SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 275 and 279

[Release No. IA–1601, File No. S7–31–96]

RIN 3235–AH07

Rules Implementing Amendments to the Investment Advisers Act of 1940

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rules.

SUMMARY: The Commission is publishing for comment new rules and rule amendments under the Investment Advisers Act of 1940 (''Advisers Act'') to implement provisions of the Investment Advisers Supervision Coordination Act (''Coordination Act'') that reallocate regulatory responsibilities for investment advisers between the Commission and the states. The proposed rules would establish the process by which certain advisers would withdraw from Commission registration, exempt certain advisers from the prohibition on Commission registration, and define certain terms. The Commission also is proposing amendments to several rules under the Advisers Act to reflect the changes made by the Coordination Act. The proposed rules and rule amendments are intended to clarify provisions of the Coordination Act and assist investment advisers in ascertaining their regulatory status.

DATES: Comments must be received on or before February 10, 1997.

ADDRESSES: Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Stop 6–9, Washington, D.C. 20549. Comments also may be submitted electronically at the following E-mail address: rule-comments@sec.gov. All comment letters should refer to File No. S7–31–96; this file number should be included on the subject line if E-mail is used. Comment letters will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, N.W., Washington, D.C. 20549. Electronically submitted comment letters will be posted on the Commission's Internet web site (http://www.sec.gov).

FOR FURTHER INFORMATION CONTACT:
Catherine M. Saadeh, Staff Attorney, or Cynthia G. Pugh, Staff Attorney, at (202) 942–0690, Office of Regulatory Policy, Division of Investment Management, Stop 10–2, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: The Commission today is requesting public comment on new rules 203A–1, 203A–2, 203A–3, 203A–4, 203A–5, 222–1, and 222–2 [17 CFR 275.203A–1, 275.203A–2, 275.203A–3, 275.203A–4, 275.203A–5, 275.222–1, and 275.222–2], and proposed amendments to rules 204–1, 204–2, 205–3, 206(4)–1, 206(4)–2, and 206(4)–4 [17 CFR 275.204–1, 275.204–2, 275.205–3, 275.206(4)–1, 275.206(4)–2, and 275.206(4)–4], and Form ADV and Form ADV–S [17 CFR 279.1 and 279.3] under the Investment Advisers Act of 1940 [15 USC 80b–1 *et seq.*] (the ''Advisers Act'' or the ''Act'').

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Executive Summary

The Commission is proposing rules and rule amendments to implement certain provisions of the Investment Advisers Supervision Coordination Act (''Coordination Act''). The Coordination Act amended the Advisers Act to, among other things, reallocate the responsibilities for regulating investment advisers (''investment advisers'' or ''advisers'') between the Commission and the securities regulatory authorities of the states. Generally, the Coordination Act requires advisers with $25 million or more of assets under management to register with the Commission; advisers with less than $25 million of assets under management that are registered with a state may not register with the Commission. The proposed rules and rule amendments would:

- Establish the process by which advisers that are currently registered with the Commission will determine their status as Commission- or state-registered advisers after the effective date of the Coordination Act;
- Amend Form ADV to require advisers to report information relevant to their status as Commission-registered advisers annually to the Commission;
- Relieve advisers from the burden of having to frequently register and then de-register with the Commission as a result of changes in the amount of their assets under management;
- Provide certain exemptions from the prohibition on registration with the Commission;
- Define certain terms used in the Coordination Act, including ''investment adviser representative,'' ''principal office and place of business,'' and ''place of business;'' and
- Clarify how advisers should count clients for purposes of the new national de minimis standard.

I. Background

On October 11, 1996 President Clinton signed into law the National Securities Markets Improvement Act of 1996 (''1996 Act'').[1] Title III of the 1996 Act, the Coordination Act, makes several amendments to the Advisers Act. The most significant of these amendments reallocates federal and state responsibilities for the regulation of the approximately 22,500 investment advisers currently registered with the

[1] National Securities Markets Improvement Act of 1996, Pub. L. 104–290, 110 Stat. 3416 (1996) (to be codified in scattered sections of 15 U.S.C.).

Commission.[2] These amendments will become effective on April 9, 1997.[3]

The reallocation of regulatory responsibilities primarily grew out of Congress' concern that the Commission's resources are inadequate to supervise the activities of the growing number of investment advisers registered with the Commission, many of which are small, locally operated, financial planning firms.[4] Congress concluded that if the overlapping regulatory responsibilities of the Commission and the states were divided by making the states primarily responsible for smaller advisory firms and the Commission primarily responsible for larger firms, the regulatory resources of the Commission and the states could be put to better, more efficient use.[5]

Congress also was concerned with the cost imposed on investment advisers and their clients by overlapping, and in some cases, duplicative, regulation.[6] In addition to the Commission, forty-six states regulate the activities of investment advisers under state investment adviser statutes.[7] States generally have asserted jurisdiction over investment advisers that ''transact business'' in their state.[8] Consequently, many large advisers operating nationally have been subject to the differing laws of many states. Compliance with differing state laws has imposed significant regulatory burdens on these large advisers.[9] Congress intended to reduce these burdens by subjecting large advisers to a single regulatory program administered by the Commission.

The Coordination Act reallocates regulatory responsibilities over advisers by limiting the application of federal law and preempting certain state laws. Under new section 203A(a) of the Advisers Act,[10] an investment adviser that 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 is prohibited from registering with the Commission unless the adviser (i) has assets under management of not less than $25 million (or such higher amount as the Commission may, by rule, deem appropriate), or (ii) is an adviser to an investment company registered under the Investment Company Act of 1940 (the ''Investment Company Act'').[11] The Commission is authorized to deny registration to any applicant that does not meet the criteria for Commission registration,[12] and is directed to cancel the registration of any adviser that no longer meets the criteria for registration.[13]

The requirement that an adviser have assets under management of at least $25 million in order to register with the Commission was designed to limit Commission regulation to advisers likely to be subject to multiple state registration requirements and whose activities affect national markets.[14] Congress recognized, however, that some advisers that do not have $25 million of assets under management may still have national businesses.[15] Therefore, the Commission was given the authority to exempt advisers from the prohibition on Commission registration if the application of the prohibition would be ''unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes'' of section 203A.[16]

By prohibiting certain state-regulated advisers from registering with the Commission, section 203A(a) gives the states the primary, although not exclusive, responsibility to regulate those advisers. Section 206 of the Advisers Act, which contains the anti-fraud provisions of the Act, will continue to apply to state-registered advisers,[17] and the Commission retains the authority in section 209 of the Advisers Act to investigate and bring enforcement actions against state-registered advisers for violating applicable provisions of the Act.[18]

The Coordination Act gives the Commission primary responsibility to regulate advisers that remain registered with the Commission by preempting certain state laws with respect to those advisers. New section 203A(b) of the Advisers Act[19] provides that state laws requiring the ''registration, licensing, or qualification as an investment adviser'' do not apply to any adviser registered with the Commission or excepted from the definition of investment adviser under section 202(a)(11) of the Advisers Act. Section 203A(b) preempts not only a state's specific registration, licensing, or qualification requirements, but all regulatory requirements imposed by state law on such investment advisers

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[2] Other amendments made by the 1996 Act to the Advisers Act include revisions to (i) section 205 [15 U.S.C. 80b–5] to create additional exceptions to the Advisers Act's limitations on performance fee arrangements, (ii) section 222 [15 U.S.C. 80b–18a] to impose certain uniformity requirements on state investment adviser laws (see section ii. G. of this Release), (iii) section 203(e) [15 U.S.C. 80b–3(e)] to permit the Commission to deny or revoke the registration of any person convicted of any felony (or of any adviser associated with such a person), and (iv) section 203(b) [15 U.S.C. 80b–3(b)] to exempt from registration certain advisers to church-sponsored employee pension plans. See 1996 Act sections 210, 304, 305(a), and 508(d).

[3] See Coordination Act section 308(a).

[4] The number of investment advisers registered with the Commission increased dramatically from 5,680 in 1980 to approximately 22,500 today. By 1995, the Commission was able to examine smaller advisers on a routine basis on average only once every forty-four years. See Testimony of Arthur Levitt, Chairman, SEC, Concerning S. 1815, the ''Securities Investment Promotion Act of 1996,'' Hearing Before the Senate Comm. on Banking, Housing, and Urban Affairs (June 5, 1996) (hereinafter Senate Hearing), app. at 2.

[5] See S. Rep. No. 293, 104th Cong., 2d Sess. 3–4 (1996) (hereinafter Senate Report).

[6] *Id.* at 2.

[7] The District of Columbia, Guam, and Puerto Rico also have enacted statutes regulating investment advisers. See D.C. Code Ann. sections 2–2631 *et seq.* (1994); Guam Gov't Code section 45201 (1996); P.R. Laws Ann. tit. 10, sections 861 *et seq.* (1992). The four states that currently do not have investment adviser statutes are Colorado, Iowa, Ohio, and Wyoming.

[8] See, e.g., Unif. Sec. Act section 203 (1985); Ark. Stat. Ann. section 23–42–301(c) (1996); Md. Code Ann., Corps & Ass'ns section 11–401(b) (1993).

[9] See Testimony of Mark D. Tomasko, Executive Vice President, Investment Counsel Association of America, Inc., Senate Hearing, at 3 (''In some [advisory] firms, there are one or more persons whose sole job is to work on state registrations and requirements.'').

[10] 15 USC 80b–3A(a).

[11] 15 USC 80a–1 *et seq.* The definition of ''investment adviser'' in the Investment Company Act includes any person who, pursuant to contract, regularly performs investment advisory services on behalf of an adviser. See section 2(a)(20) of the Investment Company Act [15 USC 80a–2(a)(20)]. Thus, any adviser that provides advisory services to a registered investment company pursuant to a contract (including a ''sub-adviser'') would be eligible to register with the Commission, regardless of the amount of assets under management.

[12] Section 203(c) of the Advisers Act [15 USC 80b–3(c)] (as amended by section 303(b)(1) of the Coordination Act).

[13] Section 203(h) of the Advisers Act [15 USC 80b–3(h)] (as amended by section 303(b)(2) of the Coordination Act).

[14] Congress has recognized that securities offerings of investment companies are ''inherently national in nature.'' See H.R. Conf. Rep. No. 864, 104th Cong., 2d Sess. 40 (1996). Therefore, advisers to registered investment companies are permitted to (and, in fact, must) register with the Commission, regardless of the amount of their assets under management.

[15] See Senate Report at 5.

[16] Section 203A(c) of the Advisers Act [15 USC 80b–3A(c)]. The exercise of this exemptive authority would not only permit registration with the Commission, but would preempt state law with respect to the exempted advisers. See section II.D. of this Release.

[17] 15 USC 80b–6. By its terms, section 206 applies to all persons who meet the definition of ''investment adviser'' in section 202(a)(11) of the Advisers Act [15 USC 80b–2(a)(11)], regardless of whether they are registered with the Commission.

[18] 15 USC 80b–9. Paragraphs (a) and (d) of section 209 of the Advisers Act [15 USC 80b–9(a),(d)] give the Commission authority to investigate all persons who violate provisions of the Advisers Act, to bring actions in federal court to enforce compliance with the Advisers Act, and, if proper showings are made, to obtain permanent or temporary restraining orders or injunctions with respect to these persons. The Commission may bring administrative actions against ''any investment adviser'' under section 203(e) of the Advisers Act, and has cease-and-desist authority under section 203(k) of the Advisers Act [15 USC 80b–3(k)] against any person who ''is violating, has violated, or is about to violate'' any provision of the Act, or who ''is, was, or would be a cause'' of such violation.

[19] 15 USC 80b–3A(b).

relating to their advisory activities or services, except those provisions that are specifically preserved by the Coordination Act.[20] After April 9, 1997, state investment adviser laws that, for example, establish recordkeeping, disclosure, and capital requirements will no longer apply to advisers registered with the Commission.[21]

The Coordination Act preserves state authority over Commission-registered advisers in three areas.[22] First, states may investigate and bring enforcement actions against Commission-registered advisers with respect to fraud and deceit.[23] States may not, however, indirectly regulate activities of Commission-registered advisers by enforcing state requirements that define ''dishonest'' or ''unethical'' business practices unless the prohibited practices would be fraudulent absent the requirements.[24] Second, states may require Commission-registered advisers to file, for notice purposes only, documents filed with the Commission.[25] Thus, for example, a state could require a Commission-registered adviser to file its Form ADV with the state, but could not require the adviser to provide any information on the state filing other than the information that is required by the Commission. Third, states may require Commission-registered advisers to continue to pay state filing, registration, and licensing fees.[26]

II. Discussion

The Commission is proposing several rules implementing the provisions of the Coordination Act designed to reallocate the regulatory responsibilities for investment advisers between the Commission and the states.

A. Form ADV–T

Approximately 22,500 investment advisers are currently registered with the Commission. Based on information provided by these advisers, the Commission estimates that more than two-thirds of them would not be eligible to register with the Commission after April 9, 1997. These advisers must withdraw from registration or their registrations will be subject to cancellation. To help determine each adviser's status under the Advisers Act, as amended by the Coordination Act, and to provide for the orderly withdrawal from Commission registration for advisers that are no longer eligible, the Commission is proposing a transition rule, rule 203A–5, and Form ADV–T. Under proposed rule 203A–5, all advisers registered with the Commission on April 9, 1997 would be required to file a completed Form ADV–T with the Commission no later than that date.

Form ADV–T would enable an adviser to determine whether it meets the criteria set forth in the Coordination Act for Commission registration, as well as the criteria in the exemptive rules being proposed by the Commission.[27] Form ADV–T would require each adviser to declare whether or not it remains eligible for Commission registration. For an adviser that declares itself not eligible for Commission registration, Form ADV–T would serve as the adviser's request for withdrawal from registration as of April 9, 1997.[28]

Proposed rule 203A–5 would require every currently registered adviser to complete, sign, and return Form ADV–T by April 9, 1997. Failure to return the form would be a violation of a Commission rule. Advisers that do not return the form or that fail to voluntarily withdraw from Commission registration despite no longer being eligible would be subject to a cancellation proceeding under section 203(h) of the Advisers Act.

Proposed Form ADV–T is attached as an appendix to this release. Comment is requested on proposed Form ADV–T, proposed rule 203A–5, and the proposed process to de-register advisers that are no longer eligible for Commission registration.

B. Assets Under Management

In most cases, the amount of assets an adviser has under management will determine whether the adviser will be registered with the Commission or the states. The Commission recognizes that it is important that advisers understand how to determine the amount of assets under management and is proposing instructions to Form ADV–T that would provide guidance in this area.

