203(b)(3) by the DFA, the SEC has proposed to rescind SEC Advisers Act Rule 203(b)(3)-1. However, in its stead, the SEC has proposed to amend SEC Advisers Act Rule 222-2 to reference the definition of “client” in new Advisers Act Rule 202(a)(30)-1 (the rule governing the counting of “clients” for purposes of the new definition of “foreign private adviser” in
Advisers Act § 202(a)(30)), without regard to paragraph (b)(4) of that Rule, provided that an adviser is not required to count as a client any person for whom the adviser provides advisory services without compensation. This new cross-reference would preserve the current no “look-through” approach of Rule 203(b)(3)-1 in counting clients for purposes of Section 222(d). See Parts II.D.2.a and II.D.2.e of Release IA-3110 at 75 Fed. Reg. 77072 and 77073, respectively, and proposed amended SEC Advisers Act Rule 222-2 in Release IA-3110 at 75 Fed. Reg. 77100. See also Part II.C.1 of Release IA-3111 at 75 Fed. Reg. 77210 – 77211, and proposed SEC Advisers Act Rule 202(a)(30)-1 in Release IA-3111 at 75 Fed. Reg. 77225 – 77226.

b. Exemptions from Multiple State Regulation

For advisers subject to state registration by reason of the DFA amendments to the Advisers Act or otherwise, Advisers Act §§ 222(b) and (c) provide some relief from the possibility that an adviser may have to comply with certain disparate regulatory requirements in the states where it has to register.

Thus, Advisers Act § 222(b) prohibits states from requiring an adviser to maintain any books or records in addition to those required under the laws of the state in which it maintains its principal place of business, provided that the adviser is registered or licensed in that state and is in compliance with the applicable books and records requirements of such state. Further, Advisers Act § 222(c) prohibits states from requiring an adviser to maintain a higher net capital or post any bond in addition to that required under the laws of the state in which it maintains its principal place of business, provided that the adviser is registered or licensed in that state and is in compliance with the applicable net capital or bonding requirements of such state.

While Advisers Act §§ 222(b) and 222(c) thus allow state-registered advisers to comply with only a single set of laws and rules governing their books and records, net capital and bonding requirements, it is noted that the initial and ongoing requirements for registered advisers in this regard may still vary significantly from state to state, as may the manner in which particular states administer and enforce their laws and rules. Thus, for example, while New York doesn’t impose any net capital or surety bond requirements on its registered advisers, New Jersey requires advisers who have custody of clients’ funds or securities to either maintain a minimum capital of $25,000 or post a $25,000 surety bond. See NYGBL § 359-eee, 2A Blue Sky L. Rep. (CCH) ¶ 42,130, New Jersey Uniform Securities Law (1967) § 49:3-57(e), 2A Blue Sky L. Rep. (CCH) ¶ 40,122, and New Jersey Bureau of Securities Rules 13:47A-2.2 and 13:47A-2.3, 2A Blue Sky L. Rep. (CCH) ¶¶ 40,422 and 40,423.

Further, states may impose any restrictions or prohibitions they may deem appropriate on any other aspect of a registered adviser’s business. Thus, while New York has no restrictions on advisory contracts, Alaska’s law prohibits compensation of advisers on the basis of a share of capital gains upon, or capital appreciation of, a client’s funds, in similar fashion to Advisers Act § 205(a)(1), but goes on to permit the state administrator, on request, to waive that prohibition for contracts conforming to Advisers Act § 205. See NYGBL § 359-eee, Id.; Alaska Securities Act § 45.55.020, 1 Blue Sky L. Rep. (CCH) ¶ 8102. Accordingly, advisers registered in Alaska must specifically request and obtain, on a case-by-case basis and at the sole discretion of the administrator, a waiver to permit fees which would be automatically allowable under the exemption in SEC Advisers Act Rule 205-3. In addition, state requirements regarding custody of client funds and securities vary and may be incompatible with one another, and advisers switching from SEC to state registration may find significant differences between SEC and state requirements.

