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Compliance Review

Ongoing Compliance Updates for Independent Investment Advisors

IN THIS ISSUE

Compliance Considerations for Advisory Firms With Dually Registered Advisors in the Independent RIA and Hybrid Business Models

Michelle L. Jacko, Esq., CSCP®, CEO, Core Compliance & Legal Services, Inc., Managing Partner and CEO, Jacko Law Group, PC

I. Introduction

As the independent advisory business model continues to grow, many independent registered investment advisory firms will at some point consider whether to hire or allow a current investment advisor representative ("IA") to conduct brokerage business as a registered representative ("RR") through an independent broker-dealer ("IBD") separate from the advisory firm. As explained below, this article will refer to the independent registered investment advisory firm as the "RIA" and the dually registered individual advisory professional as the "hybrid practice advisor" or "IA/RR." Please see the Terms section for explanations of other terms as they are used in this article.

Advisory professionals leaving wirehouses or the captive model entirely within an IBD are increasingly looking to join an existing RIA rather than start their own. And it's becoming more common for RIAs to consider hiring IA/RRs as part of their growth strategies. The advisors turning independent typically have some portion of their book of business that would need to remain commission-based (or that involves other sales-based compensation) rather than becoming advisory fee only. For the individual advisory professional or the RIA firm they start or join, this combination of fee-based and sales-based compensation within their client base has become known as the "hybrid model" of the advisory business.[1]

For principals and compliance officers of RIAs, regulation of the brokerage business and the IA/RR involved in that business is unfamiliar and can be daunting. In this article, we will discuss some of the most common regulatory compliance considerations for independent RIAs that have hired or are considering hiring advisors who are or will be IA/RRs. This discussion will also inform advisors turning independent and becoming IA/RRs.

II. Overview of Regulatory Regime

For purposes of this discussion, we assume that you are familiar with the regulatory regime for independent RIAs applicable to the conduct of the investment advisory business. This regulatory regime includes (among other things) fulfilling the following compliance requirements. The RIA must:

- Register with the Securities and Exchange Commission ("SEC") or state regulators before transacting activity by completing Form ADV Parts 1 and 2;
- Develop policies and procedures reasonably designed to help prevent the violation of securities regulations;
- Deliver the Form ADV Part 2 disclosure brochure to new clients;
- Create all client documents (agreements, client profiles, etc.); and
- Establish compliant arrangements for custody of advisory client assets and execution of brokerage transactions.

While these compliance responsibilities can be burdensome, there are many resources that the advisor can turn to for assistance. For instance, the SEC provides guides and various resources that can contribute to the development or enhancement of a compliance program for small or newly registered advisors.[2] In addition, some custodians provide resources that help advisors keep up with their regulatory compliance requirements.[3]

The advisory professional with a hybrid practice faces a dual compliance program conducted by both the IBD and RIA, under two different regulatory structures. The RIA is regulated either by the SEC or by individual states, while the IBD is regulated primarily by the Financial Industry Regulatory Authority ("FINRA").

Regulatory Body	Who Is Governed[4]	Rules to Comply With
SEC www.sec.gov	RIAs with assets under management of >$100M	Investment Advisers Act of 1940 ("Advisers Act")
State Regulators www.nasaa.org	RIAs with assets under management of <$100M	Advisers Act and state securities laws
FINRA www.finra.org	Broker-dealers	FINRA rules

The RIA firm with a hybrid model will face additional compliance challenges because it will need to both oversee its own RIA compliance program and interface with the IBD where its IAs are RRs. The IBD's compliance requirements will be governed by FINRA regulations. Importantly, the broker-dealer has an obligation to supervise the advisor's investment advisory business (conducted as an IA of the RIA), as well as the advisor's brokerage business (conducted as an RR of the IBD). Consequently, working with the IBD's compliance department is a fact of life for both the IA/RR and the RIA. This can be either a positive or a potentially frustrating experience, but it will involve additional work in any case.

For the RIA firm considering whether to have a hybrid practice advisor who is an IA/RR, determining the nature and scope of that additional work is critical. To make that determination, it is essential for the RIA to have a basic understanding of the IBD's regulatory compliance requirements (see Part III). Importantly, the RIA must understand how the IBD's compliance requirements translate into supervision of the hybrid practice advisor who is an RR of the IBD and an IA of the RIA. This relationship and the related compliance responsibilities are typically outlined in an Independent RIA Letter of Understanding ("LOU") or similarly titled document (see Parts IV and V).