1. Securities Portfolios

Section 203A(a)(2) of the Advisers Act defines ''assets under management'' as the ''securities portfolios with respect to which an investment adviser provides continuous and regular supervisory or management services.'' [29] Proposed instruction 7(a) to Form ADV–T would provide that a ''securities portfolio'' means any account at least fifty percent of the total value of which consists of securities. Real estate, commodities, and collectibles are not securities and would not be included. In order to prevent an account in which the adviser has taken a defensive position in cash from being excluded as a ''securities portfolio,'' the instruction would require an adviser to exclude cash and cash equivalents (*e.g.*, demand deposits) in determining whether an account is a securities portfolio.[30]

Instruction 7(b) would require that, once the adviser has determined that an account is a ''securities portfolio,'' the entire value of the account, including cash and any non-securities positions, be included in the value of the adviser's assets under management. Exclusion of any component of a securities portfolio is not expressly required by section 203A(a)(2), and would be inconsistent with the manner in which the value of client portfolios is traditionally calculated. Comment is requested whether there are types of assets that

[20] If Congress had intended section 203A(b) to preempt only the specific registration, licensing, and qualification requirements of state investment adviser statutes, it would not have had to preserve the authority of states to investigate fraud, require notice filings, and collect fees. *See infra* notes 22–26 and accompanying text.

[21] See, e.g., Unif. Sec. Act Model Rules 202(d)–1 (minimum financial requirements), 202(e)–1 (bonding requirements), 203(a)–1 (recordkeeping requirements), 203(b)–1 (brochure rule), and 203(c)–1 (financial reporting requirements); N.C. Admin. Code tit. 18 r. 18.1704 (1995) (minimum financial requirements); N.J. Admin. Code tit. 13, section 13:47A–2.3 (1992) (bonding requirements); Conn. Agencies Regs. section 36b–31–14b (1995) (recordkeeping requirements); Md. Regs. Code tit. 2, ch. 5 r. .05 (1994) (brochure rule); Ga. Comp. R. & Regs. r. 590–4–8.14 (1989) (financial reporting requirements).

[22] The Coordination Act also preserves state authority over certain persons who act on behalf of Commission-registered advisers. See section II.F. of this Release.

[23] Section 203A(b)(2) of the Advisers Act [15 U.S.C. 80b–3A(b)(2)].

[24] While there is no legislative history addressing the scope of section 203A(b)(2), Congress used similar language to preserve state anti-fraud laws when it preempted state regulation of securities offerings in Title I of the 1996 Act. See section 18(c)(1) of the Securities Act of 1933 [15 U.S.C. 77r(c)(1)] (''the [state] securities commission[s] * * * shall retain jurisdiction under the laws of such [s]tate[s] to investigate and bring enforcement actions with respect to fraud or deceit * * *.''). The House report discussing that section explained that ''[i]n preserving [s]tate laws against fraud and deceit * * * the Committee intends to prevent the [s]tates from indirectly doing what they have been prohibited from doing directly * * *. The legislation preempts authority that would allow the [s]tates to employ the regulatory authority they retain to reconstruct in a different form the regulatory regime * * * that [s]ection 18 has preempted.'' H.R. Rep. No. 622, 104th Cong., 2d Sess. 34 (1996) (hereinafter House Report).

[25] Coordination Act section 307(a).

[26] Coordination Act section 307(b).

[27] See section II.D. of this Release.

[28] An adviser that declares itself not eligible for Commission registration on Form ADV–T would not be required to separately file a Form ADV–W [17 CFR 279.2] in order to withdraw from registration with the Commission.

[29] 15 U.S.C. 80b–3A(a)(2).

[30] Instruction 7(a) also would explain that the following securities portfolios should be included in the determination of the amount of assets under management: (i) Family or proprietary accounts (except the personal assets of a sole proprietor), (ii) accounts for which the adviser receives no compensation, and (iii) accounts of foreign clients.

nonetheless should be excluded from a securities portfolio, and therefore from the amount of assets under management.

2. Valuation and Reporting of Securities Portfolios

Instruction 7(d) to proposed Form ADV–T would address the method and timing of the valuation of an adviser's securities portfolios.[31] The value of a securities portfolio would be required to be determined as of a date no more than ten business days before the filing of Form ADV–T.[32] The instruction would require that the methodology by which the securities are valued be the same as that used to value the securities for purposes of client reporting or to determine fees for investment advisory services.

3. Continuous and Regular Supervisory or Management Services

Instruction 7(c) to proposed Form ADV–T would provide guidance for determining whether an adviser provides an account with ''continuous and regular supervisory or management services'' within the meaning of section 203A(a)(2). The Commission would consider accounts over which advisers have discretionary authority and for which they provide ongoing management services to receive continuous and regular supervisory or management services (and therefore the assets of such accounts to be ''assets under management''). In addition, the Commission believes that a limited number of non-discretionary advisory arrangements involve such services.

Whether an adviser that does not have discretionary authority will be considered to provide continuous and regular management or supervisory services with respect to an account would depend upon the nature of the adviser's responsibilities. The greater the amount of day-to-day responsibility an adviser has, the more likely the adviser would be providing continuous and regular supervisory or management services. For example, an adviser that has traditional portfolio management responsibilities but must obtain client consent before executing a trade would provide continuous and regular management or supervisory services with respect to the account.[33]

The Commission believes that Congress intended to exclude from Commission registration most advisers that do not engage in traditional ongoing portfolio management, including most financial planners and consultants. Under the proposed instructions, a financial planner that merely undertakes to monitor the markets and advise its clients as to the advisability of changes to their portfolios would not be providing continuous and regular management or supervisory services.[34] A financial planner that otherwise would be regulated by the states could not ''opt'' to be regulated by the Commission by revising its financial planning agreements to include the statutory language or similar language unless such a revision materially changes the nature of the services being provided.[35]

In evaluating the effect that the $25 million threshold would have on the number of investment advisers registered with the Commission, Congress relied on data provided by the Commission that was derived from responses on Form ADV.[36] Thus, the Commission believes that Congress intended to include as assets under management the types of assets advisers have reported on Form ADV. The Commission is proposing to require advisers to report on Form ADV–T the amount of assets under management reported on Form ADV.[37] An adviser that reports substantially more assets under management on its Form ADV–T than on its Form ADV could be asked to explain the difference.

Comment is requested on the Commission's proposed interpretation of ''assets under management'' and the related proposed instructions to Form ADV–T. Comment also is requested on the proposed examples provided on Form ADV–T of accounts that receive continuous and regular supervisory or management services. Commenters are requested to provide additional examples. The Commission is also interested in commenters' views whether the proposed form and instructions would allow manipulation of the amount of an adviser's assets under management in order to evade the eligibility requirements and, if so, whether there are any alternative methods to address that potential problem.

4. Proposed Safe Harbor for State-Registered Investment Advisers

The Commission recognizes that section 203A(a)(2) does not, and proposed Form ADV–T would not, provide a bright-line test by which an adviser that does not have discretionary authority over client assets may determine whether it is eligible to register with the Commission. The Commission therefore is proposing rule 203A–4 to provide a safe harbor from Commission registration for an adviser that is registered with state securities authorities (rather than the Commission) based on a reasonable belief that it is prohibited from registering with the Commission because it has insufficient assets under management.

Under proposed rule 203A–4, the Commission would not assert a violation of the Advisers Act for failure to register with the Commission (or to comply with the provisions of the Advisers Act to which an adviser is subject if required to register) if the adviser reasonably believes that it does not have sufficient assets under management (at least $30 million) and is therefore not required to register with the Commission.[38] This safe harbor would be available only to an adviser that is registered with the state in which it has its principal office and place of business.

C. Transitions Between State and Commission Registration

The Coordination Act contemplates that a state-registered adviser whose assets under management increase to

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[31] In general, the value of assets under management would be required to be included on Form ADV–T only if the amount of assets under management is the sole basis upon which the adviser is eligible for Commission registration. See Part III of proposed Form ADV–T.

[32] See Instruction 7(d) to proposed Form ADV–T.

[33] The frequency with which an adviser initiates trades, provides reports to clients, or has contacts with clients would not necessarily determine whether the adviser provides continuous and regular supervisory or management services.

[34] To enable the Commission to evaluate the claims of advisers relying on the non-discretionary management of assets as the basis of eligibility to remain registered with the Commission, proposed Form ADV–T would require these advisers to append a written statement explaining the nature of the non-discretionary supervisory or management services. See Part III, Item (c) of proposed Form ADV–T.

[35] The Commission is concerned that, if financial planners were permitted to treat assets they ''monitor'' as assets under management and therefore remain registered with the Commission, the intent of Congress to reallocate regulatory responsibilities by making ''almost 72 [percent] of Commission [investment adviser] registrants'' subject primarily to state regulation would not be effected. See Senate Report at 4.

[36] See Testimony of Arthur Levitt, Chairman, SEC, Senate Hearing, app. at 2 (providing data reflected in Senate Report). The Form ADV data provided in the Commission's testimony was extracted from responses to Items 18 and 19 of Part I of Form ADV, which require information on the market value of client securities portfolios managed on a discretionary basis and managed or supervised on a non-discretionary basis.

[37] See Part III, Item (b) of proposed Form ADV–T.

[38] As discussed *infra*, the Commission is proposing to increase the $25 million threshold for Commission registration to $30 million, and to provide an optional exemption from the prohibition on registering with the Commission for advisers having between $25 and $30 million of assets under management. See section II.C.1. of this Release.

over $25 million will withdraw its state registration and register with the Commission. Conversely, an adviser whose assets under management decline below $25 million will withdraw its Commission registration and register with a state (or states).

The Coordination Act could require an adviser that has close to $25 million of assets under management to register with the Commission only to de-register and re-register with a state shortly thereafter. This could occur because of a small decrease in the value of client assets (as a result of a market decline) or the departure of one or a few clients. The Commission recognizes that this process would be burdensome and costly to advisers and therefore is proposing to use the authority provided to it in the Coordination Act to adopt a new rule, rule 203A–1, that would create a more flexible regime to avoid ''transient'' registration problems.

1. Transition from State to Commission Registration

Section 203A(a)(1)(A) of the Advisers Act authorizes the Commission to adopt a rule to increase the $25 million of assets under management threshold for Commission registration.[39] In addition, as discussed above, the Commission has authority to exempt persons not meeting the threshold from the prohibition on registering with the Commission.[40] The Commission is proposing to use these grants of authority to increase the $25 million threshold to $30 million, and to provide an optional exemption from the prohibition on registering with the Commission for advisers having between $25 and $30 million of assets under management.[41]

Proposed rule 203A–1 would permit advisers having between $25 and $30 million of assets under management to determine whether and when to change from state to Commission registration. In order to avoid having to de-register shortly after registering with the Commission, an adviser reaching the $25 million of assets under management threshold could defer registration with the Commission. An adviser would not be required to register with the Commission until its assets under management reached $30 million, and would not be subject to Commission cancellation of its registration until its assets had fallen below $25 million. A state-registered adviser whose assets under management grew to $30 million or more would be required to register with the Commission promptly when the assets reached $30 million (not when the adviser subsequently reported its assets under management to the state). Comment is requested whether the proposed $5 million ''window'' would provide advisers with sufficient flexibility to avoid the costly process of periodically registering and de-registering with the Commission and the states. Comment is also requested on other alternatives that could meet the needs of such advisers, for example, by providing a grace period for the transition from state to Commission registration, or by determining whether Commission registration is required on an annual basis.

2. Transition from Commission to State Registration

The Commission is proposing to amend Form ADV by adding new Schedule I (''eye'') that would require advisers to report information necessary to determine continued eligibility for Commission registration similar to that required by Form ADV–T.[42] The information on Schedule I would be used to determine whether the Commission should cancel the registration of an adviser because the adviser no longer meets the criteria for Commission registration. Schedule I would be required to be updated annually, within 90 days after the end of the adviser's fiscal year. An adviser whose assets under management fell below $25 million would not be required to report this event until after the end of its fiscal year (and not at all unless its assets under management remained below $25 million at the time of filing its Schedule I). Thus, eligibility for Commission registration would be determined annually based upon the value of assets under management at a single point in time. Comment is requested whether the Commission should measure assets under management more frequently, or based on the average value of assets at the end of certain periods (*e.g.*, calendar quarters).

Section 203A(b) of the Advisers Act, together with most state investment adviser statutes, will cause state registration requirements to be triggered by either a withdrawal from, or by the Commission's cancellation of, registration with the Commission. To allow an adviser facing potential cancellation of its Commission registration sufficient time to register under applicable state statutes, the Commission is proposing to provide a ''grace period'' of 90 days after the date the adviser files its Schedule I indicating that it would not be eligible for Commission registration.[43] Upon the expiration of this period, the Commission would institute proceedings to cancel the adviser's registration if the adviser had not withdrawn its registration on its own. As provided under the Advisers Act, an adviser would be given notice and an opportunity to show why its registration should not be cancelled (*i.e.*, because since the time the adviser had filed its Schedule I to Form ADV, its amount of assets under management had grown).[44] Comment is requested whether a 90-day grace period would allow sufficient time for an adviser to register with the states.

D. Exemptions from Prohibition on Registration with the Commission

As discussed above, the Coordination Act gives the Commission authority to exempt advisers from the prohibition on Commission registration if the prohibition would be ''unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes'' of section 203A.[45] Congress intended the Commission to grant these exemptions to advisers having ''a national or multistate practice.''[46] The Commission is proposing a new rule, rule 203A–2, that would exempt four types of advisers from the prohibition on Commission registration. The effect of the first three exemptions would be to make section 203 of the Advisers Act applicable to exempted advisers and, thus, require them to register with the Commission (unless exempted from Commission registration under section 203(b) of the Act). The fourth exemption would enable newly formed advisers to register with the Commission if they have a reasonable expectation that they will be eligible for Commission registration within 90 days.

1. Nationally Recognized Statistical Rating Organizations

''Nationally recognized statistical rating organization'' (''NRSRO'') is a term used in several Commission rules

[39] 15 USC 80b-3A(a)(1)(A).

[40] See supra note and accompanying text.

[41] Paragraphs (a) and (b) of proposed rule 203A–1.

[42] See section II. A of this Release.

[43] Paragraph (c) of proposed rule 203A–1. The Commission is not proposing a similar grace period after the filing of Form ADV–T. The Commission presumes that an adviser not eligible to maintain its registration with the Commission on April 9, 1997 would already be registered with the appropriate state(s) at the time of filing Form ADV–T.

[44] Section 211(c) of the Advisers Act [15 USC 80b-11(c)].

[45] Section 203A(c). See supra notes and accompanying text. As discussed above, the exercise of this exemptive authority would not only permit registration with the Commission, but would preempt state law with respect to the exempted advisers. See supra notes 19–21 and accompanying text.