In sum, while advisers subject to state registration must comply with requirements comparable to those imposed on SEC-registered advisers, in many, if not most, instances, state requirements may prove to be more burdensome than the SEC’s, and advisers registering in multiple states may find significant differences among those states’ regulatory schemes. I’ve recommended to NASAA that its “IA Switch Resource Center” (see Part B.3.e above) should include a chart reflecting the differences between SEC and individual state requirements in key areas governed by the Advisers Act and the SEC’s rules thereunder, so as to give advisers switching from SEC to state registration (as well advisers currently exempt from both SEC and state registration, but which will become subject to state registration as of July 21, 2011) a better idea what to expect.
BLUE SKY BITS AND PIECES

By: Ellen Lieberman
Debevoise & Plimpton LLP

Alan M. Parness, Counsel at Cadwalader, Wickersham & Taft LLP, and Michele A. Kulerman, Counsel at Hogan Lovells, will complete their three year tenure as Committee Chair and Vice-Chair, respectively, following the ABA Annual Meeting in August 2011. Kudos to Alan and Michele who have done an outstanding job in making our views and concerns known to securities regulators, and others, and who continue to help us all through the flow of timely information via the listserv, the Bugle and various Committee meetings. Congratulations to Shane B. Hansen, Partner at Warner Norcross & Judd LLP, currently co-chair of our Liaisons to Securities Administrators Subcommittee, and Martin A. Hewitt, Counsel at Alston & Bird LLP, currently Editor of The Blue Sky Bugle, who are expected to assume the role of the next Chair and Vice Chair, respectively, of the Committee at that time.

Mark Lab of Sullivan & Cromwell has been named as Vice Chair of the FINRA Corporate Finance Subcommittee of the ABA Committee on Federal Regulation of Securities.

Ellen M. Creede, formerly Counsel with Cleary Gottlieb Steen & Hamilton LLP, where she practiced law for more than 30 years, is relocating to Latham & Watkins LLP as Counsel and will split her time between the Dubai and New York offices. At Cleary she was heavily involved in restructuring transactions involving registered broker-dealers and investment advisers, supervision and advice on corporate finance matters at FINRA, and stock exchange listing requirements, as well as state securities law. At Latham her practice will focus on broker-dealer and investment advisory regulation, U.S. securities laws, stock exchange listing and corporate governance requirements and state securities laws compliance. She received her undergraduate degree summa cum laude degree from SUNY Buffalo and her law degree cum laude from Fordham University Law School in 1978.

Paul Peter Nicolai has been appointed as the Committee's Liaison to the Content Committee of the Business Law Section. He is a Fellow of the American Bar Foundation and President of Nicolai Law Group, P.C. in Massachusetts.

Lisa M. Pietrzak has been named Committee's Liaison to the Publications Committee of the Business Law Section. She is an associate with Richards, Layton & Finger, P.A., in Wilmington, Delaware.

Congratulations to Committee Chair Alan M. Parness, Cadwalader, Wickersham & Taft LLP, New York, and to Philip A. Feigin, Rothergerber Johnson & Lyons LLP, Denver, Colorado, whose articles from the Blue Sky Bugle (All Rule 506, All the Time and Dodd-Frank, Suitability and Fiduciary Duty, respectively), were prominently featured in the online version of Business Law Today published by the ABA Business Law Section.

We are delighted to send best wishes to Alan and Enid Parness on the birth of their beautiful granddaughter Audrey Rae Parness, on December 9, 2010. She weighed in 6 lbs, 12 oz, measured 18-1/2” long, and her mom and dad and big brother Jonah are thrilled.

I am also delighted to report that my husband, Morris S. Zedeck, whom many of you have met at various blue sky events, has published “Expert Witness in the Legal System: A Scientist’s Search for Justice.” As a consultant to attorneys and expert witness in the courts, Morris testified at 191 trials involving murder, rape, drunken driving, medical malpractice, personal injury and product liability. In the book he recounts his experiences, his perception of the legal system, and makes recommendations for improving our system of justice.

Newspapers report that Mark Sargent stepped down in July 2009 after 12 years as Dean of Villanova University School of Law. Prior to Villanova, Sargent was a professor and associate dean at University of Maryland School of Law, and had also taught at the law schools of American University, Southern Methodist University, and the University of Baltimore. Prior to his stint at Villanova, he was actively involved in publishing and contributing to work of the ABA Business Law Section, including on the topic of Blue Sky law.