Regardless of how the IBD approaches compliance and supervision of IA/RRs, there is another important consideration in the hybrid model: the standard

of care. RIAs are held to a fiduciary standard of care. The SEC has stated that such a standard includes a duty of loyalty and a duty of care (encompassing, among other things, a duty of suitability), with the duty of loyalty requiring investment advisors to act in the best interests of clients and to avoid or disclose potential and actual conflicts. In contrast, broker-dealers are held to a standard of fair dealing. This means that broker-dealers must deal fairly with customers and observe high standards of commercial honor and just and equitable principles of trade. To that end, broker-dealers have a number of specific obligations, including the duty of suitability.[5]

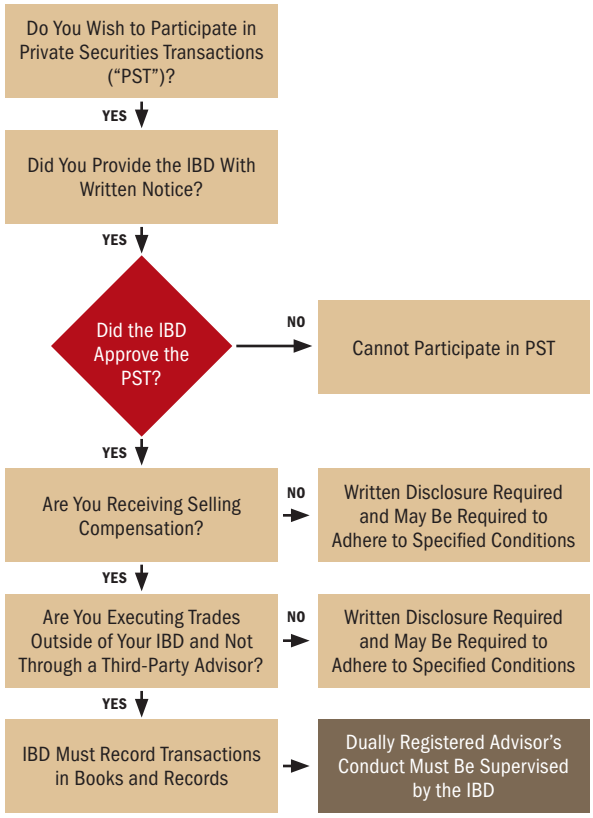
It is essential for RIAs and their IA/RRs to be aware of these differing standards and when they apply. On the one hand, investment advisory activity that the advisor conducts as an IA of the RIA is subject to fiduciary duty and, on the other hand, broker-dealer activity that the advisor conducts as an RR of the IBD is subject to the suitability standard. These requirements can be confusing, and additional training is often necessary to thoroughly understand the details involved.

III. Understanding the Regulatory Compliance Requirements for IBDs

In accordance with FINRA Rule 3270,[6] IBDs are required to oversee the outside business activities of their RRs. Additionally, under NASD Rule 3040, IBDs must supervise those private securities transactions of associated persons (including those who are RRs and also IAs of an independent RIA) by, among other things, approving or disapproving the written notice provided by the RR, which details the proposed transactions. In an attempt to provide guidance on the required oversight, FINRA (formerly, the NASD) issued Special Notice to Members 94-44 ("NTM 94-44"),[7] which provides clarification on the required supervision of IA/RRs' investment advisory activities. The notice recommends that broker-dealers supervise those individuals who participate in a private securities transaction and who receive selling compensation away from the broker-dealer for participating in the execution of any securities transaction.

Term	Definition
Private Securities Transaction	Any securities transaction outside of the regular course or scope of an RR's relationship with a broker-dealer, including new offerings not registered with the SEC
Selling Compensation	Any compensation paid directly or indirectly from any source as a result of the purchase or sale of a security
Away From the Broker-Dealer	Includes activities of individuals who are RRs and who have a relationship with an RIA that involves activities conducted away from their broker-dealer

Prior to NTM 94-44, broker-dealers were unclear as to what their obligations were under Article III, Section 40 of the NASD Rules of Fair Practice, with regard to investment advisory activities of RRs who are also IAs of an independent RIA. In particular, NTM 94-44 specifies that prior to engaging in any securities transactions away from the broker-dealer with which the RR is associated, the RR must provide written notice and receive approval. The following diagram illustrates these requirements.