[46] Senate Report at 5.

to identify a type of entity, often referred to as a ''rating agency,'' that provides ratings of securities, on the basis of which the securities receive special treatment under Commission rules.[47] All of the entities currently designated as NRSROs are registered with the Commission as investment advisers.[48] While NRSROs do not have assets under management, their activities have a significant effect on the national securities markets and the operation of federal securities laws.[49] The Commission believes that it would be inconsistent with the purposes of the Coordination Act for this type of entity to be regulated by the states rather than by the Commission, and is proposing to exempt NRSROs from the prohibition on registering with the Commission.[50]

2. Pension Consultants

Pension consultants provide various advisory services to fiduciaries of pension plans, including assistance in selecting and monitoring investment advisers that manage assets of such plans.[51] Pension consultants may not have assets under management, but their activities have a direct effect on the management of billions of dollars of pension plan assets. The Commission believes that it would be inconsistent with the purposes of the Coordination Act for these advisers to be regulated by the states rather than by the Commission, and is proposing to exempt certain pension consultants, as defined under the proposed rule, from the prohibition on registering with the Commission.

Not all pension consultants, however, are engaged in activities that substantially affect national markets. Under paragraph (b) of proposed rule 203A–2, a pension consultant would be defined as an investment adviser that provides investment advice to certain employee benefit plans with respect to assets having an aggregate value of at least $50 million during the adviser's last fiscal year.[52] Comment is requested as to the appropriateness of the proposed exemption, and the proposed criteria for determining whether a pension consultant's activities warrant exemption.

3. Certain Affiliated Investment Advisers

Some firms conduct their advisory activities through separately registered advisers, not all of which may meet the criteria for Commission registration. For example, a firm may conduct its portfolio management activities in Subsidiary A, while conducting its financial planning activities in Subsidiary B, each of which is separately registered as an investment adviser. As a result, Subsidiary B may have no assets under management and, unless another exemption is available, would be regulated by the states rather than by the Commission.

This result may be appropriate for affiliated advisers that are related only by ownership.[53] The activities of affiliated advisers, however, may be centrally managed, and the effect of the Coordination Act's prohibition on registration would be either to subject an advisory firm to different schemes of regulation or force it to reorganize its operations. The Commission believes that either result could be unfair to the adviser and a burden on interstate commerce and is therefore proposing to exempt from the prohibition on Commission registration any adviser that directly or indirectly controls, is controlled by, or is under common control with an investment adviser that is eligible to register (and is, in fact, registered) with the Commission.[54] ''Control'' would be defined, for purposes of the rule, as the power to direct or cause the direction of the management or policies of an adviser, whether through ownership of securities, by contract, or otherwise.[55] The exemption would be available only if the principal office and place of business of the adviser is the same as that of the affiliated registered adviser.[56]

Affiliated advisers having the same principal office and place of business are likely to have overlapping operations, similar books and records, and integrated compliance systems. Compliance with separate schemes of regulation may not permit the integration of such systems and therefore would be burdensome for these advisers. Moreover, the Commission has found that it is more efficient to examine all of the activities of such affiliated advisers at the same time. Comment is requested whether the proposed conditions for exempting an affiliated adviser from the prohibition on registering with the Commission are appropriate. Is having the same principal office and place of business an appropriate criterion by which to assume the integration of operations of affiliated advisers? If not, commenters are requested to provide alternative criteria.

4. Investment Advisers With Reasonable Expectation of Eligibility

A newly formed adviser may not be eligible to register with the Commission at the time of its formation, but may have a reasonable expectation that within a short period of time it will become eligible to register. For example, an adviser may not initially have assets under management, but may anticipate an inflow of assets shortly after commencing operations. The Commission recognizes that requiring a newly formed adviser to register with the states, only to de-register and

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[47] See, e.g., rule 15c3–1 under the Securities Exchange Act of 1934 (''Exchange Act'') [17 CFR 240.15c3–1] (broker-dealer net capital); rule 2a-7 under the Investment Company Act [17 CFR 270.2a-7] (money market funds).

[48] The Commission's Division of Market Regulation responds to requests for NRSRO designation through no-action letters, and has designated six rating agencies as NRSROs for purposes of the net capital rule (rule 15c3–1 under the Exchange Act).

[49] See Exchange Act Rel. No. 34616 (Aug. 31, 1994) [59 FR 46314 (Sept. 7, 1994)] (describing the use of NRSRO ratings by Congress and the Commission).

[50] Paragraph (a) of proposed rule 203A–2.

[51] See Investment Advisers Act Rel. No. 1092 (Oct. 8, 1987) [52 FR 38400, 38401 (Oct. 16, 1987)].

[52] In determining the aggregate value of advised assets, the adviser would be able to include only that portion of a plan's assets for which the adviser provided investment advice (including any advice with respect to the selection of an investment adviser to manage the assets). The value of assets would be determined as of the date during the adviser's most recently completed fiscal year that the adviser was last employed or retained by contract to provide investment advice to the plan with respect to those assets. See paragraph (b)(3) of proposed rule 203A–2.

[53] The Commission does not believe that Congress intended to permit an adviser to register with the Commission merely because it is an affiliate of a Commission-registered adviser. In section 203A(b)(1)(A) of the Advisers Act [15 USC 80b-3A(b)(1)(A)], Congress preempted state regulation of advisers and certain ''supervised persons.'' Congress defined supervised persons as persons who provide investment advice on behalf of the adviser. See section 202(a)(25) of the Advisers Act [15 USC 80b-2(a)(25)]. The principal effect of using this new defined term, rather than the term ''persons associated with an investment adviser,'' which is defined in section 202(a)(17) of the Advisers Act [15 USC 80b-2(a)(17)], is to exclude any person controlling or controlled by the adviser unless the person provides investment advice on behalf of the adviser. See section F.1. of this Release.

[54] Paragraph (c) of proposed rule 203A–2. By proposing rule 203A–2(c), the Commission is not suggesting that an advisory firm may reorganize its operations in order to circumvent the requirements of the Advisers Act. See section 208(d) of the Advisers Act [15 USC 80b–8(d)] (making unlawful for any person ''indirectly, or through or by any other person, to do any act or thing which it would be unlawful for such person to do directly'' under the Advisers Act). *Cf.* Preliminary Note 2 to rule 203(b)(3)–1 [17 CFR 275.203(b)(3)–1] under the Advisers Act.

[55] Under this definition, any person that directly or indirectly has the right to vote 25 percent or more of the voting securities or is entitled to 25 percent or more of the profits of an adviser would be presumed to control that adviser.

[56] The definition of ''principal office and place of business'' in proposed rule 203A–3(c) would also apply to this rule. See section II.E.2. of this Release.

register with the Commission shortly thereafter, would be unfair, burdensome, and inconsistent with the purposes of section 203A. Therefore, the Commission is proposing to exempt certain newly formed advisers from the prohibition on Commission registration.

Under proposed rule 203A–2(d), an adviser with a reasonable expectation that it will be eligible for Commission registration within 90 days after the date the adviser's registration becomes effective would be permitted to register with the Commission. At the end of the 90-day period, the adviser would be required to file an amended Schedule I. If the adviser indicates on the amended Schedule I that it has not become eligible to register with the Commission, the adviser would be required to file a Form ADV-W concurrently with the Schedule I, thereby withdrawing from registration with the Commission. The proposed exemption would be available only to advisers that are not registered or required to be registered with either the states or the Commission.

The Commission requests comment on the utility, scope, and conditions of the proposed exemptions, including whether the exemptions should require Commission registration for advisers meeting the exemptive criteria. Are there other classes of advisers that the Commission should exempt because their prohibition from registering with the Commission would be unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes of section 203A? Comment is also requested whether the 90-day period is adequate or whether it should be longer.

E. Investment Advisers Not Regulated or Required To Be Regulated by States

Under section 203A(a)(1) of the Advisers Act, advisers that are not regulated or required to be regulated as investment advisers in the state [57] in which they have their principal office and place of business must register with the Commission regardless of the amount of assets they have under management.[58] This provision makes clear that the Commission will retain regulatory responsibility for advisers with a principal office and place of business in states that have not enacted investment adviser statutes, and for foreign advisers doing business in the United States. The Coordination Act does not, however, provide an explanation of when an adviser is ''regulated or required to be regulated'' as an investment adviser, nor does it define ''principal office or place of business.''

1. ''Regulated or Required To Be Regulated''

Although the phrase ''regulated or required to be regulated'' is used in section 203A(a)(1), the legislative history of this provision suggests that Congress equated regulation by a state with registration with the state.[59] This interpretation seems appropriate since an adviser exempt from registering under a state statute typically is subject only to the anti-fraud provisions of the state statute and not to substantive regulatory provisions. Accordingly, the Commission proposes to interpret section 203A(a)(1) as requiring any person who meets the definition of investment adviser in section 202(a)(11) of the Advisers Act (and that is not otherwise exempt from registration by section 203(b) of the Act) [60] to register with the Commission if the person has a principal office and place of business in a state that has an investment adviser statute, but is not required to be registered (and, in fact, is not registered) under that statute. The person may not be required to register with the state as a result of an exemption from registration or an exception from the definition of ''investment adviser'' in that state's statute.[61]

One effect of this proposed interpretation would be that all advisers will be regulated either by the Commission or the states, except for advisers that are exempt from registration under both the Advisers Act and state statutes. Another effect would be that some advisers a state has determined not to regulate would be registered with the Commission even though their operations may be very limited. The Commission requests comment whether it should recommend that Congress amend section 203A(a)(1) to prohibit an adviser from registering with the Commission if it has its principal office and place of business in a state that has enacted an investment adviser statute (regardless of whether that statute requires the adviser to register).

''Principal Office and Place of Business''

Currently, advisers are required to identify their principal place of business in response to Item 2A of Form ADV. Form ADV does not, however, define the term principal place of business. Because of the added regulatory significance of the determination of the state in which the adviser has its principal place of business, the Commission is proposing to define the term ''principal office and place of business'' to mean the ''executive office of the investment adviser from which the officers, partners, or managers of the investment adviser direct, control, and coordinate the activities of the investment adviser.'' [62]

2. F. Persons Who Act on Behalf of Investment Advisers

In addition to preempting state law with respect to investment advisers that are registered with the Commission, the Coordination Act preempts state law with respect to ''supervised persons'' of Commission-registered advisers.[63] The Coordination Act defines a supervised person as any ''partner, officer, director * * * , or employee of an investment adviser, or other person who provides investment advice on behalf of the investment adviser and is subject to the supervision and control of the investment adviser.'' [64] Thus, the definition of supervised person parallels the traditional Commission view that persons performing advisory services on behalf of an adviser are not required to

[57] The term ''state'' is defined in section 202(a)(19) of the Advisers Act [15 USC 80b–2(a)(19)] to include the District of Columbia, Puerto Rico, the Virgin Islands, and any other possession of the United States.

[58] 15 USC 80b–3A(a)(1).

[59] Senate Report at 4 (''The Commission will continue to supervise all advisers that are based in a state that does not register investment advisers.'').

[60] 15 USC 80b–3(b). Section 203(b) exempts from registration (i) any adviser whose clients are all residents of the state within which the adviser maintains its principal office and place of business, and that does not furnish advice or issue reports with respect to securities listed or admitted to unlisted trading privileges on any national securities exchange (the ''intrastate'' exemption); (ii) any adviser whose only clients are insurance companies (the ''insurance company'' exemption); (iii) any adviser that, among other things, does not hold itself out generally to the public as an adviser and during the course of the preceding twelve months had fewer than fifteen clients (the ''small adviser'' exemption); (iv) any adviser that is a charitable organization and that provides advice only to other charitable organizations (the ''charitable adviser'' exemption, added by section 5 of the Philanthropy Protection Act of 1995, Pub. L. 104–62, 109 Stat. 682, 685 (1995) (codified in scattered sections of 15 U.S.C.)); and (v) any adviser that provides advice solely to church plans (the ''church plan adviser'' exemption, added by section 508(d) of the 1996 Act).

[61] For example, a lawyer who provides discretionary advisory services as a ''bona fide fiduciary'' may not be required to register as an investment adviser under Massachusetts law. Unless the lawyer's performance of such services is solely incidental to the practice of law (within the meaning of section 202(a)(11)(B) of the Advisers Act), the lawyer would likely be required to register under the Advisers Act even if the lawyer provides such services with respect to less than $25 million of assets. Compare Mass. Ann. Laws ch. 110A, section 401(m) (1996) with section 202(a)(11)(B) of the Advisers Act [15 USC 80b–2(a)(11)(B)].

[62] Paragraph (c) of proposed rule 203A–3.

[63] Section 203A(b).

[64] Section 202(a)(25).

separately register.[65] The definition of supervised person includes a person whose status is an ''employee,'' as well as a person who provides advice on behalf of the adviser pursuant to a contract, as long as the person is under the supervision and control of the adviser.[66]

The Coordination Act, however, does preserve certain state laws with respect to certain supervised persons of Commission-registered advisers by providing that a ''[s]tate may license, register, or otherwise qualify any investment adviser representative who has a place of business located within that [s]tate.'' [67] The Coordination Act does not define ''investment adviser representative,'' nor does it describe what constitutes a ''place of business.'' In order to clarify these terms and thus the scope of state preemption under the Coordination Act, the Commission is proposing a rule defining these terms.

1. ''Investment Adviser Representative''

The Congressional committee reports provide no indication as to which persons providing investment advice on behalf of Commission-registered advisers Congress intended states to continue to register. Testimony in support of preserving state authority over investment adviser representatives, however, suggests that Congress intended to permit state securities authorities to establish qualification standards for investment adviser representatives in order to protect individual, or ''retail,'' investors.[68]

While the term ''investment adviser representative'' is used in many states' laws, the Commission believes that it would be inconsistent with the policies underlying the 1996 Act to be guided by individual state's investment adviser statutes. Many states define ''investment adviser representative'' differently,[69] and in ways that reach persons who do not provide advice to retail investors (e.g., portfolio managers of mutual funds).[70] In light of the many provisions in the Coordination Act designed to promote uniformity of regulation, and the decision of Congress to preempt state laws regulating the offering of shares of investment companies,[71] the Commission does not believe that Congress intended the definition of ''investment adviser representative'' to incorporate state law. The Commission thus concludes that Congress used the undefined term ''investment adviser representative'' with the expectation that the Commission would use its existing rulemaking authority to define it.[72] The Commission is proposing to adopt a rule defining the term ''investment adviser representative'' in a manner consistent with the policy concerns that appear to have given rise to the exception from the provisions of the Coordination Act that preempt state law with respect to Commission-registered advisers and their supervised persons.