The Securities and Exchange Commission announced November 19 that Jennifer B. McHugh, a senior advisor to Chairman Mary Schapiro, has been named acting director of the agency's Division of Investment Management. In a release, the SEC said McHugh is stepping in to replace Andrew “Buddy” Donohue, who leaves the agency after four years at the helm of
the Division. McHugh will hold the position until a new director is appointed, at which time she will return to the Chairman's office. In her capacity as senior advisor, McHugh advises the Chairman on issues related to mutual funds and investment advisers. McHugh joined the SEC in 1999 to focus on mutual fund rulemaking. In 2000, she was named special counsel in the Office of Investment Adviser Regulation. From 2001 to 2009, McHugh served as senior advisor to the Investment Management Director. Before joining the SEC staff, she was an associate at Dechert LLP.

David S. Massey, North Carolina Deputy Securities Administrator, took office as the new President of NASAA in September 2010. The new NASAA Board of Directors includes Immediate Past President of NASAA Denise Voigt Crawford, Texas Securities Commissioner; NASAA President-Elect Jack Herstein, Assistant Director of the Nebraska Securities Bureau; NASAA Secretary Rick Hancox, Executive Director of the New Brunswick Securities Administrative Branch; NASAA Treasurer Fred J. Joseph, Colorado Securities Commissioner; Joseph P. Borg, Alabama Director; Preston DuFauchard, California Corporations Commissioner; Patricia D. Struck, Administrator of the Wisconsin Securities Division; and Franklin Widmann, Director of the Florida Division of Securities.

After 41 years at the Wisconsin Division of Securities, Randall E. Schumann is retiring from his current position as Legal Counsel, Wisconsin DFIR Division of Securities. Randy was active in NASAA including on the Corporate Finance Section Committee, as well as at the Wisconsin Division. Probably two decades ago he (and I) served on a joint ABA-NASAA task force that drafted a model control share act. We wish him well!

New York State will have a new Attorney General on January 1, 2010, as Eric T. Schneiderman takes the reins from Andrew Cuomo who, in turn, will become New York’s Governor. Schneiderman graduated with honors from Harvard Law School, clerked in the U.S. District Court for the Southern District of New York, and was a partner at the law firm of Kirkpatrick and Lockhart. Schneiderman was elected to the New York State Senate beginning in 1998 and helped pass pro-choice, hate crimes, and gun control legislation. He variously served as Senate Deputy Democratic Leader, on the New York State Commission on Sentencing Reform, as co-founder of Legislators Against Illegal Guns and as Chair of the Senate Codes Committee (dealing with criminal and civil justice legislation). Eric R. Dinallo, formerly head of New York’s Investment Protection Bureau in the Department of Law and then from 2007-2009 New York’s Superintendent of Insurance, ran unsuccessfully against Schneiderman in the Democratic primary for the attorney general nomination, and now serves as a member of Schneiderman’s transition team. Dinallo in December 2010 joined Debevoise & Plimpton LLP as Partner. He is expected to represent clients throughout the financial sector in a broad range of regulatory matters, including investigations, enforcement actions and compliance matters, and in litigation and other corporate representations. As Superintendent of Insurance he was involved in restructuring American International Group Inc. As head of the Investment Protection Bureau, Dinallo had oversight of research analyst and IPO spinning cases. He is also a former general counsel of insurance broker Willis Group Holdings and head of regulatory affairs of Morgan Stanley.

Effective January 3, 2011, Bruce Kuhse was named General Counsel of Florida’s Office of Financial Regulation which regulates, among others, state-chartered banks, thrifts and credit unions, securities dealers and investment advisers, mortgage brokers, small loan companies, collection agencies and installment sellers. He previously served for six years as Chief Counsel of the Division of Financial Institutions. He received his J.D. degree with highest honors from Florida State University and was admitted to the Florida Bar in 2000. Kuhse served in the U.S. Navy for 22 years before attending law school and holds B.S. in Aerospace Engineering and an M.S. in Systems Management from the University of Southern California, and is a graduate of the U.S. Navy Test Pilot School.

We report with sadness the death of Fred Bunker Davis. Fred was 79 years old, and his death resulted from injuries sustained in a fall in his home. He was a graduate of Oberlin College and of Harvard Law School in 1957, served as a New York Assistant Attorney General and practiced Blue Sky law in New York at Mudge, Stern, Baldwin and Todd and at Cahill Gordon and Reindel and, from the early 1980’s until his retirement in 1999, at Kutak Rock in Omaha, Nebraska. Fred is survived by his wife, Janet, and his daughters Susannah and Rachel.
Sonnenblick, his son-in-law Richard Sonnenblick and his granddaughter Lily.

