



SECURITIES INDUSTRY PRACTICE GROUP

# ALERT

## SEC PROPOSES AMENDMENTS TO INVESTMENT ADVISERS ACT

On May 20, 2009, the United States Securities and Exchange Commission (“Commission” or “SEC”) issued Release No. IA-2876, proposing certain amendments to the Investment Advisers Act of 1940 (“Advisers Act”). These proposed amendments, among other things, would require registered investment advisers (“RIAs”) who maintain custody of client funds or securities to undergo an annual surprise examination by an independent public accountant. This independent public accountant would be required to verify client funds and securities, and issue a written report to the RIA opining upon whether the controls in place for the custody of client assets are satisfactory. The SEC believes these amendments would provide the Commission with better information about RIAs’ custodial practices, and provide additional safeguards under the Advisers Act when an adviser (or its affiliates) has custody of client funds or securities. These proposed requirements are an obvious outgrowth of the Madoff scandal.

These proposed amendments are merely another step in the regulatory approach to RIAs various regulators have pursued since the financial scandals broke. For example, examiners from both the SEC and the various states have stepped up their RIA examination programs of RIAs even before these proposed amendments, typically focusing in on various records maintained by RIAs.

However, RIAs, with a little preparation, may be able to avoid many issues including those potentially posed by the proposed new amendments. We are advising our RIA clients to focus and manage their record-keeping with an eye towards the regulators’ interests. From our experience, regulators are looking at

four broad categories of documents that they believe will provide them with insight into RIAs’ operations and whether clients are being protected. The individual categories and the documents generally requested follow:

1) Financial:

- accounts payable
- monthly journals (receipts and disbursements)
- general ledgers
- trade tickets and investment blotters
- brokerage statements (business and personal)
- bank registers and statements (checking, money market and savings)
- credit card statements
- financial statements (income statements and balance sheets)
- tax returns

2) Administrative:

- RIAs’ articles of incorporation
- compliance and supervisory procedures manuals
- lists of names and addresses for W-2 and Form 1099 employees
- IAR current registrations
- regulatory files (e.g., FINRA Forms U-4)
- investment advisory agreements
- disclosure documents (ADV Part II amendments)
- POA authorizations

- custody authorizations – no custody of funds except hedge funds
- discretionary trading authorizations
- IA fee debit authorizations
- hard dollar fee schedules
- soft dollar compensation agreements
- arbitrations, complaints and litigation files
- personal security transactions
- unrelated business transactions
- solicitors' agreement
- lists of names and addresses of paid referral networks
- Privacy and Code of Ethics statements
- Anti-Money Laundering documentation
- Insider Information statements
- do not call files
- data processing (hardware and software) files

3) Advertising:

- advertising files
- sales literature
- financial illustrations
- client newsletters

- web pages and e-mail
- mutual fund prospectuses

4) Client records:

- lists of names and addresses of clients where the RIAs must identify discretionary, custodial or other types of accounts
- client files
- brokerage new account forms
- investment advisory agreements
- disclosure agreements (ADV-Part II)
- authorizations (including custody, trading, disbursement and IA fees)
- powers-of-attorney
- suitability-risk profile worksheets
- correspondence and e-mail files
- account statements

As a result, well before these proposed amendments, federal and state RIA regulators have been actively investigating and examining RIAs and their business. Accordingly, we recommend that, in interacting with regulators, it is best to begin preparing before “they come a knockin’.” Fox Rothschild LLP counsel may be of great assistance in arriving at solutions in these preparations.

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