Proposed rule 203A–3(a) would define ''investment adviser representative'' to be a ''supervised person'' of an investment adviser, if a substantial portion of the business of the supervised person is providing investment advice to clients who are natural persons. The term therefore would exclude (and thereby preclude states from registering) supervised persons who provide advice to investment companies, businesses, educational institutions, charitable institutions and other entities that are not natural persons. Supervised persons who provide advice to natural persons, but who do not ''on a regular basis solicit, meet with, or otherwise communicate to clients'' also would be excepted from the definition.[73] This exception is intended to exclude personnel of an adviser who may be involved in the formulation of investment advice given to natural persons, but who are not directly involved in providing advice to (or soliciting) clients. In addition, supervised persons who give only impersonal advice would be excepted.[74] This provision is intended to exclude personnel who may be involved, for example, in preparing a newsletter, providing general market timing advice, or preparing a list of recommended purchases for inclusion on a web site.

As discussed above, the definition of ''investment adviser representative'' would include only those supervised persons a ''substantial portion'' of whose business is providing advice to natural persons. A substantial portion of a supervised person's business would be providing advice to natural persons if, during the preceding twelve months, more than ten percent of the supervised person's clients consisted of natural persons, or more than ten percent of the assets under management by the adviser attributable to the supervised person were assets of clients who are natural persons.[75] This provision is intended to permit representatives who provide advisory services primarily to clients that are not natural persons to accept so-called ''accommodation clients'' without being required to register as investment adviser representatives

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[65] Persons who perform investment advisory services on behalf of, and under the supervision and control of, a registered adviser are not required to separately register as investment advisers. See, *e.g.*, Abid Mansoor (pub. avail. Feb. 5, 1992); Corinne E. Wood (pub. avail. Apr. 17, 1986); The Burney Company (pub. avail. Feb. 7, 1977). Persons who provide advice on behalf of persons excepted from the definition of investment adviser in section 202(a)(11) are likewise excepted from the definition of investment adviser. See Robert S. Strevell (pub. avail. Apr. 29, 1985).

[66] Senate Report at 4.

[67] Section 203A(b)(1)(A).

[68] The North American Securities Administrators Association (''NASAA'') addressed this matter in its testimony before the Senate committee.

Of particular concern to the states is the potential loss of licensing authority over [investment adviser representatives] associated with [advisory] firms operating out of small branch offices nationwide. Typically, a small number of [investment adviser representatives] operate out of each office providing, almost exclusively, retail investment advisory services * * *. Because of the local nature and retail clientele of these [representatives], the states have a strong interest in maintaining oversight of them.

See Testimony of Dee R. Harris, President, NASAA, Senate Hearing at 6–7.

NASAA recommends * * * requiring all supervised persons that provide advice to retail clients to be licensed with the states regardless of the size of their [advisory] firm. Supervised persons would be exempt from state licensure if they do not solicit retail business nor hold themselves out as providing investment advice to a retail clientele.

See NASAA Recommendations Relating to S. 1815 and H.R. 3005 (July 8, 1996), at 1–2.

[69] The investment adviser statutes of New Hampshire and New Jersey define ''investment adviser representative'' to include any person who is authorized to represent an investment adviser in providing investment advice. See N.H. Rev. Stat. Ann. section 421–B:2(II) (1991 & Supp. 1996). The investment adviser statutes of Oklahoma, Oregon, and Virginia define ''investment adviser representatives'' to include persons who prepare reports or analyses concerning securities. See Okla. Stat Ann. tit. 71 section 2(l) (Supp. 1997); Or. Rev. Stat. section 59.015(16)(a)(B) (1995); Va. Code Ann. section 13.1–501(A) (1993).

[70] See Unif. Sec. Act section 401(g) (1986 amendments) (defining ''investment adviser representative'' to include any person employed by or associated with an investment adviser, other than clerical or ministerial personnel, who manages accounts or portfolios of clients, or who determines which recommendations or advice regarding securities should be given); *Definitions and Procedures for Investment Adviser Representatives and Branch Offices* (Order of West Virginia Deputy Commissioner of Securities, amended eff. Oct. 11, 1995) (defining ''investment adviser representative'' to include clerical and ministerial employees).

[71] See 1996 Act section 102 (amending section 18(b)(2) of the Securities Act of 1933 [15 USC 77r(b)(2)] to preempt state law requiring registration of securities issued by investment companies that are registered or that have filed a registration statement with the Commission); see also Senate Report at 6–7; House Report at 30–31.

[72] This conclusion is also suggested by the fact that, although the drafters of section 203A had available to them two terms—''person associated with an investment adviser'' and ''supervised person''—that could have been used to describe persons the states would have authority to register, the drafters chose to use neither term. ''Person associated with an investment adviser'' is defined in section 202(a)(17), and ''supervised person'' is defined in section 202(a)(25) of the Advisers Act.

[73] Paragraph (a)(1)(i) of proposed rule 203A–3.

[74] Paragraph (a)(1)(ii) of proposed rule 203A–3.

[75] Paragraph (a)(2)(ii) of proposed rule 203A–3.

under state law.[76] Comment is requested whether the criteria for determining whether a substantial portion of an investment adviser representative's business is providing advice to retail persons are workable. If not, commenters are requested to provide alternatives.

The Commission notes that persons not falling within the definition of ''investment adviser representative,'' while not subject to state registration and qualification standards, would not be ''unregulated.'' Although the Commission does not separately register persons associated with investment advisers, the Commission regulates their activities in connection with the regulation of investment advisers. These persons are subject to most of the provisions of the Advisers Act, either directly, as persons associated with investment advisers, or indirectly, as aiders and abettors.[77]

Comment is requested on the proposed definition of ''investment adviser representative,'' and whether the exclusions from the term (and thus state registration requirements) are appropriate. Comment is requested whether supervised persons a substantial portion of whose business is providing services to natural persons who have a high net worth or meet other indicia of financial sophistication should be excepted from the definition.[78] Should an investment adviser representative that is dually-registered as a broker-dealer agent in a state be excepted from the definition of ''investment adviser representative''?

2. ''Place of Business''

While section 203A(b)(1)(A) preserves the ability of a state to register and regulate ''investment adviser representatives'' of Commission-registered advisers, the section limits a state's authority to only those investment adviser representatives who have a ''place of business'' within the state. The Coordination Act does not define the phrase ''place of business.''

The Commission is proposing new rule 203A–3(b) to clarify that, for purposes of section 203A(b)(1)(A), a place of business is any ''place or office from which the investment adviser representative regularly provides advisory services or otherwise solicits, meets with, or communicates to clients.'' Under section 203A(b)(1)(A) and proposed rule 203A–3(b), an investment adviser representative may be required to register in multiple states if the adviser representative has multiple places of business. A place of business need not be a formal office, but it cannot be merely an office of an agent for service of process or a mail box. A place of business may, however, include a hotel room, temporarily rented office space, or even the home of a client, if the adviser representative regularly provides advisory services or solicits, meets with, or otherwise communicates to the client at that location.

If, however, an investment adviser representative does not regularly provide advisory services or otherwise solicit, meet with, or communicate to clients at any place or office, proposed rule 203A–3(b) would define the place of business of such investment adviser representative to be the residence of each client. This provision is designed to prevent itinerant investment adviser representatives from claiming that they have no place of business and thus are not subject to any state's registration or qualification requirements. As a practical matter, therefore, an investment adviser representative likely will designate at least one place or office in a state in which he or she regularly communicates to clients as a place of business.

Comment is requested whether the proposed rule will provide clear guidance for determining whether an investment adviser representative has a place of business in a particular state. Comment is specifically requested whether additional guidance or criteria would be appropriate to address investment adviser representatives that provide services to clients through electronic media.[79]

The Commission is aware that some have suggested that section 203A(b)(1)(A) could be interpreted to permit a state to require every investment adviser representative to establish a place of business in the state (such as the office of the Secretary of State) as a condition of doing business in that state. Under this interpretation, every investment adviser representative doing business in a state would be potentially subject to the state's registration and qualification requirements. The Commission does not believe that the place of business clause should be interpreted in this manner. Interpreting ''place of business'' as the equivalent of ''doing business'' would have the effect of nullifying the restriction that the inclusion of the phrase ''place of business'' places on a state's authority to regulate investment adviser representatives. In the Commission's view, Congress could not have intended this result, or it would not have included the place of business clause in section 203A(b)(1)(A).[80]

Moreover, this interpretation would nullify restrictions imposed by Congress in the Coordination Act on the applicability of state adviser laws to out-of-state advisers. In the Coordination Act, Congress amended section 222 of the Advisers Act to create a national de minimis standard that makes state investment adviser laws (other than provisions prohibiting fraud) inapplicable to an adviser that has fewer than six clients who are residents of the state and that does not have a place of business in the state.[81] Requiring an adviser to have a place of business in any state in which the adviser has even a single client (because it is doing business in the state), would render the new national de minimis standard meaningless.

3. Solicitors

Investment advisers frequently engage others to solicit clients on their behalf. A solicitor is a ''person associated with an investment adviser'' with respect to the adviser for which it solicits.[82] An adviser has an obligation to supervise its solicitors with respect to activities performed on its behalf.[83] Solicitation of clients, however, may not involve providing investment advice on behalf

[76] The proposed exception would be available to all investment adviser representatives, regardless of whether they hold themselves out as providing advisory services to natural persons. Limiting this exception to representatives that do not hold themselves out as providing advisory services to natural persons would be a difficult standard to apply, as representatives may not specify the type of client to whom their advertisements and other communications are directed.

[77] See sections 203 (d)–(f) of the Advisers Act [15 U.S.C. 80b–3 (d)–(f)].

[78] *E.g.,* clients with whom an adviser may enter into an advisory contract providing performance-based compensation under rule 205–3 of the Advisers Act [17 CFR 275.205–3].

[79] An investment adviser representative that provides investment advisory services through a web site generally would be considered to have its place of business at the physical location where the representative typically conducts his or her web site-related advisory business. For example, a representative works on a computer at home in State X where he or she designs a web site that solicits information from clients and evaluates the information provided by clients in response to the site. The representative e-mails its materials to a web server in State Y for posting on the web. Under the rule, as proposed, the representative's place of business would be considered to be in State X.

[80] This interpretation would, therefore, violate the principal of statutory interpretation that a statute is to be construed so as to give effect to all its language. See, *e.g., United States* v. *Menasche,* 348 U.S. 528, 538–39 (1955).

[81] Section 222(d) of the Advisers Act [15 U.S.C. 80b–18a(d)]; see section II.G. of this Release.

[82] Investment Advisers Act Release No. 688 (July 12, 1979) [44 FR 42126 (July 18, 1979)] (adopting rule 206(4)–3). The release noted that a solicitor for an adviser providing solely impersonal advice is not necessarily a ''person associated with an investment adviser.'' *Id.* at 42129 n.20.

[83] *Id.* at 42129.

of the adviser, in which case the solicitor would not be a ''supervised person'' of the adviser within the meaning of section 202(a)(25) of the Advisers Act. The Commission believes, therefore, that section 203A(b) of the Advisers Act does not generally preempt state regulation of a solicitor for a Commission-registered adviser, unless the solicitor is independently registered with the Commission as an investment adviser, or is excepted from the definition of investment adviser in section 202(a)(11) of the Advisers Act.[84]

G. National De Minimis Standard

The Coordination Act also amends the Advisers Act to add new section 222(d), which makes state investment adviser statutes inapplicable to advisers that (i) do not have a place of business in the state and (ii) have fewer than six clients who are residents of that state (''national de minimis standard'').[85] The Commission believes that the national de minimis standard was intended to ease the regulatory burdens on advisers who may be uncertain as to when they are subject to state registration requirements as a result, for example, of a client moving to another state.[86]

Most, but not all, state investment adviser statutes exempt advisers that do not have a place of business in, and have a limited number of clients that are residents of, the state.[87] The maximum number of clients an adviser may have before state registration is required varies from state to state.[88] Section 222(d) establishes a national de minimis standard of five clients; a state may have a higher, but not a lower, de minimis threshold.[89]

The term ''client'' is not defined in the Advisers Act, nor is it generally defined in state investment adviser statutes or regulations.[90] The scope of a de minimis exemption or exclusion may be broadened or narrowed, depending on who is determined to be a ''client.''[91] In order to effect the intent of Congress to create a uniform minimum de minimis threshold, the Commission is proposing a new rule, rule 222–2, defining the term ''client'' for purposes of section 222(d).[92]

Proposed rule 222–2 would treat as a single client a natural person and (i) any relative or spouse of the natural person sharing the same principal residence, and (ii) all accounts of which such persons are the sole primary beneficiaries.[93] The proposed rule also would treat as a single client a corporation, general partnership, trust[94] or other legal organization (other than a limited partnership) that receives investment advice based on its investment objectives rather than the objectives of its shareholders, partners, members, or beneficial owners. A limited partnership would be counted as a single client if it would be counted as a single client under rule 203(b)(3)–1 of the Advisers Act.[95] Comment is requested on this definition of ''client.'' Are there other typical client relationships that the proposed rule fails to address?

The Commission notes that the manner in which clients are counted has significance under section 203(b)(3), which exempts from registration with the Commission certain advisers having fewer than fifteen clients during the course of the preceding twelve months. Should the Commission adopt a single rule regarding the counting of clients under both sections 203(b)(3) and 222(d)? If so, should the Commission reconsider some of the provisions of rule 203(b)(3)–1, *e.g*, the requirement that limited partnership interests be securities?[96] Since clients include foreign clients of an adviser,[97] should the rule specifically address the status of foreign clients?

H. Other Amendments to Advisers Act Rules

The Commission is proposing amendments to several rules under the Advisers Act to reflect changes made by the Coordination Act.

1. Amendments to Form ADV; Elimination of Form ADV–S

As discussed above,[98] the Commission is proposing to amend Form ADV to add a new Schedule I, which would be substantially similar to Form ADV–T.[99] Pending future revisions of Form ADV, Schedule I would be used by the Commission to screen applicants as to eligibility for Commission registration. Schedule I would be required to be included with all new registrations filed on or after April 9, 1997.

The Commission is also proposing amendments to rule 204–1 to require an adviser to file an amended Schedule I annually within 90 days of the end of the adviser's fiscal year.[100] Like Form ADV–T, Schedule I would require an adviser to declare whether it remains eligible for Commission registration. Unlike Form ADV–T, however,

[84] Rule 206(4)–3 under the Advisers Act [17 CFR 275.206(4)–3] would, however, continue to govern cash payments by a Commission-registered adviser to a solicitor.

[85] Because state investment adviser statutes, including state registration requirements, will be preempted with respect to advisers registered with the Commission or excluded from the definition of investment adviser under the Advisers Act, the national de minimis standard affects only advisers subject to state registration.

[86] The legislative history of the Coordination Act does not explain Congress' intent in adopting this national standard.

[87] See, e.g., Unif. Sec. Act section 204(1)(iii) (1985). Delaware, Massachusetts, and Texas, for example, do not have de minimis provisions.

[88] Compare N.Y. Gen. Bus. Law section 359–eee(1)(a)(5) (1996) (forty clients) with Pa. Stat. Ann. tit. 70 section 1–102(j)(vii) (1994) (four clients).