We send sincere condolences to Susan M. Cohen, Of Counsel at Bingham McCutchen LLP, and her family on the unexpected loss of Susan’s mother, (Evelyn) Myra Cohen, on November 14, 2010. Susan often spoke of her mother whom she will greatly miss.

We are sorry to report the death of Jack L. Beyers, who died on December 13, 2010, after a long fight with pulmonary fibrosis. He served as the Securities Administrator of the State of Washington from the late 1980s until October 1993 when the Securities Division was transferred to the Department of Financial Institutions. He mentored many employees who are still at the Division today and left a legacy of firm but fair enforcement. The staff at the Department of Financial Institutions will miss his kind and gentle manner.

PENDING FLORIDA PETITION SEEKS WAIVER OF RULE DISQUALIFYING FELONS FROM REGISTRATION TO SELL SECURITIES

By: R. Michael Underwood
Fowler White Boggs, P.A.

In the wake of a scandal about convicted felons getting mortgage broker's licenses from the Florida Office of Financial Regulation (“OFR”), last year the Florida Legislature adopted Chapter 2009-242, Laws of Florida, which, among other provisions, requires disqualification of convicts from selling securities in Florida.

On March 2, 2010, OFR’s Rule 69W-200.0021, Florida Administrative Code, became effective. Titled “Effect of Law Enforcement Records on Applications for Registration of Associated Persons,” the complex rule generally provides for disqualification of individuals to sell securities or render investment advice for fifteen years after conviction of, or entry of a guilty or nullo contendere plea to, a felony involving the securities industry or fraudulent or dishonest dealing or “moral turpitude.” A shorter disqualification period is provided for similar misdemeanors and a greater period for multiple crimes. Mitigating factors are available to reduce the disqualification period, but only for a maximum of three years.

“Moral turpitude” is a legal concept that describes conduct shocking to most or all members of the community. It involves acts of baseness, vileness, or depravity. OFR’s rule does not attempt to define “moral turpitude.” Instead, it contains a list of those felonies that OFR finds always to constitute crimes of moral turpitude. The validity of OFR’s approach is yet to be tested. Florida law on which offenses involve moral turpitude is unclear except on one point: It “depends not only on the nature of the offense, but also on the attendant circumstances.” Florida Bar v. Davis, 361 So.2d 159, 161 (Fla. 1978). Because the rule does not allow applicants to show that under “the attendant circumstances” their offense did not involve moral turpitude, applicants disqualified on this basis might have been denied due process of law, making the rule invalid.

Whether OFR’s approach to defining disqualifying offenses is ultimately upheld, another aspect of the rule raises questions of due process. There is no “grandfather clause” either in the rule or the underlying statute. Under Section 517.1205, Florida Statutes, applications for registration of associated persons of securities dealers or investment advisors are de novo when the person changes firms. As a result, persons can be registered and doing business in Florida for many years and suddenly find themselves “disqualified” when seeking registration with a new firm. What is worse, the disqualifying offense may have already been dealt with by the regulator through a period of special supervision, probation, or restricted registration and the applicant’s fitness for access to Florida investors thereby established. Notwithstanding the applicant’s sacrifice and the regulators’ investment of resources in the supervision, must the determination that the registered representative is fit for unrestricted access to Florida investors now be overturned?

This is the precise situation in OFR’s pending Administrative Proceeding Number 0099-SR-9/10, noticed in Florida Administrative Weekly on September 17, 2010. The Petitioner in that matter had a record of multiple criminal offenses as a teenager. When he applied for registration to sell securities in 2002, OFR informed him that the offenses were grounds for denial, but allowed him to be registered if he and his firm would agree to “certain restrictions . . . necessary to fulfill the Department’s duty to protect the health, safety, and welfare of the investing public.” OFR deemed its duty to have been discharged in 2005. After 36 months under restricted registration, OFR decided the
restrictions were no longer necessary to protect investors. No further disciplinary action by OFR was found to be necessary until the Petitioner sought registration with a new broker dealer last year. OFR informed him that under Rule 69W-600.0021 the offenses committed when he was 18 and 19 years old (even applying the maximum allowed mitigation factors) prevent him from being registered in Florida until 2037!