Because NTM 94-44 raised many questions in the industry, FINRA issued NASD Notice to Members 96-33 ("NTM 96-33") to provide broker-dealers with clarifying rules for supervising IA/RRs.[8] Specifically, NTM 96-33 focuses on the types of records that can be used and the recordkeeping systems that may be established to help ensure that outside investment advisory transactions are properly recorded and the IA/RR is adequately supervised.

Even if the dually registered advisor does not participate in the execution of a securities transaction and provides fee-based financial planning services only (without making specific purchase recommendations for securities), the advisor still must provide the broker-dealer with written notification of the outside business activity pursuant to FINRA Rule 3270.[9]

In particular, NTM 96-33 suggests that the IBD:

1. Develop and maintain a recordkeeping system that captures the IA/RR's transactions;
2. Provide adequate supervision over the IA/RR's transactions (which may include suitability reviews);
3. Develop recordkeeping systems that may involve many of the following books and records:
   a. Names of the advisory clients, cross-referencing those who are also clients of the IBD
   b. Copies of client advisory agreements (including any powers of attorney)
   c. Duplicate confirmations and client account statements
   d. Correspondence files for dually registered advisors
   e. Advertising files where the advisor holds him- or herself out to be a dually registered advisor
   f. Exception reports (including active trading reports, cancelled trades, etc.)
   g. Suitability reviews

Because the IBD has the freedom to develop whatever type of system the IBD believes is adequate, no two compliance programs for supervising dually registered advisors look the same. Often there can be variations between IBDs, both in terms of overall philosophy (for example, what to review and when) and in day-to-day processes, procedures, and response times. So it is important for advisors to understand each IBD's overall compliance approach and process at the outset of the relationship.

IV. Common Compliance Requirements IBDs Impose on IA/RRs and Their RIAs

While broker-dealers and investment advisors are both required to supervise their associated persons, broker-dealers generally are subject to more exacting supervisory requirements. The compliance requirements for broker-dealers are much more rule-based and clearly defined than the compliance standards for RIAs, which are principle-based and primarily defined in the industry by best practices, SEC no-action letters, and enforcement actions. For example, FINRA rules explicitly require broker-dealers to establish a supervisory system that includes a robust written supervisory procedures manual,[10] a continuing education plan, and the assignment of a direct supervisor for each RR; RIAs may not be subject to these requirements. In addition, IBDs must conduct periodic audits and supervise the outside business activities and private securities transactions of associated persons.[11]

In the hybrid model, and based on NTM 94-44 and 96-33, many broker-dealers take a conservative

approach and request the following documents in order to satisfy their books and records and supervisory requirements:

1. Privacy notice (to ensure that the advisor is using either the Model Privacy Form[12] or other similar disclosure and delivering it no less than annually);
2. Form ADV of the RIA (to approve the disclosures and ensure accuracy and completeness prior to delivery to the SEC and clients or prospects);
3. FINRA Rule 3030—Outside Business Activities written notification form;
4. FINRA Rule 3040—Private Securities Transactions written notification form;
5. Duplicate email transmissions of the IA/RR (to capture correspondence files);
6. Duplicate transaction reporting for the IA/RR (to ensure that all client transactions go through, or are delivered simultaneously to, the broker-dealer);
7. Advertising and client communication reviews (including duplicate electronic communications);
8. Payment of supervisory overrides;
9. Amendments to all advisory documents for the IA/RR's clients (i.e., Form ADV, investment advisory agreements, policies and procedures manual, etc.);
10. Any new written requests for approval for outside business activities; and
11. Any requests by the IA/RR to sell a new product or service.

In addition, the broker-dealer may ask the advisor to demonstrate how he or she is supervising others within the RIA, particularly if the RRs associated with the RIA are selling complex products or services that the advisor does not have a sophisticated understanding of. Consider the following case study:

New Co. is an RIA that is managed by Harry R. Pitt, who is the RIA principal and also a dually registered advisor. Pitt enters into an agreement to bring Joe Black on board. Black's advisory business focuses on an asset allocation model that uses ETFs and mutual funds, coupled with the purchase of variable annuities as needed. Black would be registered with the same IBD as Pitt. Pitt has no experience in selling variable annuities.