[89] In this sense, although section 222(d) is entitled the ''national de minimis standard,'' the section actually establishes a minimum threshold for state de minimis provisions, rather than a uniform standard that must be applied by each state.

[90] Several states have addressed the issue of whether a limited partnership should be treated as a single client of an adviser for purposes of their state de minimis provisions. See, e.g., D.C. Mun. Regs. tit. 17 section 1822 (1996); Ga. Comp. R. & Regs. r. 590–4–8–.11 (1989); Pa. Bull., Miscellaneous Interpretations—June 1986. Connecticut, however, appears to be the only state that has adopted a detailed definition of ''client'' for purposes of its de minimis provision. See Conn. Agencies Regs. section 36b–31–3(d)(2)–(4) (1995).

[91] For example, one state may treat a family as a single client while another may require an adviser to count each family member. Although both states may have a five client threshold for registration, the actual thresholds are substantially different.

[92] In addition, the Commission is proposing to adopt a rule defining the terms ''place of business'' and ''principal place of business'' for purposes of section 222. Proposed rule 222–1(a) would define place of business in the same manner as proposed rule 203A–3(b), except the term is applied to the adviser rather than the supervised persons of the adviser. Proposed rule 222–1(b) would define principal place of business in the same manner that proposed rule 203A–3(c) would define ''principal office and place of business.''

[93] A joint account thus would be treated as a separate client under the proposed rule unless the primary beneficiaries are family members who share the natural person's principal residence. See paragraphs (a)(1) and (a)(2) of proposed rule 222–2.

[94] The Division of Investment Management has stated that where several trusts share a common trustee, each trust generally should be treated as a separate client for purposes of section 203(b)(3) of the Advisers Act [15 USC 80b–3(b)(3)]. See OSIRIS Management (pub. avail. Feb. 17, 1984); Philip Eiseman (pub. avail. July 22, 1976). The Division also has stated that trusts with identical beneficiaries could be treated as a single client. See OSIRIS Management, *supra*; First Security Investment Management (pub. avail. Mar. 25, 1985). Should the rule address these circumstances by treating multiple legal entities with identical shareholders, partners, members or beneficiaries as a single client?

[95] 17 CFR 275.203(b)(3)–1 (providing a safe harbor to count a limited partnership, as opposed to each limited partner, as a client for purposes of section 203(b)(3) of the Advisers Act).

[96] Rule 203(b)(3)–1(b)(2)(i) [17 CFR 203(b)(3)–1(b)(2)(i)].

[97] Vocor International Holding S.A. (pub. avail. Apr. 9, 1990); Walter L. Stephens (pub. avail. Nov. 18, 1985).

[98] See section II.C.2. of this Release.

[99] Schedule I is not attached to this Release.

[100] 17 CFR 275.204–1. These amendments also establish uniform updating requirements for Commission and state adviser registrations. The Commission is proposing these updating requirements in concurrence with NASAA.

Schedule I would not operate as a request for withdrawal of the adviser's registration from the Commission; rather, an adviser that declares itself not eligible for Commission registration on Schedule I would be required to withdraw from Commission registration by accompanying the Schedule I with a Form ADV–W.[101]

If an annual amendment requirement to Form ADV is adopted, the Commission will have no regulatory need for advisers to file Form ADV–S, the annual report for advisers registered under the Advisers Act. The Commission is therefore proposing to amend rule 204–1 to delete references to Form ADV–S, and proposing to repeal Form ADV–S and amend rule 279.3 to refer to Form ADV–T. Because the Commission expects to require Form ADV–T to be filed on or before April 9, 1997, and that filing will achieve the same purpose as Form ADV–S, the Commission is issuing a separate release staying rule 204–1(c) and suspending the requirement to file Form ADV–S.[102]

2. Rule 204–2—Books and Records

In light of the Congressional determination not to subject advisers registered with the states to substantive federal regulatory requirements after April 9, 1997, the Commission is proposing to amend rule 204–2 to make the books and recordkeeping requirements of that rule applicable only to advisers registered with the Commission. Additionally, the Commission is proposing to amend rule 204–2 to require advisers that register with the Commission after April 9, 1997 to preserve any books and records the adviser was previously required to maintain under state law.[103] These books and records would be required to be maintained in the manner and for the period of time as the other books and records required to be maintained under rule 204–2(a).[104]

3. Rule 205–3—Performance Fee Arrangements

By its terms, section 205 prohibits all advisers, except those exempt from registration under section 203(b), from entering into advisory contracts in which the adviser would be compensated on the basis of performance of client accounts.[105] Therefore, advisers prohibited from registering with the Commission after April 9, 1997 would still be subject to the limitations of section 205. Rule 205–3 provides an exemption from these limitations, but applies only to advisers registered with the Commission. The Commission is proposing to amend rule 205–3 to make this exemption available to all advisers, including those registered only under state law after April 9, 1997.

4. Rules 206(4)–1, 206(4)–2, and 206(4)–4—Anti-Fraud Rules

The Commission has adopted four rules pursuant to its authority under section 206(4) to ''define, and prescribe means reasonably designed to prevent * * * acts, practices, and courses of business [that] are fraudulent, deceptive, or manipulative.'' [106] These rules prohibit certain abusive advertising practices, govern the adviser's custody of funds and securities of clients, address the payment of cash to persons soliciting on behalf of the adviser, and require certain disclosure to clients regarding the adviser's financial condition and disciplinary history.[107] Each of these rules, other than the cash solicitation rule, applies to all advisers, regardless of whether they are registered with the Commission. The Commission is proposing to amend these rules to make them applicable only to advisers registered (or required to be registered) with the Commission. By proposing to exclude advisers not registered with the Commission from these rules, the Commission is not suggesting that the practices prohibited by these rules would not be prohibited by section 206 if they were engaged in by an adviser not registered with the Commission.[108] Rather, the Commission recognizes that these rules contain prophylactic provisions, and that the application of these provisions to state-registered advisers may be more appropriately a matter for state law.

I. Provisions of the Advisers Act that Continue to Apply to State-Registered Investment Advisers

Several provisions of the Advisers Act would continue to apply to advisers no longer registered with the Commission after April 9, 1997. These include the Act's prohibitions on advisory contracts that (i) contain certain performance fee arrangements, (ii) permit an assignment of the advisory contract to be made without the consent of the client, and (iii) fail to require an adviser that is a partnership to notify clients of a change in the membership of the partnership.[109] In addition, advisers subject to state registration would continue to be subject to the Advisers Act's requirement to establish, maintain, and enforce written procedures reasonably designed to prevent the misuse of material nonpublic information.[110] Comment is requested whether the Commission should recommend that Congress amend the Act in order to make all or some of these provisions inapplicable to advisers either (i) not registered with the Commission, or (ii) prohibited from registering with the Commission pursuant to section 203A(a)(1) of the Advisers Act.

III. General Request for Comments

Any interested persons wishing to submit written comments on the rule and form changes that are the subject of this Release, to suggest additional changes, or to submit comments on other matters that might have an effect on the proposals contained in this Release, are requested to do so.

IV. Cost/Benefit Analysis

The proposed rules would implement Congressional intent to reallocate regulatory responsibilities for investment advisers between the Commission and state securities authorities. The proposed rules would impose some incidental burdens on investment advisers that would be required to file Form ADV–T, and those advisers that would, on an ongoing basis, be required to file Schedule I. Such burdens appear necessary, however, in order to implement the Coordination Act.

Many of the proposed rules clarify provisions of the Coordination Act and thereby permit investment advisers to more readily ascertain their regulatory status and that of their supervised

[101] A separate Form ADV–W would continue to be required, in order to assure that the Commission staff is able to act promptly on the withdrawal from registration. Subject to the proposed grace period under rule 203A–1(c), failure to file the completed Form ADV–W would subject an adviser to the commencement of proceedings to cancel its registration.

[102] 17 CFR 275.204–1(c); see Investment Advisers Act Rel. No. 1602 (Dec. 20, 1996).

[103] Proposed paragraph (k) of rule 204–2.

[104] Under the proposed revisions, an adviser changing from state to federal registration would count the period during which the books and records were maintained under state law.

[105] Section 205(a)(1) [15 U.S.C. 80b–5(a)(1)]. Section 205(a) states that ''[n]o investment adviser, unless exempt from registration pursuant to section 203(b)'' may enter into, extend, or renew any investment advisory contract that provides for performance-based compensation. See Section . of this Release.

[106] 15 USC 80b–6(4).

[107] See rules 206(4)–1 to –4 [17 CFR 275.206(4)–1 to –4].

[108] The anti-fraud provisions of the Advisers Act will still apply to state-registered advisers after April 9, 1997. See supra note 17 and accompanying text.

[109] Section 205(a)(1)–(3) of the Act [15 U.S.C. 80b–5(a)(1)–(3)].

[110] Section 204A of the Act [15 USC 80b–4A].

persons. Other provisions grant exemptions and thereby reduce regulatory burdens by (i) relieving advisers from the burden of having to frequently register and then de-register with the Commission as a result of changes in the amount of assets under management; and (ii) exempting certain advisers from the prohibition against registration and thereby preempting state law, the application of which would be unfair, a burden on interstate commerce, and inconsistent with Congressional intent in enacting the Coordination Act. The Commission also is proposing to revise several of its rules that currently apply to all investment advisers to make such rules applicable only to advisers registered or required to be registered with the Commission.

The Commission anticipates that the implementation of the Coordination Act will reduce the aggregate regulatory burden borne by the investment advisory industry, but that the proposed rules themselves are not expected to significantly affect compliance costs. The Commission believes that the proposed rules would not impose significant additional costs on investment advisers.

Comment is requested on the impact of the proposed rules on individual investment advisers and the industry as a whole. Commenters should submit data indicating the expected dollar impact of the proposed rules on the revenues and expenses of investment advisers. Comment is requested on the cost of filing Form ADV-T and Schedule I of Form ADV. Commenters should submit data indicating the cost of filing Form ADV-T and Schedule I of Form ADV. Commenters also should submit data on the expected effects of the proposed rules on the customers of investment advisers (such as the amount of fees paid).

For purposes of making determinations required by the Small Business Regulatory Enforcement Fairness Act of 1996, the Commission is requesting information regarding the potential impact of the proposed rules on the economy on an annual basis. Commenters should provide empirical data to support their views.

Comment is requested on this cost/benefit analysis. Commenters are requested to provide views and empirical data relating to any costs and benefits associated with the proposed rules.

V. Summary of Regulatory Flexibility Analysis

The Commission has prepared an Initial Regulatory Flexibility Analysis (‘‘IRFA’’) in accordance with 5 USC 603 regarding proposed rules 203A–1, 203A–2, 203A–3, 203A–4, 203A–5, 222–1, 222–2, and proposed amendment to rules 204–1, 204–2, 205–3, 206(4)–1, 206(4)–2, 206(4)–4, and 279.3 under the Advisers Act. The following summarizes the IRFA.

As set forth in greater detail in the IRFA, the Coordination Act makes several amendments to the Advisers Act. The most significant of these amendments reallocates federal and state responsibilities for the regulation of investment advisers currently registered with the Commission by limiting the application of federal law and preempting certain state laws. The proposed rules and rule amendments are intended to clarify these provisions of the Coordination Act and thereby assist investment advisers in ascertaining their regulatory status as of April 9, 1997.

The proposed rules and rule amendments would reduce substantially regulatory burdens on investment advisers that are small entities by effecting the intent of Congress to reduce significantly the number of small advisers that are subject to Commission regulation. The IRFA indicates that the proposals would minimize certain regulatory burdens for investment advisers, including small-entity investment advisers, by, among other things, preventing advisers from being required to frequently register and deregister with the Commission as a result of changes in the amount of their assets under management.

An investment adviser generally is a small entity if it manages assets of $50 million or less, in discretionary or non-discretionary accounts, as of the end of its most recent fiscal year and does not render other advisory services.[111] The Commission estimates that approximately 17,000 of the 22,500 advisers currently registered with the Commission are small entities. Of these small-entity advisers, the Commission estimates that approximately 800 will remain eligible for Commission registration after April 9, 1997.[112]

The proposed rules would require all Commission-registered investment advisers to file new Form ADV-T no later than April 9, 1997. The IRFA notes, however, that the Commission anticipates that as a consequence of this one-time filing, approximately 72 percent of the investment advisers currently registered with the Commission would no longer be subject to federal investment adviser regulatory requirements, including reporting and recordkeeping requirements. The Commission believes that the incidental burden imposed by this one-time filing requirement would be necessary in order to implement the Coordination Act. The proposed amendments to rule 204–1 would require all Commission-registered investment advisers to annually update new Schedule I. The IRFA explains that because the Commission, by separate release, is staying rule 204–1(c) under the Advisers Act and suspending the current requirement that Commission-registered advisers annually file Form ADV-S (and will eliminate this requirement if the proposed rules and amendments are adopted), this new annual reporting requirement should not be a significant additional burden on any small-entity investment advisers that remain eligible for Commission registration.

The IRFA further indicates that the proposed amendments to rule 204–2 would make the books and recordkeeping requirements of this rule applicable only to advisers registered with the Commission, and so would eliminate these recordkeeping requirements with respect to small entities and other advisers that are not eligible for Commission registration after April 9, 1997. The proposed amendments to this rule would require advisers that register with the Commission after April 9, 1997 to preserve any books and records the adviser was previously required to maintain under state law, but this requirement is not expected to be a significant additional burden on advisers that register with the Commission after April 9, 1997.

As explained further in the IRFA, the Commission has considered significant alternatives to the proposed rules that would accomplish the stated objective of implementing the provisions of the Coordination Act that reallocate regulatory responsibility for investment advisers between the Commission and the states. As a result, the Commission has proposed to increase the threshold for Commission registration from $25 to $30 million of assets under management, and to provide an optional exemption from the prohibition on registering with the Commission for advisers having assets under management of between $25 and $30 million. This optional exemption would give such advisers, including many small entities, the flexibility to decide

[111] Rule 275.0–7 [17 CFR 275.07].

[112] The Commission estimates that most of the 16,200 (72 percent) advisers currently registered with the Commission that will be ineligible for Commission registration after April 9, 1997 will be small entities. Based on that estimate, the Commission anticipates that approximately 800 small-entity advisers will remain eligible for Commission registration after that date.

when it would be best for them to transition between state and Commission registration, and *vise versa.* The IRFA concludes that the Commission believes that the rules and rule amendments, as proposed, will not adversely affect small entities. Finally, the IRFA addresses each of the other requirements set forth under 5 U.S.C. § 603.

The Commission encourages the submission of comments with respect to any aspect of the IRFA. Such comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed rules are adopted, and will be placed in the same public file as comments on the proposed rules themselves. Cost-benefit information reflected in the ''Cost/Benefit Analysis'' section of this Release also is reflected in the IRFA. A copy of the IRFA may be obtained by contacting Cynthia G. Pugh, Securities and Exchange Commission, 450 5th Street, N.W., Mail Stop 10–2, Washington, D.C. 20549.

