

RIAs switching to state registration may be examined by a second regulator, too

The audit may come remotely from a state where the advisor doesn't have a place of business

by Guest Columnist, Les Abromovitz
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As more registered investment advisers make the transition from SEC to state registration, they are expecting examinations by a new regulator. They might not, however, be expecting examinations by more than one state securities regulator.

STATE SCHEDULES EXAM OF OUT-OF-STATE RIA

A state-registered adviser in Florida recently received notification that a desk audit would be conducted by a securities regulator in the Midwest. A desk audit is conducted remotely by securities examiners instead of visiting the RIA's offices.

Although a desk audit is not unusual, it is out of the ordinary for an RIA to be examined by a regulator in a state where the firm is registered but does not have a place of business. Generally, examinations of state-registered investment advisers are conducted by the state where the RIA's principal office is located.

An examination of an RIA with an office in another state might be less surprising if it is scheduled in response to a complaint, which does not appear to be the case with this adviser. It is also more common where there is a coordinated examination of an RIA by several states in which the firm is registered.

ISOLATED CASE OR THE START OF A TREND?

State-registered RIAs will face a significant compliance burden if they are subjected to multiple examinations. This particular desk audit requested numerous documents and files, including copies of the RIA's most recent financial statements. The RIA was required to send a balance sheet, trial balance, and income statements for the last three years. The adviser was also required to send copies of all bank statements relating to the RIA for the last twelve months.

With more RIAs becoming state-registered and as budgets get tighter, it is interesting that at least one state has decided now to initiate examinations of investment advisers with no place of business in its jurisdiction. Perhaps, however, the desk audit might be explained by a memorandum of understanding developed by the North American Securities Administrators Association Inc. in December 2009, which called for state securities regulators to assist one another with RIA exams.

Even if an out-of-state securities regulator is conducting an RIA's exam, it may not enforce a higher minimum net capital requirement or any bond that is in excess of the amount required by the state in



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which the firm maintains its principal place of business. Furthermore, an RIA is obligated to comply only with its home state's books-and-records rule.

CHECK YOUR CLIENT LIST

Ironically, the RIA that received notice of this desk audit was not required to be registered in the state conducting the examination. When the RIA checked its records, the firm found that it only had three clients in that state. As such, the RIA fell within the de minimis exemp-

tion for registration as an investment adviser. Even if the RIA withdrew its registration, however, the examination would still proceed.

An RIA's policies and procedures should require the firm to review its list of clients on a regular basis. The list should also indicate where those clients reside. With that information in hand, the RIA can determine where it should and should not be registered.

It will be interesting to hear if other states are conducting desk audits of RIAs with no place of business in their

jurisdictions. Any news on this front can be posted or e-mailed to me at the address below.

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