Q: What might the IBD require of Pitt?

A: The answer to this question depends on the unique supervisory structure established by the IBD. For example, the IBD could require that the RIA offer only certain variable annuities for which the IBD conducted due diligence for an advisory platform. In other words, Black may be permitted to sell only certain variable annuity products that have already been vetted by the IBD. In addition, the IBD could inquire as to whether Pitt understands the product enough to assess whether it's suitable for clients. If he does not, Pitt may likely have to take continuing education on variable annuity sales and suitability considerations in order for him to supervise Black's sale of variable annuities. Finally, if the variable annuity sales are not going through the IBD, the IBD could require duplicate records of all directed variable annuity transactions and, if possible, direct electronic feeds of the trade confirmation and client account statements.

Looking for more information on compliance or regulatory issues?
Schwab's compliance website includes compliance tools and many other resources to assist you. Visit **www.schwabadvisorcenter.com > News & Resources > Compliance**. (See page 11 for more information.)

Absent the requisite operational systems, these requirements may present additional administrative and supervisory burdens that the advisor did not envision, and may be costly from both a human capital and operational standpoint. It is important to confirm that any custodian or directed business provider has the ability to provide direct feeds of duplicate records to the IBD in order to avoid administrative challenges in the future.

V. Factors to Weigh When Hiring RRs

Given the expansive client needs of today, both fully independent RIAs and advisors in the hybid model are seeking to hire dually registered advisors. Historically, advisory firms often sought to hire advisors who would associate only with their broker-dealer of record, primarily because the IBD demanded that in order to simplify its supervision and books and records requirements. However, today it is becoming more common for an RIA to have two or more hybrid practice advisors, each of whom is associated with a different IBD.

If you're looking to hire a dually registered advisor, consider the following steps first.

A. Conduct a Background Check

One of the greatest challenges in hiring an RR is learning about the candidate's background. RIAs who are not affiliated with a broker-dealer will not have the benefit of receiving a detailed account of any and all regulatory reporting relating to the candidate, including all customer complaints received or internal investigations that may be pending at the candidate's former firm. Consequently, it is imperative for the RIA to proactively conduct due diligence on all new hires, particularly if the RR will be servicing clients. Advisors may wish to take the following steps, as applicable:

1. Conduct a background investigation prior to hiring. This investigation may include searching for civil and criminal court records;

In order to approve the outside business activity the RR conducts as an IA of the independent RIA, the IBD may require the RR to:

- Make available, before commencing the activity, the RIA's written supervisory policies and procedures manual pursuant to Rule 206(4)-7, as well as the RIA's code of ethics, privacy policy and notice, Form ADV Parts 1 and 2, summary of the business continuity plan, client contracts (investment management and/or financial planning agreements), solicitor contracts, disclosure documents, and list of custody/clearing arrangements;
- Permit the IBD to conduct an examination of the IA/RR's advisory activities at the RIA at least once per year;
- Establish direct online access to each custody platform where the RIA's advisory clients maintain accounts managed by the IA/RR;
- Provide new account forms for each advisory client's account managed by the IA/RR;
- Pay a fee for the IBD's ongoing supervision over the IA/RR's advisory activities (the fee is typically deducted from the RR's commissions);
- Agree not to transact in securities products that would otherwise be prohibited through the IBD; and
- Provide access to the dually registered advisor's email to monitor his or her communications conducted through the RIA.

checking credit reports, workers' compensation records, credentials, and previous employment records; and speaking with the candidate's references.

2. Use BrokerCheck to see if there have been any previous disciplinary reporting pages (DRPs) completed on the RR. This information can be obtained by going to www.finra.org/Investors/ToolsCalculators/BrokerCheck.

3. Request a copy of the RR's Form U4 or Form U5. While much of this information may be included on the BrokerCheck report, it is important to see if there is any additional information that may impact your decision to hire the RR.

4. Request a copy of the RR's Independent RIA Letter of Understanding ("LOU") from the IBD with which the IA/RR is associated. Typically, the LOU will specify exactly what terms the RR will need to comply with in order for the IBD to approve the outside business activity the RR will conduct as an IA of the independent RIA.