Instead of protecting investors, OFR’s rule in this instance positively harms them. It also harms the financial services industry in Florida. The investment in years of training and supervision is lost. This applies as well to the regulator, which also has lost all benefit of Petitioner’s sensitivity gained during strict supervision and passed along to other members of the industry through his example, training, and recruitment. Most important, the disqualification adds no protection of the investing public that was not already achieved by the period of restricted registration.

Florida’s Administrative Procedure Act provides at Section 120.542, Florida Statutes, for a temporary or permanent waiver or variance of a rule. It requires a showing of hardship and a demonstration “that the purpose of the underlying statute will be or has been achieved by other means.” If the purpose of this aspect of Florida’s securities laws is to protect investors from persons with criminal backgrounds, that purpose was already accomplished and this Petition should be granted.

CANADIAN SECURITIES REGULATORS PROPOSE REGISTRATION FOR NON-CANADIAN INVESTMENT FUND MANAGERS

By: Rebecca A. Cowdery and Paul G. Findlay
Borden Ladner Gervais LLP

In recent years, the Canadian Securities Administrators (CSA) finalized an extensive re-vamp of the rules that govern the registration under securities legislation of securities dealers and advisers. The rules provided for in National Instrument 31-103 Registration Requirements and Exemptions (NI 31-103) became effective as of September 28, 2009, with certain important transition periods most of which ended September 28, 2010.

NI 31-103 applies to industry participants based in countries outside Canada, including the United States, which are acting as advisers or dealers in securities in one or more Canadian provinces. Non-Canadian firms engaging in the business of either advising or dealing in securities must be registered as advisers (portfolio managers) or dealers, unless one of the so-called “international” exemptions applies. Firms that are regulated in their home jurisdiction as an adviser and that meet specified conditions (including advising only “permitted clients”) do not need to be registered in a Canadian province in reliance on the “international adviser” exemption. A similar exemption is provided for “international dealers.”

In addition to overhauling the rules that apply to advisers and dealers, the CSA also created a new category of registration for firms that are “acting as investment fund managers”. An investment fund manager is a firm that “directs the business, operations or affairs” of an investment fund. Investment funds would include privately offered hedge funds and pooled funds as well as publicly offered mutual funds and closed-end funds. Whether private equity funds or venture capital funds are caught may depend upon their structure and investment objectives.

NI 31-103 presently clearly requires an investment fund manager (IFM) to register as an IFM in the province where its head office is based. Firms that do not have a head office in Canada are not presently required to be registered, although the CSA signaled when they were finalizing NI 31-103 that they planned to develop rules that would require non-Canadian IFMs to be registered.

In draft amendments to NI 31-103 published for comment in October 2010, the CSA set out proposed rules that would require registration of non-Canadian IFMs as “investment fund managers” in potentially multiple Canadian jurisdictions. Comments are due on the CSA’s proposals by January 13, 2011 and the CSA’s goal is to have the new rules in force by September 2011.

Under the CSA’s proposals, unless one or more of the proposed exemptions discussed below applies, registration would be required by an international IFM in each province and territory where:

1 Please see Canadian Registration Reform Provides Easier Access for U.S. Broker-Dealers and Advisers The Blue Sky Bugle [insert cite].
• residents of that province or territory are securityholders of the investment funds managed by the international IFM; and/or,

• the IFM or the investment funds it manages have actively solicited residents to purchase securities of the investment funds.

This registration requirement would apply to international IFMs notwithstanding that the fund manager and the investment funds may be regulated by another regulator and regardless of the jurisdiction where the investment funds are organized and actually managed.

The CSA’s proposals represent a curious resurrection of a regulatory principle that was abandoned for advisers with the implementation of NI 31-103. Prior to NI 31-103, certain members of the CSA, and most notably the Ontario Securities Commission, took the position that non-resident portfolio managers of non-resident investment funds that were distributed in their jurisdiction had to be registered in that province or territory as an adviser. This was referred to by some as the “look-through” or “flow-through” theory of advice, in that the applicable regulators “looked through” the fund and determined that the securityholders residing in the particular province were acquiring the advisory services of the non-resident portfolio manager despite the fact that the advice was provided to the fund outside of the province in question (in many cases, outside Canada).