VI. Paperwork Reduction Act

Certain provisions of the proposed rules and rule amendments contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (44 USC 3501 *et seq.*), and the Commission has submitted them to the Office of Management and Budget (''OMB'') for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title for the collections of information are: ''Rule 203A–2(d),'' ''Rule 203A–5 and Form ADV–T,'' ''Rule 203–1 and Form ADV,'' ''Rule 204–1,'' and ''Rule 204–2,'' all under the Advisers Act. Form ADV, rule 204–1, and rule 204–2, which the Commission is proposing to amend, contain currently approved collections of information under OMB control numbers 3235–0049, 3235–0048, and 3235–0278, respectively. The proposed rules and rule amendments are necessary to implement recent changes to the Advisers Act. An agency may not sponsor, conduct, or require response to an information collection unless a currently valid OMB control number is displayed.

Rule 203A–2(d)

Proposed rule 203A–2(d) contains two related collection of information requirements. The collection of information would be necessary to determine the eligibility of certain investment advisers to rely on the proposed ''reasonable expectation'' exemption from the prohibition on Commission registration, and to implement that exemption. It is anticipated that this collection of information would be found at 17 CFR 275.203A–2(d). An adviser relying on the exemption provided by proposed rule 203A–2(d) would be required to file a short written undertaking on Schedule E to Form ADV, indicating that the adviser will withdraw from registration if on the 90th day after registering with the Commission the adviser does not meet the eligibility requirements for registration under section 203A of the Advisers Act and rules thereunder. At the end of the 90-day period, the adviser also would be required to file an amended Schedule I to Form ADV. If the adviser indicates on the amended Schedule I that it has not become eligible to register with the Commission, the adviser would be required to file a Form ADV–W concurrently with the Schedule I, thereby withdrawing its registration with the Commission. The likely respondents to this information collection are newly formed investment advisers that are not currently registered with the Commission or with the states. The Commission estimates that there would be 100 such respondents per year, and that each respondent would respond one time per year. The weighted average total annual time burden for each respondent is estimated to be 57.5 minutes. This figure is based upon the following estimates: (i) 45 minutes for the approximately 90 advisers that advise registered investment companies, that do not need to calculate assets under management to complete Schedule I, or that need to calculate assets under management but do so as part of their normal business operations; (ii) 2 hours for the approximately 10 advisers that must calculate assets under management for the sole purpose of filing Schedule I; and (iii) 5 minutes for all respondents to prepare the undertaking required on Schedule E to Form ADV. The Commission estimates that the aggregate annual burden for all respondents would be 95.83 hours. Providing this information would be mandatory to qualify for the exemption under proposed rule 203A–2(d), and responses would not be kept confidential.

Rule 203A–5 and Form ADV–T

Proposed rule 203A–5 and Form ADV–T contain collection of information requirements. This collection of information is necessary for the Commission to determine whether advisers meet the proposed eligibility criteria for Commission registration set forth in section 203A of the Advisers Act and rules thereunder, and to provide for the orderly withdrawal from Commission registration for advisers that are no longer eligible. It is anticipated that this collection of information would be found at 17 CFR 275.203A–5 and 17 CFR 279.3. Under proposed rule 203A–5, all advisers registered with the Commission on April 9, 1997 would be required to file a completed Form ADV–T no later than that date. Form ADV–T would require each adviser to declare whether it remains eligible for Commission registration. For an adviser that declares itself not eligible for Commission registration, Form ADV–T would serve as a request for withdrawal of the adviser's registration as of April 9, 1997. The likely respondents to this information collection are all investment advisers registered with the Commission on April 9, 1997. The Commission estimates that there would be 22,500 such respondents to this collection of information. Each respondent would respond once. The weighted average annual time burden for each respondent is estimated to be 53.33 minutes. This figure is based upon the following estimates: (i) 45 minutes for the approximately 20,000 advisers that advise registered investment companies, that do not need to calculate assets under management to complete Form ADV–T, or that need to calculate assets under management but do so as part of their normal business operations; (ii) 2 hours for the approximately 2,500 advisers that must calculate assets under management for the sole purpose of filing Form ADV–T. The aggregate annual burden for all 22,500 advisers is estimated to be 19,998 hours. Providing the information would be mandatory, and responses would not be kept confidential.

Rule 203–1 and Form ADV

Rule 203–1 and Form ADV, including the proposed new Schedule I to Form ADV, contain information collection requirements. Form ADV is required by rule 203–1 to be filed by every applicant for registration with the Commission as an investment adviser, is mandatory, and responses are not kept confidential. This collection of information is found at 17 CFR 275.203–1 and 17 CFR 279.1. The Commission in the past received approximately 3,500 applications for registration on Form ADV in one year. The weighted average burden hours for completing Form ADV is currently 9.0063, and the total annual burden hours currently approved by OMB for this form is 31,522 hours.

The Commission is proposing to amend Form ADV to include a new Schedule I. The Commission is not proposing to amend rule 203–1. Schedule I would require an applicant to declare whether it is eligible for Commission registration. This new requirement is necessary for the Commission to determine whether advisers meet the eligibility criteria for Commission registration set forth in section 203A of the Advisers Act and rules thereunder. The likely respondents to this information collection would be all applicants for registration with the Commission after April 9, 1997. Based on the Commission's experience in processing adviser applications, and the percentage of applicants in the past without assets under management, the Commission estimates that after April 9, 1997 the number of applicants for registration will decrease from approximately 3,500 to between 500 and 1,000 annually. The weighted average total annual time burden for each applicant to complete Schedule I on average is estimated to be 52.5 minutes. This figure is based upon the following estimates. Compliance with the requirement to complete Schedule I imposes a total burden per applicant of approximately 45 minutes for the approximately 90 percent of the applicants that advise registered investment companies, that do not need to calculate assets under management to complete Schedule I, or that need to calculate assets under management but do so as a part of their normal business operations. For the approximately 10 percent of the applicants that must calculate assets under management for Schedule I, however, this burden would be 2 hours. Providing this information would be mandatory. Amending Form ADV to include new Schedule I is estimated to increase the weighted average burden hours for applicants completing Form ADV to 9.8813 hours. As a result of the new Schedule I, together with the reduction of the number of investment advisers registered with the Commission, the annual aggregate burden for all respondents for completing amended Form ADV is estimated to be between 4,940.65 and 9,881.3 hours.

Rule 204–1

Rule 204–1, including the proposed amendment to the rule, includes collection of information requirements. Rule 204–1 sets forth the circumstances requiring the filing of an amendment to Form ADV, the form that must be filed with the Commission to register as an investment adviser. This collection of information is found at 17 CFR 275.204–1, is mandatory, and responses are not kept confidential. The total annual burden currently approved by OMB for rule 204–1 is approximately 21,438 hours for the 20,088 advisers registered with the Commission in 1994.

The proposed amendments to rule 204–1 would require an adviser to file an amended Schedule I to Form ADV annually within 90 days of the end of the adviser's fiscal year. Schedule I would require an adviser to declare whether it remains eligible for Commission registration. The new requirement is necessary for the Commission to determine whether advisers continue to meet the eligibility criteria for Commission registration set forth in section 203A of the Advisers Act and rules thereunder. The likely respondents to this information collection are all investment advisers registered with the Commission after April 9, 1997. The Commission estimates that there would be 6,300 such respondents to this collection of information (28% of the approximately 22,500 registered investment advisers as of April 9, 1997). Each respondent would respond one time per year. The total annual time burden for each respondent is estimated to be 52.14 minutes. This figure is based upon the following estimates. Compliance with the requirement to file an amended Schedule I would impose a total annual burden per adviser of approximately 45 minutes for the approximately 5,700 advisers that advise registered investment companies, that do not need to calculate assets under management to complete Schedule I, or that need to calculate assets under management but do so as part of their normal business operations. For the approximately 600 advisers that must calculate assets under management for Schedule I, however, this burden would be 2 hours. Providing the information would be mandatory and responses would not be kept confidential. Based on the Commission's experience under rule 204–1, and taking into account the proposed new requirement to annually amend Schedule I, the Commission estimates that each adviser eligible for Commission registration after April 9, 1997 will respond to the information collection requirements of rule 204–1, as proposed to be amended, an average of 1.5 times annually. The Commission estimates that the annual aggregate burden for all respondents to rule 204–1 will be 18,297.09 hours.

Rule 204–2

Section 204 of the Advisers Act provides that investment advisers required to register with the Commission must make and keep for prescribed periods such records, and furnish such copies thereof, and make and disseminate such reports as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors. Rule 204–2 sets forth requirements for keeping, maintaining and preserving specified books and records by investment advisers. This collection of information is found at 17 CFR 275.204–2, is mandatory, is used by the Commission staff in its oversight program, and generally is kept confidential. See section 210(b) of the Advisers Act [15 U.S.C. 80b–10(b)]. Currently, compliance with the rule requires approximately 235.47 hours each year per Commission-registered investment adviser, for a total of 5,180,340 hours for all 22,000 advisers registered last year.

The proposed amendments to rule 204–2 would clarify the application of the rule's recordkeeping requirements to advisers that register with the Commission after having been registered with the states. The proposed amendments are necessary (i) to make the books and recordkeeping requirements of that rule applicable only to advisers registered with the Commission, and (ii) to clarify the rule's application to investment advisers that transfer from state to Commission registration after April 9, 1997. The Commission is proposing to amend rule 204–2 to make the rule's books and recordkeeping requirements applicable only to advisers registered with the Commission after the Coordination Act's effective date. This amendment would relieve the approximately 16,200 of the 22,500 advisers currently registered that will not be eligible for Commission registration after April 9, 1997 from the recordkeeping burdens imposed by this rule.

The Commission is also proposing to amend rule 204–2 to require an adviser that registers with the Commission after April 9, 1997 to preserve any books and records that the adviser was previously required to maintain under state law. These books and records would be required to be maintained in the manner and for the period of time as the other books and records required to be maintained under rule 204–2(a). This collection of information would be found at 17 CFR 275.204–2. The likely respondents to this information collection are all investment advisers registered with the Commission after April 9, 1997. The Commission estimates that there would be 6,300 such respondents to this collection of information. Each respondent would retain records on an ongoing basis. The total annual time burden for each respondent is estimated to be 235.47 hours. The proposed amendments would not change the burden last reported to the OMB. As a result of the reduction of the number of investment advisers registered with the Commission, the annual aggregate burden for all respondents to the recordkeeping requirements under rule 204–2 is estimated to be 1,483,461 hours.

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to—

(i) Evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility;

(ii) Evaluate the accuracy of the agency's estimate of the burden of the proposed collections of information;

(iii) Enhance the quality, utility, and clarity of the information to be collected;

(iv) Minimize the burden of the collections of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons desiring to submit comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, D.C. 20503, and should also send a copy of their comments to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Stop 6–9, Washington, D.C. 20549 with reference to File No. S7–31–96. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, so a comment to OMB is best assured of having its full affect if OMB receives it within 30 days of publication.

VII. Statutory Authority

The Commission is proposing new rule 203A–1 pursuant to the authority set forth in section 203A(a)(1)(A) [15 U.S.C. 80b–3A(a)(1)(A)]; section 203A(c) [15 U.S.C. 80b–3A(c)]; and section 211(a) [15 U.S.C. 80b–11(a))] of the Investment Advisers Act of 1940.

The Commission is proposing new rule 203A–2 pursuant to the authority set forth in section 203A(c) of the Investment Advisers Act of 1940 [15 U.S.C. 80b–3A(c)].

The Commission is proposing new rules 203A–3 and 203A–4 pursuant to the authority set forth in section 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b–11(a)].

The Commission is proposing new rule 203A–5 pursuant to the authority set forth in sections 203(c)(1) and 204 of the Investment Advisers Act of 1940 [15 U.S.C. 80b–3(c)(1) and 80b–4].

The Commission is proposing amendments to rule 204–1 pursuant to the authority set forth in section 204 of the Investment Advisers Act of 1940 [15 U.S.C. 80b–4].

The Commission is proposing amendments to rule 204–2 pursuant to the authority set forth in sections 204 and 206(4) of the Investment Advisers Act of 1940 [15 U.S.C. 80b–4 and 80b–6(4)].

The Commission is proposing amendments to rule 205–3 pursuant to the authority set forth in section 206A of the Investment Advisers Act of 1940 [15 U.S.C. 80b–6A].

The Commission is proposing amendments to rules 206(4)–1, 206(4)–2, and 206(4)–4 pursuant to the authority set forth in section 206(4) of the Investment Advisers Act of 1940 [15 U.S.C. 80b–6(4)].

The Commission is proposing new rules 222–1 and 222–2 pursuant to the authority set forth in section 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b–11(a)].

The Commission is proposing amendments to rule 279.3, new Form ADV–T, and amendments to Form ADV pursuant to the authority set forth in sections 203(c)(1) and 204 of the Investment Advisers Act of 1940 [15 U.S.C. 80b–3(c)(1) and 80b–4].

Text of Proposed Rules and Form

List of Subjects in 17 CFR Parts 275 and 279

Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 275—RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

The authority citation for Part 275 is revised to read as follows:

Authority: 15 U.S.C. 80b–3, 80b–4, 80b–6(4), 80b–6A, 80b–11, unless otherwise noted.

Section 275.203A–1 is also issued under 15 U.S.C. 80b–3A.

Section 275.203A–2 is also issued under 15 U.S.C. 80b–3A.

Section 275.204–2 is also issued under 15 U.S.C. 80b–6.

2. Sections 275.203A–1 through 275.203A–5 are added to read as follows:

§ 275.203A–1 Eligibility for Commission registration.

(a) *Threshold Increased to $30 Million of Assets Under Management.* No investment adviser that is registered or required to be registered as an investment adviser in the State in which it maintains its principal office and place of business shall register with the Commission under section 203 of the Act (15 U.S.C. 80b–3), unless the investment adviser:

(1) Has assets under management of not less than $30,000,000, as reported on the Form ADV (17 CFR 279.1) of the investment adviser; or

(2) Is an investment adviser to an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*).

(b) *Exemption for Investment Advisers Having Between $25 and $30 Million of Assets Under Management.* Notwithstanding paragraph (a) of this section, an investment adviser that is registered or required to be registered as an investment adviser in the State in which it maintains its principal office and place of business may register with the Commission if the investment adviser has assets under management of not less than $25,000,000 but not more than $30,000,000, as reported on the Form ADV (17 CFR 279.1) of the investment adviser. This paragraph (b) shall not apply to an investment adviser:

(1) To an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*); or

(2) That is exempted by § 275.203A–2 from the prohibition in section 203A(a) of the Act (15 U.S.C. 80b–3A(a)) on registering with the Commission.