5. Request a list of all political contributions that the RR may have made over the past two years. This will be particularly important for those RIAs who have government contracts or transact in municipal securities.[13]

6. Request disclosure of all outside business activities currently performed by the IA/RR. It is very important to understand all potential conflicts of interest prior to entering into any new-hire arrangement. Not only will the RIA need to know about these conflicts in order to disclose them on Form ADV Part 2, but the RIA will also want to know if the IA/RR's interests align with those of the RIA.

B. Weigh the Pros and Cons of Hiring a Dually Registered Advisor (IA/RR)

Although it comes with additional compliance burdens, there are potential benefits to hiring a dually registered advisor. First, this option allows the RIA to expand the talent pool during the hiring process. In addition, it potentially permits the RIA to provide new product offerings. Moreover, it allows the dually registered advisor to maintain legacy brokerage accounts and earn trail and ongoing commissions through the IBD, which might be essential to the advisor who is considering joining the independent RIA.

From a compliance standpoint, the RIA may welcome the supervisory interaction with the IBD as a means of having "independent oversight" of its advisory activities. Also, some advisors believe they benefit from the IBD/RIA relationship because clients may derive a sense of comfort from knowing that the IBD is looking at what their advisor is doing.[14] Many IBDs are providing a disclosure letter that advisors can give to their RIA clients, which lets clients know that the IBD may view their nonpublic consumer information, regardless of whether the client has a brokerage account, for the sole purpose of supervising the activities of the dually registered advisor. Once advisory clients learn about this oversight, they often view it positively.

On the flip side, depending on the IBD's requirements, the supervisory oversight may infringe upon the culture and business practices of the RIA and constrict the RIA's ability to operate in a completely independent manner. First, many advisors, particularly those who are in a fully independent RIA and not associated with an IBD, do not want to have to pay a fee to the IBD for its supervision (if the fee is imposed on the RIA, rather than debited from the IA/RR's commissions), particularly if the IA/RR is involved in only a small part of the advisory business.

Second, advisors may object to the cost: with additional operational requirements comes additional expense. The RIA may have to duplicate several books and records in order to comply with the IBD's requirements. Moreover, the RIA may have to use particular vendors (such as particular custodians or email surveillance providers) in order to allow for direct feeds to the IBD. Also, there may be certain inherent conflict of interest considerations. For example, the IBD may allow for a privacy notice that has an opt-out provision, while the RIA's privacy notice may have no opt-out option. For advisors with sensitive client relationships, these factors must be weighed.

Finally, the advisor will need to weigh the potential liability associated with hiring an IA/RR. Importantly, the RIA will be impacted by the fact that the hybrid practice advisor is subject to a second regulator—FINRA—and oversight by the IBD. The RIA may be faced with the challenge of hiring a hybrid practice advisor who offers complex brokerage products that the RIA is not familiar with, which will raise concerns over the RIA's supervisory obligations regardless of whether the IBD is supervising the activity. The RIA should be familiar with the products and services being offered by the IA/RR and should adopt written policies and procedures that closely mirror the IBD's requirements for approving (or disapproving) certain sales transactions and outside business activities, as applicable. The development of strong internal controls and supervisory protocols is of paramount importance for the RIA's compliance program and business risk management, particularly when hiring hybrid practice advisors.

VI. Conclusion

In this paper, we addressed some of the key distinctions between fully independent RIAs and the hybrid model, focusing on the dual regulatory framework. Importantly, in the hybrid model, it is essential to understand the regulatory compliance requirements that FINRA imposes on the IBD in order to foresee the compliance challenges the RIA is likely to face. When entering into the hybrid model or hiring a new dually registered advisor, the principal(s) of the RIA will need to carefully evaluate the IBD's compliance requirements. No two IBDs are alike, and each imposes differing standards on independent RIA firms with whom the IBD's RRs associate.

From a compliance standpoint, many service providers, including custodians such as Schwab, can support the books and records needs of the RIA to help satisfy the IBD's requirements.

Prior to entering into any agreement, it is important to consult with your outside counsel to discuss the Letter of Understanding received from the IBD and to customize terms, as necessary. While some terms may be non-negotiable (based on FINRA requirements), it may be possible to tailor others to the advisor's particular business model, particularly if no securities transactions are contemplated. Notably, advisors should carefully weigh the regulatory compliance, operational, and administrative requirements prior to entering into the hybrid model. Despite the challenges, RIAs may find the opportunities for growth to be worth the costs.