Under the CSA’s draft proposals for non-resident IFMs, by distributing investment funds in a particular province or territory, the manager of that fund is considered to be “acting as an investment fund manager” in that province or territory, notwithstanding that the firm and the funds are situate and are actually managed in another jurisdiction. This means that, while non-resident portfolio managers of non-Canadian investment funds that are distributed in a Canadian province or territory will not be subject to registration as an adviser, the non-resident IFM of those same investment funds will likely become subject to registration as an IFM – a peculiar result.

An international IFM will be able to rely on a de minimis registration exemption where it manages non-Canadian investment funds and the following conditions apply:

• the IFM does not have a physical place of business in Canada;

• the investment funds managed by the IFM are incorporated, formed or organized under the laws of a non-Canadian jurisdiction and are distributed only to “permitted clients” (primarily institutions and very high net worth individuals) under prospectus exemptions and the permitted clients receive prescribed information about the non-registered and non-resident status of the IFM;

• the fair value of all of the assets attributable to Canadian security holders of any investment fund for which the IFM acts as IFM is not more than 10 percent of the fair value of all the assets of the fund as at the end of the IFM’s most recently completed financial year;

• the fair value of the assets of all funds managed by the IFM that are attributable to Canadian security holders is not more than CDN $50 million as at the end of the IFM’s most recently completed financial year; and,

• the IFM submits annual filings in each applicable province and territory.

A “grandfathering” exemption has also been proposed for both international IFMs and Canadian IFMs if they (and their investment funds) do not actively solicit investors in a Canadian jurisdiction after September 28, 2011 and they manage investment funds that are not reporting issuers in Canada. Accordingly, IFMs that have Canadian investors in their privately offered funds as at September 28, 2011 can continue to act as an IFM for those funds and to permit their funds to issue securities to Canadians, so long as they do not actively solicit further investments in any jurisdiction of Canada after September 28, 2011 without having to be registered.

The Ontario Securities Commission (OSC) and the Autorité des marchés financiers (AMF) (the Ontario
and Quebec securities regulatory authorities) appear concerned about the scope of this grandfathering exemption and the potential for “systemic risk” to the Canadian capital markets. Simultaneously with the CSA publication, the OSC and the AMF published jointly a request for comments on whether it would be appropriate to apply to the proposed “grandfathering” exemption the same threshold limitations – i.e. size of the investment fund attributable to Canadian security holders – as are proposed for the proposed “de minimis” exemption. The OSC and AMF proposals would undoubtedly reduce the number of international IFMs who would be able to rely on the proposed grandfathering exemption.

The CSA propose guidance on what they consider to be “active solicitation”. In their view “active solicitation” refers to intentional actions taken by an investment fund or its IFM to encourage a purchase of the fund’s securities. Included would be such things as

- direct communication to encourage residents of a province or territory to purchase securities
- advertising in Canadian media (including through the Internet), if the advertising is intended to encourage the purchase of the fund’s securities and
- purchase recommendations made by a third party (e.g. a dealer) if the third party is entitled to compensation from the IFM or the fund for the recommendation to or subsequent purchase.

International IFMs that are not otherwise registered in any category in any Canadian jurisdiction and, if the proposals are adopted, would be required to be registered will be subject to the proficiency and conduct requirements associated with being an IFM registrant. The IFM category is primarily a “firm” registration category with the ultimate designated person (UDP) and chief compliance officer (CCO) being the only registered individuals. The CCO is subject to Canadian-based proficiency requirements. As a firm, registered IFMs are subject to, among other things, requirements for:

- capital and insurance;
- financial reporting;
- conflicts of interest management;
- record keeping; and,
- compliance systems, including having written policies and procedures.

Non-Canadian IFMs will also be required to provide a specified notice to fund security holders about their “non-resident” status.

Non-Canadian IFMs will be able to rely on the “passport” system for registration applications in Canada – and would therefore designate a principal regulator which would take responsibility of reviewing the application and ensuring continuing compliance. Registration fees will be payable in each province and territory where the firm is registered.

If these proposals are enacted, it will become more difficult for non-Canadian investment funds to be offered in Canada.

