TO REGISTER OR NOT TO REGISTER: A PRIMER FOR ONTARIO INVESTMENT ADVISERS

Canada-U.S. Cross-Border Alert
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If you are an investment advisor registered by the OSC or other Canadian provincial regulator, you may have cast longing eyes at taking on a couple United States clients, yet also considered with some trepidation whether such a step requires registering with the Securities and Exchange Commission ("SEC") under the United States Investment Advisers Act of 1940. As we are frequently asked about the process to register in the United States or whether an exemption to such registration may apply, this primer will clear up some of the questions you may have and serve as a starting point for further discussion.

Introduction

Money managers, investment consultants and financial planners are regulated in the United States as "investment advisers" under the U.S. Investment Advisers Act of 1940 (the "Advisers Act") and/or similar state statutes. Formally, a person or firm comes under the purview of the Advisers Act if it (1) is engaged in the business of (2) providing advice to others or issuing reports or analyses regarding securities (3) for compensation.

Firms that are registered under the Advisers Act are subject to a broad fiduciary duty to their clients rather a comprehensive regulatory regime, although it must comply with SEC rules regarding anti-fraud, advisory fees, restrictions on advertising, custody of client assets, proxy voting and recordkeeping; as well as adherence to an internal compliance program maintained by a Chief Compliance Officer (CCO), which includes a written code of ethics. Depending on the nature of your cross-border business, you may wish to stay exempt from the requirements of the Advisers Act, or alternatively, explore one of the routes to formally register with the SEC.

Exemption from Registration: Foreign Private Advisers

Even if you have U.S. clients, you may qualify for a *de minimis* exemption from registration under the Advisers Act, if you:

(1) Have no place of business in the United States;

(2) Have, in total, fewer than 15 clients in the United States (including U.S. investors in private funds advised by the adviser);

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(3) Have aggregate assets under management attributable to such clients and investors of less than US$25 million; and

(4) Do not represent yourself to the public in the United States as an investment adviser.

So long as all four prongs of the test above are satisfied, you may conduct your advisory business with existing U.S. clients on the basis of this exemption from registration

Exempt Reporting Issuers: Private Fund Advisers

A lighter form of registration under the Advisers Act is available to an adviser solely to private funds that have less than US$150 million in assets under management in the United States. Such an adviser may not have other types of clients. A "private fund" is a fund that (1) does not publicly offer its securities and (2) either (A) has fewer than 100 beneficial owners of its outstanding securities or (B) limits its owners to "qualified purchasers" (as defined in the U.S. Investment Company Act of 1940), which generally include natural persons who own at least US$5 million in investments.

In determining whether an adviser has less than US$150 million in AUM in the United States, an adviser with a principal office and place of business outside the United States (1) must include only assets managed at a "place of business in the U.S." and (2) may exclude from this consideration assets managed on behalf of non-U.S. clients. As a result, a Canadian adviser may use the private fund adviser accommodation if: (1) all of its clients that are U.S. persons are private funds (even if some Canadian clients are not); and (2) management activities in the United States are limited to no more than US$150 million of private fund assets. A Canadian adviser's Canadian clients will not count in determining whether it qualifies for the private fund adviser exemption so long as the assets of the Canadian clients are managed from Canada.

Advisers Act Registration

Alternatively and with a view to expanding its U.S. business, a Canadian adviser managing Canadian clients or a private fund organized outside of the United States may make the decision to register as an investment adviser under the Advisers Act. Most of the substantive provisions of the Advisers Act would be inapplicable to the adviser with respect to its private funds under a line of SEC staff no action letters. This alternative permits the adviser to accept U.S. clients that are not private funds, i.e., separate accounts, with respect to which the adviser would be subject to all of the provisions of the Advisers Act.

Even if the decision is made to register under the IAA, this may not be as daunting a prospect as you imagine. The OSC already sets a very high bar in terms of regulatory compliance and documentation, and your present policies and procedures may not need a fundamental overhaul in order to bring them under IAA compliance.

The registration documents consist of two broad parts. First the adviser must file with the SEC a Form ADV – a broad disclosure document that discloses facts about the firm's business practices, ownership, clients, employees, history and principals as well as any disciplinary history. Within 45 days of filing, the SEC will either grant registration or institute an administrative proceeding to deny registration. Once registered, the firm will immediately be considered a registrant under the Advisers Act and subject to all of its rules and regulations.

The second broad registration document that must be prepared and filed with the SEC is the firm's "adviser brochure," which describes in narrative format, disclosure of the adviser's business practices, investment strategies, fees, conflicts of interest, and disciplinary information. This brochure is required to be provided to clients and prospective clients of the adviser.

Limited Reporting Requirements for Private Fund Advisers

Advisers that qualify for the Private Fund Adviser exemption are considered "exempt reporting advisers" and must report certain information on an abbreviated SEC Form ADV and update the information at least annually. No brochure needs to be prepared by such advisers. They also are subject to certain limited requirements under the Advisers Act:

- Pay-to-play rules.
- Antifraud rules (including policies prohibiting the use of material non-public information).
- Recordkeeping rules (when and if adopted by the SEC) for exempt reporting advisers.
- Periodic examinations.

Current information from advisers' Form ADVs filed with the SEC is publicly available through the SEC website: www.adviserinfo.sec.gov.

Ongoing Compliance

The Advisers Act does not provide a comprehensive regulatory regime for advisers, but rather imposes on them a broad fiduciary duty to act in the best interest of their clients. As the SEC explained:

> Unlike the laws of many other countries, the U.S. federal securities laws do not prescribe minimum experience or qualification requirements for persons providing investment advice. They do not establish maximum fees that advisers may charge. Nor do they preclude advisers from having substantial conflicts of interest that might adversely affect the objectivity of the advice they provide. Rather, investors have the responsibility, based on disclosure they receive, for selecting their own advisers, negotiating their own fee arrangements, and evaluating their advisers' conflicts.

Once registered, Advisers are subject to five types of requirements: (1) fiduciary duties to clients; (2) substantive prohibitions and requirements; (3) contractual requirements; (4) recordkeeping requirements; and (5) administrative oversight by the SEC, primarily by inspection. Other than (5), the requirements of the Advisers Act should not require wholesale changes to the procedures of an OSC-registered firm and the policies and procedures of such a registrant are generally capable of straightforward modification to accommodate the U.S. requirements.

However, the advisory firm will become subject to oversight by the SEC, including audits and examinations to demonstrate compliance both with the Advisers Act and adherence to its own compliance controls (and the effectiveness of these compliance controls). For foreign registrants, the SEC often conducts such examinations in coordination with a foreign regulator such as the OSC. The firm will also have to submit an "annual updating amendment" to its Form ADV that reaffirms the eligibility information and updates the responses to any item for which the information from the Form ADV is no longer accurate. The firm must also highlight any changes required to its brochure.

Although the SEC has authority to examine exempt reporting advisers, indications are that it does not currently plan to conduct routine examinations of these advisers. However, this may change at any time given changing regulatory priorities.

For any questions you have regarding this matter, please contact Timothy Ho (416.595.2673).