Terms	
Advisor	An individual investment professional, as opposed to a firm, who provides investment advice to clients, perhaps along with other investment services such as brokerage.
Advisory	For purposes of this paper, *advisory* is defined as business for which an advisor, acting as an IA representative of an RIA, typically charges a fee that is a percentage of assets under management.
Financial Industry Regulatory Authority (FINRA)	The most common self-regulatory organization (SRO) that broker-dealers are members of. FINRA administers the registration and licensing of individual brokers or RRs through Form U4 and the Series 7 qualification exam, among other things.
Hybrid Practice Advisor or Dually Registered Advisor (IA/RR)	An advisor whose practice includes both investment advice provided as an IA representative of an RIA, and brokerage services provided as an RR of an IBD.
Independent RIA	A registered investment advisory firm that is not owned by a broker-dealer, bank, insurance company, or other large financial services firm. Independent RIAs are generally owned by individual advisors who are responsible for running all firm functions, including compliance.
Independent Broker-Dealer (IBD)	A broker-dealer that is not affiliated with a commercial or investment bank or an investment company but may be affiliated with an insurance company.
Investment Advisor Representative (IA)	An advisor who is employed by, or otherwise associated with, and renders investment advice to clients on behalf of an RIA.
Override/Supervisory Override	A commission collected by a broker-dealer or registered principal related to the oversight and supervision of the RR's activities.
Registered Investment Advisor (RIA)	For purposes of this report, a firm (not an individual) that is registered as an investment advisor with either the SEC or the applicable state securities regulatory authorities. While an advisor (investment professional) can register as an RIA, the vast majority of advisors are IAs of RIA firms and need not register as RIAs themselves.

Terms	
Registered Representative (RR)	An individual professional who is employed by, is an independent contractor of, or is otherwise associated with (i.e., an "associated person" of) a broker-dealer and is engaged in the securities business of the firm, often interacting with clients.
Securities And Exchange Commission (SEC)	The federal regulatory authority in the United States with jurisdiction over securities markets and businesses, including RIAs and broker-dealers, as well as self-regulatory organizations such as FINRA.
Suitability	A requirement that a brokerage or advisory firm and its advisors must have reasonable grounds for believing a recommendation fits the investment needs of a client.

About the Author

Michelle L. Jacko is the founder and CEO of Core Compliance & Legal Services, Inc., a compliance consultation firm which offers compliance services to broker-dealers, registered investment advisors, hedge/private funds, banks, investment companies, and financial professionals. In addition, Ms. Jacko is managing partner and CEO of Jacko Law Group, PC, a securities law firm which offers securities and general corporate legal services nationwide.

Ms. Jacko specializes in investment advisor, broker-dealer, and private fund formations; regulatory compliance; mergers and acquisitions; operational risk management; and business transitions, with emphasis on securities regulations. Her consultation practice is focused on policies and procedures, testing of compliance programs (including evaluation of internal controls and supervision), performance advertising, soft dollar arrangements, best execution, separation agreements, and more. In 2006, Ms. Jacko was named a Top 20 Rising Star for "Who's Who" in Upcoming Compliance Professionals by *Compliance Reporter* magazine.

Previously, Ms. Jacko served as "of counsel" at Shustak & Partners, PC. Prior to that, she was vice president of compliance and branch manager of the Home Office Supervision team at LPL Financial Services (Linsco/Private Ledger Corp.). Ms. Jacko also served as legal counsel of investments and chief compliance officer at First American Trust, FSB and compliance manager at Nicholas-Applegate Capital Management LLC. In addition, Ms. Jacko was with PIM Financial Services, Inc. and Speiser, Krause, Madole, Mendelsohn & Jackson.

Ms. Jacko received her JD from St. Mary's University School of Law and her BA in international relations from the University of San Diego. She is admitted to the State Bar of California and United States District Court, Southern District of California. Michelle is a former two-term board member for the National Society of Compliance Professionals (NSCP), holds NSCP's Certified Securities Compliance Professional® (CSCP®) designation, and is an active member of its Regulatory Affairs and Meetings Committees.