Note to paragraphs (a) and (b). Paragraphs (a) and (b) together make registration with the Commission optional for certain investment advisers that have between $25 and $30 million of assets under management. This option is not available to an investment adviser that (1) is not registered or required to be registered in the State in which it maintains its principal office and place of business, (2) is an investment adviser to a registered investment company, or (3) is exempted by § 275.203A–2 from the prohibition on registering with the Commission.

(c) *Grace Period.* An investment adviser registered with the Commission, upon filing an amendment to Form ADV (17 CFR 279.1) that indicates that it would be prohibited by section 203A(a) of the Act (15 U.S.C. 80b–3A(a)) from registering with the Commission shall be subject to having its registration cancelled pursuant to section 203(h) of the Act (15 U.S.C. 80b–3(h)), *Provided,* *That* the Commission shall not commence any cancellation proceeding on the basis of the amendment until the expiration of a period of not less than 90 days from the date the amendment is received by the Commission.

§ 275.203A–2 Exemptions from prohibition on Commission registration.

The prohibition of section 203A(a) of the Act (15 U.S.C. 80b–3A(a)) shall not apply to:

(a) *Nationally Recognized Statistical Rating Organizations.* An investment adviser that is a nationally recognized statistical rating organization, as that term is used in paragraphs (c)(2)(vi)(E), (F), and (H) of § 240.15c3–1 of this chapter.

(b)(1) *Pension Consultants.* An investment adviser that is a pension consultant with respect to assets of plans having an aggregate value of at least $50,000,000.

(2) An investment adviser is a pension consultant if the investment adviser provides investment advice to:

(i) Any employee benefit plan described in section 1002(2) of the Employee Retirement Income Security Act of 1974 (''ERISA'') (29 U.S.C. 1002(2));

(ii) Any governmental plan described in section 1002(32) of ERISA (29 U.S.C. 1002(32));

(iii) Any church plan described in section 1002(33) of ERISA (29 U.S.C. 1002(33)); or

(iv) Any plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions for the benefit of its employees.

(3) In determining the aggregate value of assets of plans, only that portion of a plan's assets for which the investment adviser provided investment advice (including any advice with respect to the selection of an investment adviser to manage such assets) may be included. The value of assets shall be determined as of the date during its most recent fiscal year that the investment adviser was last engaged to provide investment advice to the plan with respect to those assets.

(c) *Investment Advisers Controlling, Controlled By or Under Common Control with a Investment Adviser Registered with the Commission.* An investment adviser that controls, is controlled by, or is under common control with, an investment adviser eligible to register, and registered with, the Commission (''registered adviser''), provided that the principal office and place of business of the adviser is the same as that of the registered adviser. For purposes of this paragraph, control means the power to direct or cause the direction of the management or policies of an adviser, whether through ownership of securities, by contract, or otherwise. Any person that directly or indirectly has the right to vote 25 percent or more of the voting securities or is entitled to 25 percent or more of the profits of an adviser is presumed to control that adviser.

(d) *Investment Advisers Expecting to Be Eligible for Commission Registration Within 90 Days.* An investment adviser that:

(1) Is not registered or required to be registered with the Commission or a securities commissioner (or any agency or officer performing like functions) of any State and has a reasonable expectation that it would be eligible to register with the Commission within 90 days after the date the investment adviser's registration with the Commission becomes effective;

(2) Includes in Schedule E to its Form ADV (17 CFR 279.1) an undertaking to withdraw from registration with the Commission if, on the 90th day after the date the investment adviser's registration with the Commission becomes effective, the investment adviser would be prohibited by section 203A(a) of the Act (15 U.S.C. 80b–3A(a)) from registering with the Commission; and

(3) Within 90 days after the date the investment adviser's registration with the Commission becomes effective, files an amendment to Form ADV (17 CFR 279.1) revising Schedule I thereto and, if the amendment indicates that the investment adviser would be prohibited by section 203A(a) of the Act (15 U.S.C. 80b–3A(a)) from registering with the Commission, the amendment is accompanied by a completed Form ADV–W (17 CFR 279.2) whereby it withdraws from registration with the Commission.

§ 275.203A–3 Definitions.

For purposes of section 203A of the Act (15 U.S.C. 80b–3A) and rules thereunder:

(a)(1) *Investment adviser representative* of an investment adviser means a supervised person of the investment adviser if a substantial portion of the business of the supervised person is providing investment advice to clients who are natural persons. Notwithstanding this paragraph, a supervised person is not an investment adviser representative if the supervised person:

(i) Does not on a regular basis solicit, meet with, or otherwise communicate to clients of the investment adviser; or

(ii) Provides only impersonal investment advice.

(2) For purposes of paragraph (a)(1) of this section:

(i) *Impersonal investment advice* means investment advisory services provided by means of written material or oral statements that do not purport to meet the objectives or needs of specific individuals or accounts; and

(ii) *A substantial portion of the business* of a supervised person is providing investment advice to clients who are natural persons if, during the course of the preceding 12 months:

(A) Clients who are natural persons represented more than 10 percent of the clients of the supervised person; or

(B) Assets of clients who are natural persons represented more than 10 percent of the assets under management attributable to the supervised person.

(b) *Place of business* of an investment adviser representative means a place or office from which the investment adviser representative regularly provides advisory services or otherwise solicits, meets with, or communicates to clients, unless the investment adviser representative does not regularly provide advisory services or otherwise solicit, meet with, or communicate to clients at any place or office, in which case the place of business of such investment adviser representative will be the residence of each client.

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

§ 275.203A–4 Investment advisers registered with a State securities commission.

The Commission shall not assert a violation of section 203 of the Act (15 U.S.C. 80b–3) (or any provision of the Act to which an investment adviser becomes subject upon registration under section 203 of the Act) for the failure of an investment adviser registered with the securities commission (or any agency or office performing like functions) in the State in which it has its principal office and place of business to register with the Commission if the investment adviser reasonably believes that it does not have assets under management of at least $30,000,000 and is therefore prohibited from registering with the Commission.

§ 275.203A–5 Transition rules.

(a) Every investment adviser registered with the Commission on

April 9, 1997 shall file a completed Form ADV–T (17 CFR 279.3) no later than April 9, 1997.

(b) If an investment adviser registered with the Commission on April 9, 1997 would be prohibited from registering with the Commission under section 203A of the Act (15 U.S.C. 80b–3A), and is not otherwise exempt from such prohibition, such investment adviser shall withdraw from registration with the Commission on Form ADV–T (17 CFR 279.3).

(c)(1) Except as provided in paragraph (c)(2) of this section, an investment adviser that indicates on Form ADV–T (17 CFR 279.3) that the investment adviser withdraws from registration with the Commission shall be deemed to have withdrawn from registration as of the later of:

(i) April 9, 1997; or

(ii) The date the investment adviser first files with the Commission Form ADV–T or any amendment to Form ADV–T (17 CFR 279.3) that indicates that the investment adviser withdraws from registration with the Commission.

(2) If, prior to the effective date of the withdrawal from registration of an investment adviser on Form ADV–T (17 CFR 279.3), the Commission has instituted a proceeding pursuant to section 203(e) of the Act (15 U.S.C. 80b–3(e)) to suspend or revoke registration, or a proceeding pursuant to section 203(h) of the Act (15 U.S.C. 80b–3(h)) to impose terms or conditions upon withdrawal, the withdrawal from registration shall not become effective except at such time and upon such terms and conditions as the Commission deems necessary or appropriate in the public interest or for the protection of investors.

3. Section 275.204–1 is revised to read as follows:

§ 275.204–1 Amendments to application for registration.

(a) Every investment adviser whose registration with the Commission is effective on the last day of its fiscal year shall, within 90 days of the end of its fiscal year, unless its registration has been withdrawn, cancelled or revoked prior to that day, file:

(1) Schedule I of Form ADV (17 CFR 279.1);

(2) A balance sheet if the balance sheet is required by Item 14 of Part II of Form ADV (17 CFR 279.1); and

(3) An executed page one of Part I of Form ADV (17 CFR 279.1).

(b) If the information contained in the response to Items 1, 2, 3, 4, 5, 8, 11, 13A, 13B, 14A and 14B of Part I of any application for registration as an investment adviser, or in any amendment thereto, becomes inaccurate for any reason, or if the information contained in response to any question in Items 9 and 10 of Part I, all of Part II (except Item 14), and all of Schedule H of any application for registration as an investment adviser, or in any amendment thereto, becomes inaccurate in a material manner, the investment adviser shall promptly file an amendment on Form ADV (17 CFR 279.1) correcting the information.

(c) For all other changes not designated in paragraph (b)(2) of this section, an investment adviser shall file an amendment on Form ADV (17 CFR 279.1) updating the information together with the amendments required by paragraph (a) of this section.

4. Section 275.204–2 is amended by revising the introductory text of paragraph (a) and adding paragraph (k) to read as follows:

§ 275.204–2 Books and records to be maintained by investment advisers.

(a) Every investment adviser registered or required to be registered under section 203 of the Act (15 U.S.C. 80b–3) shall make and keep true, accurate and current the following books and records relating to its investment advisory business:

* * * * *

(k) Every investment adviser that registers under section 203 of the Act (15 U.S.C. 80b–3) after April 9, 1997 shall be required to preserve in accordance with this section the books and records the investment adviser had been required to maintain by the State in which the investment adviser had its principal office and place of business prior to registering with the Commission.

5. Section 275.205–3 is amended by revising the section heading and paragraph (a) to read as follows:

§ 275.205–3 Exemption from the compensation prohibition of section 205(a)(1) for registered investment advisers.

(a) *General.* The provisions of section 205(a)(1) of the Act (15 U.S.C. 80b–5(a)(1)) shall not prohibit any investment adviser from entering into, performing, renewing or extending an investment advisory contract which provides for compensation to the investment adviser on the basis of a share of the capital gains upon, or the capital appreciation of, the funds, or any portion of the funds, of a client, *Provided,* That all the conditions in this section are satisfied.

* * * * *

6. Section 275.206(4)–1 is amended by revising the introductory text of paragraph (a) to read as follows:

§ 275.206(4)–1 Advertisements by investment advisers.

(a) It shall constitute a fraudulent, deceptive, or manipulative act, practice or course of business within the meaning of section 206(4) of the Act (15 U.S.C. 80b–6(4)), for any investment adviser registered or required to be registered under section 203 of the Act (15 U.S.C. 80b–3), directly or indirectly, to publish, circulate or distribute any advertisement:

* * * * *

7. Section 275.206(4)–2 is amended by revising the introductory text of paragraph (a) to read as follows:

§ 275.206(4)–2 Custody or possession of funds or securities of clients.

(a) It shall constitute a fraudulent, deceptive or manipulative act, practice or course of business within the meaning of section 206(4) of the Act (15 U.S.C. 80b–6(4)) for any investment adviser registered or required to be registered under section 203 of the Act (15 U.S.C. 80b–3) who has custody or possession of any funds or securities in which any client has any beneficial interest, to do any act or take any action, directly or indirectly, with respect to any such funds or securities, unless:

* * * * *

8. Section 275.206(4)–4 is amended by revising the introductory text of paragraph (a) to read as follows:

§ 275.206(4)–4 Financial and disciplinary information that investment advisers must disclose to clients.

(a) It shall constitute a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of section 206(4) of the Act (15 U.S.C. 80b–6(4)) for any investment adviser registered or required to be registered under section 203 of the Act (15 U.S.C. 80b–3) to fail to disclose to any client or prospective client all material facts with respect to:

* * * * *

9. Sections 275.222–1 and 222–2 are added to read as follows:

§ 275.222–1 Definitions.

For purposes of section 222 (15 U.S.C. 80b–18a) of the Act:

(a) *Place of business* of an investment adviser means a place or office from which the investment adviser regularly provides advisory services or otherwise solicits, meets with, or communicates to clients, but does not include a motor vehicle unless the motor vehicle is the only place of business of the investment adviser; and

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

§ 275.222–2 Definition of ''client'' for purposes of the national de minimis standard.

For purposes of section 222(d)(2) of the Act (15 U.S.C. 80b–18a(d)(2)), the following shall be deemed a single client:

(a) A natural person, and:

(1) Any relative, spouse, or relative of the spouse of that person who has the same principal residence; and

(2) All accounts of which the natural person and the persons referred to in paragraph (a)(1) of this section are the sole primary beneficiaries;

(b) A corporation, general partnership, limited liability company, trust, or any legal organization (other than a limited partnership) that receives investment advice based on its investment objectives rather than the individual investment objectives of its shareholders, partners, members, or beneficial owners; and

(c) A limited partnership that would be counted as a single client under § 275.203(b)(3)–1.

PART 279—FORMS PRESCRIBED UNDER THE INVESTMENT ADVISERS ACT OF 1940

10. The authority citation for Part 279 continues to read as follows:

Authority: The Investment Advisers Act of 1940, 15 U.S.C. 80b–1, *et seq.*

11. Section 279.3 and Form ADV–S are revised to read as follows:

§ 279.3 Form ADV–T, transition form for determining eligibility for Commission registration.

This form shall be filed pursuant to § 275.203A–5(a) of this chapter by every investment adviser registered with the Commission on April 9, 1997.

Note: The text of Form ADV–T (17 CFR 279.3) will not appear in the Code of Federal Regulations.

12. By revising Instructions 2 and 7 of Form ADV (referenced in § 279.1), and by adding Instruction 10 to read as follows:

Note: The text of Form ADV (17 CFR 279.1) does not and the amendments will not appear in the Code of Federal Regulations.

Form ADV

* * * * *

Form ADV Instructions

* * * * *

2. Organization

This Form contains two parts. Parts I and II are filed with the SEC and the jurisdictions; Part II can generally be given to clients to satisfy the brochure rule. The Form also contains the following schedules:

- Schedule A—for corporations;
- Schedule B—for partnerships;
- Schedule C—for entities that are not sole proprietorships, partnerships or corporations (*e.g.*, limited liability companies and limited liability partnerships);
- Schedule D—for reporting information about individuals under Part I Item 12;
- Schedule E—for continuing responses to Part I items;
- Schedule F—for continuing responses to Part II items;
- Schedule G—for the balance sheet required by Part II Item 14;
- Schedule H—for satisfaction of the brochure rule by sponsors of wrap fee programs; and
- Schedule I—for reporting information related to eligibility for SEC registration.