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**BLUE SKY CHALLENGE: WHERE TO LOOK AND FIND IT ACCURATELY AND COMPLETELY**

*By: Hugh H. Makens*

Warner Norcross & Judd LLP

As a securities advisory board member to LexisNexis, I am charged with commenting on various securities publications on a variety of topics. Commenting on Robert Rapp's work, in Matthew Bender's *Blue Sky Regulation, 2nd Ed.*, is a little like going on vacation. You get to sit back and enjoy life, and those details which distract one from enjoyment of work are all put to rest before I pick up the chapters to review.

Bob is a member of our Committee, and has been active in the securities field as a partner at Calfee, Halter & Griswold, LLP in Cleveland for many years. He is Adjunct Professor of Law teaching financial markets at the Case Western Reserve University Law School and served as a Practitioner in Residence at Cornell Law School. He is prolific in his publications and has served on both the NASD Legal Advisory Board and currently on the NASDAQ Market Operations Review Committee.
He began writing for Matthew Bender over 20 years ago as a contributing author to both Federal Securities Act of 1933 and the first edition of Blue Sky Regulation. He learned that one of the penalties for quality work and experience is more work, and he became the principal contributor to Blue Sky Regulation. In 2003 he authored the 2nd edition. He took on the challenge and gave the Treatise a new identity while keeping it as a valuable resource in a changing regulatory world.

Bob observes that to say that state securities regulation has been in a transformational period would be a serious understatement. The greatest challenge in authoring a Blue Sky law treatise is melding the old and the new across 50 states and four territories in a manner that is meaningful to practitioners, courts, and researchers in all of the jurisdictions. A down-home example is found in Ohio, which regulates securities on the basis of a 1929 statute, while surrounding states have been and are adopting the Uniform Securities Act of 2002.

Our game is continually changing and Bob does a masterful job on a current basis of keeping his material up-to-date. He observes that overarching our field is the redefinition of the role of state securities regulation in a national, and indeed, global, market setting that came first with NSMIA, and continues in emergent proposals for regulatory reform today.

In writing Blue Sky Regulation today, his goal is to anchor all of the states securities regulation in common principles and objectives which make it as relevant today as it ever has been, in whatever jurisdiction, and also in the national market and regulatory setting. Bob feels that what has taken place post-NSMIA, and what is happening now in the wake of the financial crisis and the ensuing potential regulatory revolution cements the role of state securities laws, and dramatically underscores the historic role of state regulators as the "cops on the beat" for frontline investor protection. This guides Bob in creation and writing and is the heart and soul of every chapter of Blue Sky Regulation.

What is most gratifying for the practitioner is that Bob writes this as far more than a legal treatise, since it has practical guidance and is written in a style that is very easy to read and comprehend. It is extraordinarily thorough. For those of you who aren't familiar with the wonderful resource, it is time to take a hard, long look.

FROM THE OTHER SIDE OF THE DESK

By: Sue Noble
ParaBlue Service™

“I have to save the world. Again.” Buffy Summers, Season 2, Episode 22 of Buffy the Vampire Slayer.

Buffy the Vampire Slayer was featured in a 1992 film and a television series (as well as a spinoff series and a wide variety of other material, such as comic books and video games) with the same name, created by writer/producer/director Joss Whedon as an antidote to the stereotypical view of horror film victims as little blonde girls who come to horrific ends. Classically, these victims either scream helplessly or are ambushed and quickly dispatched before they can resist. Buffy Summers, on the other hand, has supernatural powers allowing her to fight and conquer supernatural foes, such as vampires and demons. Buffy has also conquered a malevolent ghost and a god.

One might assign a hierarchy to these supernatural creatures: vampires, being the most common and mixed with humans, would be lowest ranking, and pure demons (which can destroy entire cities) would be above both of them. Next higher would be the god, which had lesser demons as henchmen, while the malevolent ghost has no rank, as it is entirely outside the usual scheme of things.

This scheme of analogies worked very well when the publication deadline was Halloween. Halloween has come and gone, and Thanksgiving has intervened. There’s nothing supernatural about turkey (unless it was cooked by your mother), but it’s going to prove useful all the same.

What does all of this have to do with blue sky? If I’m truthful, not much. But it offers another way to think about the current and potential regulatory schemes. Consider the following arbitrary selection of concepts as (in increasing order of awfulness) a turkey, a malevolent ghost, a vampire, a demon, or a god. Or perhaps it’s a Buffy, able to overcome all, even if she did have to give up her life to conquer the god.
• Change in net worth test for accreditation of investors (Compliance & Disclosure Interpretation §179.01).