Ms. Jacko frequently authors industry articles and presents at conferences throughout the nation. She is vice president and co-founder of the Southern California Compliance Group and is involved in the American Bar Association (Business Law Section), State Bar of California, and San Diego County Bar Association, where she serves on its Business Law Section Advisory Board. She also is a member of the FINRA Board of Arbitrators. She can be reached at 1-619-278-0020, ext. 2002, or michelle.jacko@corecls.com.

Online Compliance Resources

Visit **www.schwabadvisorcenter.com > News & Resources > Compliance** for compliance and regulatory information. Schwab works with third-party firms to provide select resources that help keep you informed of certain regulatory and compliance developments. Access Compliance Hot Topics, templates and guideline documents, a Rulemaking Calendar, archived issues of *Compliance Review*, third-party resources and discounts. These resources are complimentary and available to advisors who work with Schwab Advisor Services.

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[1] Schwab Market Knowledge Tools® (MKT), "Understanding the Hybrid Practice, Considerations for Advisors in Transition," 2011.

[2] For example, please refer to "Common Compliance Issues for Small and Newly-Registered Advisers" at www.sec.gov/info/cco/infosmallias2008.pdf, "Information for Newly-Registered Investment Advisers" at www.sec.gov/divisions/investment/advoverview.htm, and "Risk Assessment Flow Chart" at www.sec.gov/info/cco/flowchart2007.pdf.

[3] Schwab, for instance, through its Designated Brokerage Services offer, has a robust personal trading platform that can assist with capturing essential data to review personal securities trades of advisory personnel. Additionally, Schwab Advisor Services provides compliance resources to clients on the Compliance page of Schwab Advisor Center (www.schwabadvisorcenter.com) under "News & Resources."

[4] As of the publication of this paper, the $100M limit for SEC registration is a proposed rule; see 17 CFR Parts 275 and 279, Release No. IA-3110, File No. S7-36-10.

[5] In accordance with Section 913 of the Dodd-Frank Act, the SEC issued a study on January 22, 2011, in which the SEC staff recommended that all brokers and financial advisors adhere to the same strict fiduciary standard that currently applies to investment advisors when they provide personalized investment advice to retail customers. Please refer to www.sec.gov/news/studies/2011/913studyfinal.pdf. Notably, this new standard is proposed and is not yet effective as of the date of this paper.

[6] On December 15, 2010, FINRA Rule 3270 became effective. FINRA Rule 3270 requires each RR of a broker-dealer to provide the broker-dealer with prior written notice of an outside business activity. FINRA Rule 3270, which replaced NASD Rule 3030 and NYSE Rule 346, specifically identifies the types of activities that would be subject to the rule and requires each RR to disclose to the broker-dealer whenever he or she intends to serve as an employee, independent contractor, sole proprietor, officer, director, or partner of another entity, or will be compensated, or reasonably expects to be compensated, by another entity in connection with any business activity outside the scope of such individual's relationship with the broker-dealer. Passive investments and activities subject to NASD Rule 3040 (i.e., the private securities transaction rule) are exempt from the requirements under FINRA Rule 3270.

[7] For the entire release, please refer to: http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=1730&element_id=1489&highlight=94-44#r1730.

[8] For additional information, please refer to: www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p013792.pdf.

[9] See NTM 94-44.

[10] In contrast, RIAs registered with the SEC and some states must have certain written policies and procedures to prevent the circumvention of federal securities laws. Note, however, that these written policies and procedures are not required to be written *supervisory* procedures [emphasis added].

[11] Whether the primary place of business for an IA/RR is considered a branch or an unregistered location can vary. The LOU generally provides information as to whether the IA/RR would be considered part of a branch or non-branch office location, and can provide insight into what to expect as far as on-site inspections. Typically, branch offices are inspected with greater frequency than non-branch office locations.

[12] To view the Model Privacy Form, visit www.sec.gov/news/press/2009/2009-248.htm.

[13] Effective September 13, 2010, the SEC adopted the "Pay to Play Rule," which prohibits investment advisors from providing paid advisory services to a government client for two years after the advisor or certain of its executives or employees make a contribution to certain elected officials or candidates. See www.sec.gov/rules/final/2010/ia-3043.pdf.

[14] Importantly, regardless of whether the IBD may look at the RIA's activities, the SEC and/or applicable state securities regulatory authorities will ultimately hold the RIA responsible for any violation of its securities laws and regulations regardless of any relationship with or review from a broker-dealer.