* * * * *

7. SEC Filings

- Submit filings in triplicate to the Securities and Exchange Commission, Washington, D.C. 20549. There is no fee for amendments.
- Non-residents—Rule 0–2 under the Investment Advisers Act of 1940 (17 CFR 275.0–2) covers those non-resident persons named anywhere in Form ADV that must file a consent to service of process and a power of attorney. Rule 204–2(j) under the Investment Advisers Act of 1940 (17 CFR 275.204–2(j)) covers the notice of undertaking on books and records non-residents must file with Form ADV.
- Federal Information Law and Requirements—Investment Advisers Act of 1940 Sections 203(c), 204, 206, and 211(a) authorize the SEC to collect the information on this Form from applicants for investment adviser registration. The information is used for regulatory purposes, including deciding whether to grant registration. The SEC maintains files of the information on this Form and makes it publicly available. Only the Social Security Number, which aids in identifying the applicant, is voluntary. The SEC may return as unacceptable Forms that do not include all other information. By accepting this Form, however, the SEC does not make a finding that it has been filled out or submitted correctly. Intentional misstatements or omissions constitute Federal criminal violations under 18 USC 1001 and 15 USC 80b–17.

* * * * *

10. Updating

Amendments to this form should be filed:

—Promptly for any changes in: Part I—Items 1, 2, 3, 4, 5, 8, 11, 13A, 13B, 14A, and 14B;

—Promptly for material changes in: Part I—Items 9 and 10, all items of Part II except Item 14, and all Items of Schedule H;

—Within 90 days of the end of the fiscal year for the filing of Schedule I and any other changes.

Note: Every investment adviser is required to file Schedule I no later than 90 days after the end of its fiscal year.

* * * * *

Dated: December 20, 1996.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

BILLING CODE 8010–01–P

APPENDIX [NOTE: The text of Form ADV-T will not appear in the Code of Federal Regulations.]

FORM ADV-T

Form for Declaring Eligibility for SEC Registration After Effective Date Of Amendments to Investment Advisers Act of 1940

OMB APPROVAL
OMB Number:
Expires:
Estimated average burden hours per response:

This is an	[ ] Initial Filing of Form ADV-T [ ] Amendment to Previously Filed Form ADV-T	Registrant's investment adviser SEC file number: 801-

PART I General Information About Registrant

(a) Full name of registrant (if individual, state last, first, and middle name):

(b) Name under which business is conducted, if different:

(c) If business name is being amended, give previous name:

(d) Address of principal office and place of business: (*See Instruction 2*)

(e) Mailing address, if different:

(f) Is the address in items (d) or (e) being amended in this filing? ☐ Yes ☐ No

(g) Telephone number at principal place of business:

(h) Person to contact for further information about this Form:

____
(name) (title)

____
(telephone number)

(i) Current State Registration

Check the state(s) in which registrant is registered as an investment adviser as of the date of this Form:

AL ___	AK ___	AZ ___	AR ___	CA ___		CT ___	DE ___	DC ___	FL ___	GA ___	HI ___	ID ___
IL ___	IN ___		KS ___	KY ___	LA ___	ME ___	MD ___	MA ___	MI ___	MN ___	MS ___	MO ___
MT ___	NE ___	NV ___	NH ___	NJ ___	NM ___	NY ___	NC ___	ND ___		OK ___	OR ___	PA ___
RI ___	SC ___	SD ___	TN ___	TX ___	UT ___	VT ___	VA ___	WA ___	WV ___	WI ___		

Puerto Rico ___ Other (specify): ______________________________

PART II Eligibility for SEC Registration

The Investment Advisers Supervision Coordination Act, P.L. 104-290, authorizes the Commission to cancel the registration of any investment adviser that does not meet the criteria for SEC registration set forth in new section 203A of the Investment Advisers Act of 1940, as amended ("Advisers Act"). This legislation will become effective on April 9, 1997. This Part II requires the registrant to declare what its status under the Advisers Act will be after April 9, 1997.

Check either (a), (b), or (c):

(a) ☐ After April 9, 1997, registrant will not be subject to having its SEC registration cancelled.

In order for a registrant to be eligible to maintain its registration with the Commission, registrant must respond affirmatively (by checking the appropriate box or boxes) to at least one of the items (i) through (vii) below:

Registrant:

(i) ☐ has assets under management of $25 million or more;

Complete the Assets Under Management Worksheet in Part III if "assets under management" is the sole basis of registrant's eligibility for SEC registration (i.e., this item (i) is checked, and none of items (ii) through (vii) below are checked).

(ii) ☐ is not registered (or required to be registered) as an investment adviser in the State in which it maintains its principal office and place of business (*See Instruction 3*);

(iii) ☐ is an investment adviser to an investment company registered under the Investment Company Act of 1940;

(iv) ☐ is a nationally recognized statistical rating organization;

(v) ☐ is a pension consultant (as that term is used in rule 203A-2(b));

(vi) ☐ is an investment adviser that controls, is controlled by, or is under common control with, an investment adviser eligible to maintain its registration with the Commission, and whose principal office and place of business is the same as that adviser (*See Instruction 4*);

(vii) ☐ has received an order of the Commission exempting registrant from the prohibition on registration with the Commission. A copy of the Commission order is attached.

(b) ☐ After April 9, 1997, registrant will be subject to having its SEC registration cancelled. Registrant hereby withdraws its registration. *See Instruction 5.*

(c) ☐ After April 9, 1997, registrant will not be subject to having its SEC registration cancelled, but nonetheless hereby withdraws its registration. This option is available only to certain registrants reporting between $25 and $30 million in assets under management. *See Instruction 6.*
If this item (c) is checked, complete the Assets Under Management Worksheet in Part III.

Registrants are reminded that it is a violation of section 207 of the Advisers Act to make any untrue statement of a material fact in any report filed with the Commission, or willfully to omit to state in any such report any material fact which is required to be stated therein.

PART III Assets Under Management Worksheet

Complete this worksheet if required by Part II.

(a) State the amount of registrant's assets under management: *See Instruction 7.*

$________________________ as of ______________________, 1997

(b) State the amount reported on registrant's current Form ADV, Part I for:

Item 18(B): __________________ (aggregate market value of client securities portfolios managed on a discretionary basis)

Item 19(B): __________________ (aggregate market value of client securities portfolios managed or supervised on a non-discretionary basis)

(c) If, but for the inclusion of client accounts that registrant manages on a non-discretionary basis, registrant would not have $25 million of assets under management, attach a written statement describing the nature of the supervisory or management services provided to such accounts. *See Instruction 8.*

PART IV Execution

The undersigned represents that he or she has executed this Form on behalf of, and with the authority of, said registrant.

The undersigned and registrant represent that the information and statements contained herein, including exhibits attached hereto and other information filed herewith, all of which are made a part hereof, are current, true, and complete.

Date:

Name of Registrant:

By:

Typed Name and Title:

BILLING CODE 8010–01–C

Form ADV–T Instructions

Instruction 1

(a) This Form must be executed and filed in triplicate with the Securities and Exchange Commission, Mail Stop A–2, Registrations and Examinations, 450 Fifth Street, N.W., Washington, D.C. 20549. An exact copy should be retained by the registrant. There is no fee for filing this Form.

(b) All copies of the Form filed with the Commission shall be executed with a manual signature in Part IV. One of the filed copies must contain an original signature, the other two copies may contain photocopied signatures. If the Form is filed by a sole proprietor, it must be signed by the proprietor; if it is filed by a partnership, it must be signed in the name of the partnership by a general partner; if filed by an unincorporated organization or association which is not a partnership, it must be signed in the name of the organization or association by a duly authorized person who directs or manages or who participates in the directing or managing or its affairs; if filed by a corporation, it must be signed in the name of the corporation by a principal officer duly authorized. If signed by an officer of a corporation, organization, or associations his or her title must be given.

(c) When amending this Form, complete the entire document and circle the number or letter of any items being amended (*i.e.*, if a box is no longer being checked, circle the box to indicate that it previously had been checked).

(d) A Form that is not prepared and executed in compliance with applicable requirements may be returned as not acceptable for filing. Acceptance of this Form, however, shall not constitute any finding that it has been filed as required or that the information submitted is true, correct, or complete.

(e) Failure to file this Form is a violation of rule 203A–5(a) under the Investment Advisers Act of 1940, as amended (''Advisers Act''). Additionally, failure to file this Form will result in the taking of appropriate steps by the Commission to determine whether a registrant is still in existence and is still engaged in business as an investment adviser and may, therefore, lead the Commission to order cancellation of a registrant's registration, pursuant to section 203(h) of the Advisers Act.

(f) Unless the context clearly indicates otherwise, all terms used in this Form have the same meaning as in the Advisers Act and in the General Rules and Regulations of the Commission thereunder.

(g) Sections 203(c)(1) and 204 of the Advisers Act authorize the Commission to collect the information on this Form from registrants. The Commission will maintain files of the information on this Form and will make the information publicly available.

Instruction 2

Registrant's principal office and place of business is the executive office from which the officers, partners, or managers of the registrant direct, control, and coordinate registrant's activities. *See* rule 203A–3(c).

Instruction 3

Under the Advisers Act, a registrant whose principal office and place of business (*see* Instruction 2) is in a State that does not regulate the registrant as an investment adviser is eligible to maintain its registration with the Commission, even if none of the other criteria for SEC registration (*e.g.*, $25 million of assets under management) are met. Currently, these States are Colorado, Iowa, Ohio, and Wyoming. In addition, a registrant whose principal office and place of business is located in a country other than the United States is eligible to maintain its registration with the Commission. These registrants should check the box in item (a)(ii) of Part II.

A registrant whose principal office and place of business is in a State that regulates investment advisers, but that is excepted from regulation or exempted from registration under that State's investment adviser statute, is not ''registered'' as an investment adviser in that State. Such a registrant is eligible to maintain its registration with the Commission, and therefore should check the box in item (a)(ii) of Party II.

Instruction 4

A registrant that controls, is controlled by, or is under common control with, an investment adviser that is eligible to maintain its registration with the Commission after April 9, 1997 (the ''eligible adviser'') is eligible to maintain its registration with the Commission if the principal office and place of business of the registrant is the same as that of the eligible adviser. *See* rule 203A–2(c).

Instruction 5

If item (b) of Part II is checked, registrant's investment adviser registration with the SEC will be withdrawn effective as of the later of (i) April 9, 1997 or (ii) the date the registrant first files this Form or any amendment to the Form that indicates that registrant withdraws its registration.

Instruction 6

Under rule 203A–1(b), certain investment advisers that have assets under management of not less than $25 million but nor more than $30 million may (but are not required to) register with the Commission. An adviser wishing (and eligible) to take advantage of this option should check item (c) of Part II. This option is *not* available to an adviser that is required to be registered with the Commission regardless of the amount of its assets under management, *i.e.*, an adviser (i) to a registered investment company, (ii) that is not registered (or required to be registered) as an investment adviser in the State in which it maintains its principal office and place of business (see Instruction 3), or (iii) that is exempted by rule 203A–2 from the prohibition on registering with the Commission (NRSROs, pension consultants, and certain advisers controlling, controlled by, or under common control with SEC-registered advisers).

Registrants wishing to withdraw their SEC registration by checking item (c) of Part II must report their assets under management in the Assets Under Management Worksheet in Part III. If item (c) of part II is checked, registrant's investment adviser registration with the SEC will be withdrawn effective as of the later of (i) April 9, 1997 or (ii) the date registrant first files this Form or any amendment to the Form that indicates that registrant withdraws its registration.

Instruction 7

In determining the amount of assets the registrant has under management, include the total value of securities portfolios with respect to which the registrant provides continuous and regular supervisory or management services.

(a) An account is a securities portfolio if at least 50% of the total value of the account (less cash and cash equivalents) consists of securities. Include securities portfolios that are: (i) family or proprietary accounts (unless the registrant is a sole proprietor, in which case the personal assets of the sole proprietor should be excluded); (ii) accounts for which the registrant receives no compensation for its services; and (iii) accounts of clients who are not U.S. residents.

(b) Include the entire value of each securities portfolio for which the registrant provides ''continuous and regular supervisory or management services.''

(c) A registrant provides continuous and regular supervisory or management services with respect to a securities portfolio if the registrant (i) has discretionary authority over and (ii) provides ongoing management or supervisory services with respect to the portfolio.

Whether a registrant that provides ongoing management or supervisory services on a *non-discretionary* basis provides continuous and regular supervisory or management services is a question of fact. The greater the registrant's ongoing responsibilities, the more likely the adviser will be providing continuous and regular supervisory or management services.

To assist registrants, the Commission is providing examples of accounts that receive continuous and regular supervisory and management services. These examples are not exclusive.

Accounts That Receive Continuous and Regular Supervisory and Management Services

• Accounts for which the adviser provides traditional portfolio management services on a discretionary basis;

• Accounts for which the adviser provides ongoing management services, (*i.e.*, is responsible for the selection of which securities to buy and sell and when to buy and sell them) without a grant of discretionary authority;

• Accounts managed by other advisers (i) that the adviser has been given a grant of discretionary authority to hire and discharge on behalf of the client, and (ii) among which the adviser has the authority to allocate and reallocate account assets; and

• Accounts for which the adviser provides asset allocation services by (i) continuously monitoring the needs of the clients and the markets in which account assets are invested, and (ii) allocating and reallocating account assets to meet client objectives under a grant of discretionary authority.

Accounts That do Not Receive Continuous and Regular Supervisory and Management Services

- Accounts for which the adviser provides only periodic advice (no matter how frequent), *e.g.*, an account for which the adviser has prepared a financial plan which is periodically reviewed and updated;
- Accounts for which the adviser provides advice only on a periodic basis or as a result of some market event or change in client circumstances (even if the adviser has discretionary authority), *e.g.*, an account that is reviewed and adjusted on a quarterly basis or upon client request;
- Accounts for which adviser provides market timing recommendations (to buy or sell) but does not manage on an ongoing basis;
- Accounts for which adviser provides impersonal advice, *e.g.*, market newsletter;
- Accounts for which adviser provides only an initial asset allocation, without continuous and regular monitoring and reallocation; and
- Accounts for which the registrant undertakes to monitor the markets and apprise the client of any developments, or make recommendations as to the reallocation of client assets upon any developments.

(d) Determine the total amount of assets under management based on the current market value as determined within 10 business days prior to the date of filing this Form. Current market value should be determined using the same methodology as the account value reported to clients or calculated to determine fees for investment advisory services

(e) Include only those accounts for which registrant provides continuous and regular supervisory and management services as of the date of filing this Form.

Instruction 8

The written statement required by item (c) of Part III should be attached only if registrant does not have at least $25 million in discretionary assets under management. For example, a registrant that has $30 million of discretionary and $5 million of non-discretionary assets under management would not be required to attach the statement. A registrant that has $20 million of discretionary and $5 million of non-discretionary assets under management would attach a statement, but the statement would only be required to describe the nature of the supervisory and management services. provided to the $5 million of non-discretionary assets. A registrant that has $20 million of discretionary and $5 million of non-discretionary assets under management, but that is an adviser to a registered investment company (and therefore has an additional basis of eligibility for SEC registration) would not be required to attach the statement.

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