• Proposed Rule 202(a)(11)(G)-1 defining exclusion of “family offices” from the definition of “investment adviser” under the Investment Advisers Act of 1940.

• The “switch” from federal to state investment adviser regulation.

• Proposed rules relating to asset-backed securities (SEC Release 33-9150).

• The NASAA initiative to develop electronic filing of Form D.

• The position taken by some states that federal preemption is not available for Rule 506 transactions if state filing requirements are not satisfied.

• The position taken by many states that a Form D filed with the SEC must be received by the state no later than the 15th day after the date of first sale, which can have the effect of significantly shortening the time for filing with the SEC.

• The position taken by some states that a statute permitting establishment of a Rule 506 filing requirement is the same as actually establishing the requirement.

• The requirements by various states for items above and beyond federal Form D requirements and/or NSMIA requirements, such as disclosure of items not contained in Form D, original signatures on behalf of the issuer and the like.

There is such an incredible amount of change under way, and there are so many widely varying interpretations and requirements, that it took less than an hour to generate this short list of issues. A complete list would be overwhelming. Buffy, where are you now that we need you?

EDITORIAL

By: Martin A. Hewitt
Alston & Bird LLP

Once again, another year has flown by. While each passing year is unique, the one just ending will most certainly go down as one of the most tumultuous of all time and, if not on a par with, a very close second to those years which produced both the Securities Act and the Securities Exchange Act.

It is indisputable that regulation and enforcement are both needed to combat the forces of evil, and thanks to Messrs Dodd and Frank we now have a “new and improved” regulatory regime. The impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “DFA”) may not be fully known for years to come; however, we can all hope that after the dust settles we will have a system which is both robust and fair.

On the bright side, this brave new world presents us all (regulators and practitioners alike) the opportunity to work together to create an efficient regulatory environment which protects investors while encouraging the raising of capital. Our hope is that in the coming months, we can all find common ground and learn to appreciate one another’s unique perspectives. While such a wish may seem like so much pie in the blue sky, this is a golden opportunity which comes along once every several decades or so.

The SEC has opened its doors and left the porch light on for fellow regulators, counsel, and industry to come on in and discuss how best to implement the DFA. No one is naive enough to believe that all the problems of the financial world can be solved at once or forever, but now is the time to sit across from one another, without a particular ax to grind, to work rationally through the very real challenges we face.

One basic concept upon which everyone can agree is that fraud and other nefarious activity must be limited if not stopped altogether. The unfortunate thing is that the next Madoff is, more than likely, already out there. He or she is already winning the minds, hearts and bank accounts of unsuspecting investors. I have said many times that greed and stupidity are the inseparable Siamese twins of Wall Street. This will always be the case. Such greed and stupidity can be found in the fraudsters as well as those investing with them. How difficult is it for someone to understand that if the rate of return on an investment seems too
high to be true, it probably is? Not that there is any problem with risk taking, but people have to understand that the more they stand to make, the more they stand to lose. Unfortunately, everyone reading this already understands that basic concept. The problem is how to communicate that to the average investor.

As part of the DFA, certain bad actor disqualifiers will be implemented. This makes perfect sense, but the devil is in the details. What constitutes fraud varies from jurisdiction to jurisdiction. In some states, filing one form or another late is considered *per se* fraud but it is usually nothing more than administrative oversight or the inability to complete such filings on a timely basis because the information needed is not readily available. This is a classic example of a case in which the lines of communication among regulators, industry, and counsel must be open.

Will we ever be able to prevent the Madoffs of the world from inflicting harm? Unfortunately, the honest answer is no. Can we minimize the effect a bad actor has on investors individually as well as on the entire financial system? We have no choice but to succeed in this endeavor.

So as this decade comes to a close, let’s try to work together to solve myriad problems with the understanding that such problems are really opportunities to create a workable system of regulation and enforcement.

Happy holidays to one and all.

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Photo Credit: For those of you who don’t recognize our new Committee mascot on the Blue Sky Bugle masthead, it is a “blue footed booby.” Alan Parness took this photo in the Galapagos Islands in May, 2010.

Below is a picture of the sun rising off of Cape Cod, MA. It sums up nicely the dawn of a new decade full of promise.
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