

5 Questions...

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5 Questions seeks out experts in their respective fields to answer...well, five questions on topics of importance to securities industry professionals in the fields of compliance and regulation...



Getting Started as an RIA

1) How much time will compliance take up in my new business?

Certainly, compliance is very important as the RIA is subjected to a general fiduciary duty. Unlike the broker-dealer environment, however, compliance in the investment adviser world is (so far, anyway) principle-based, and not rule-based. This means you can gear your compliance regime to fit the needs of your clients, and not some investment banking desk far from your office. Generally speaking, you may find there are fewer day to day compliance tasks, but more intensive periodic reviews of activity. For example, a one or two person shop might not need to review trades daily for client accounts to assure they meet objectives, but might undertake a review on a quarterly basis for that purpose. A simple business, with one or two people providing investment advice to a limited number of clients might find that compliance tasks take up less than 10 hours a week normally and a longer period of time at quarter end. A somewhat larger and more complicated business will require more time, though automation and outside support can reduce the amount of time you will need to take away from your core business.

2) What licenses do I need to conduct business and who will hold them?

Each state has different requirements for the people who actually provide investment advice (known as investment adviser representatives). Some will accept a Series 7, some a Series 65, and others a Series 66, while still others may give credit so long as the individual has certain professional qualifications, such as a CFP. If your firm will be conducting futures or commodities business, the firm may need to be registered as a commodities pool operator and individuals may need a Series 3 registration. An investment adviser firm can sponsor an IAR and hold the Series 65, while a broker-dealer is generally required to hold the Series 7, 66 and any other licenses you may have (for example, the Series 24 (principal's license), the Series 4 (registered options principal), etc. A Series 7 is not generally required so long as the investment adviser representative will not be receiving transaction-based compensation, and the other trading and principal's license are not required to do business as an RIA. *Continued on page 2*

Our guest: Maria McGarry Special Partner The Sutro Group LLC

Maria McGarry, a noted expert in hedge fund and '40 Act compliance, recently joined The Sutro Group as a Special Partner. Based in Philadelphia, her most recent experience was as General Counsel and Chief Compliance Officer of an investment adviser to a hedge fund where she spearheaded the registration process and developed, implemented and enforced the firm's compliance procedures. We are privileged to have her as this edition's special guest...

5 Questions: Getting Started as an RIA (cont.)

3) Will I (or my employees) be able to trade for their own accounts?

Subject to general fiduciary duties, the securities laws, company policy and/or your preferences, yes. All registered investment advisers are required to have a Code of Ethics which sets forth, among other things, the adviser's policy on personal trading. Some advisers prefer to prevent it entirely in order to reduce potential conflicts, while others will permit it only if trades have been pre-cleared by the Chief Compliance Officer. Your Code of Ethics should be designed to prevent all advisory personnel from advantaging themselves, or appearing to advantage themselves, at the expense of the clients, so if you determine to permit personal trading, at a minimum you should consider limiting the timeframes in which personnel may invest, as well as considering whether to permit personnel to invest in the same securities recommended for your client portfolios. Under no circumstances, though, will you be permitted to trade between client accounts and those in which you have a significant beneficial interest (generally greater than 25%).

4) Can I just start a hedge fund, have my current clients invest in that entity and not register?

That's not impossible, but it is increasingly unlikely as recent turmoil makes unregistered financial entities of any sort less palatable to regulators. In order to avoid registration as investment companies under the Investment Company Act of 1940, hedge funds have to meet a number of requirements. Typically, your hedge fund won't qualify for those exemptions unless your entire clientele is limited to one state, or all are wealthy and sophisticated investors. If your client base fits the statutory

descriptions, you could, theoretically, just create a single portfolio in which they would invest and that entity itself might not have to register. But the law is changing quickly here, and it's very likely that all hedge funds will have to register under the 1940 Act.

5) How much will compliance cost me?

Whatever the number, it's less than what it will cost if you fail to do it correctly. The good news is that the filing fees for required filings tend to be modest, in the neighborhood of a few hundred dollars annually. The amount varies depending on how many states you are required to register and how many IARs you will be required to license.

As for the cost of personnel and systems, the SEC has been careful to date not to specify a required compliance model, though it does require you to name a Chief Compliance Officer, who can have other duties. Whether you hire someone to do the job full-time, or assign the title to a principal with other duties and then delegate some tasks outside is up to you. Salaries and consultant costs vary from region to region and firm to firm. If you use a consultant or outside

*For a more detailed analysis of
RIA registration issues, please go
to:*

www.thesutrogroup.blogspot.com

counsel to help customize your Compliance Manual, your Code of Ethics and the procedures you'll need to implement them, you will have a better idea of just how much will need to get done and how best to allocate resources to those tasks.



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To Our Colleagues:

Compliance professionals are being challenged by one of the most tumultuous periods in the history of the financial markets: the Societe Generale trading scandal, the demise of Bear Stearns and Lehman Bros., continuing fallout from the credit crunch (including the acquisition of Merrill Lynch by B of A and the conversion of Morgan Stanley and Goldman Sachs into Bank Holding Companies), a volatile stock market and very active rule making by the SEC (i.e. re-establishing the uptick rule, forthcoming regs on privacy, hedge fund registration etc.). In 5 Questions, we'll highlight important issues and offer practical advice that will help legal and compliance professionals meet the challenges of today's complex regulatory environment. We look forward to working with you...

The Sutro Group: News and Notes

- **The Sutro Group has been selected as a preferred provider of compliance and regulatory services for Pershing LLC's introducing broker-dealer and independent registered investment advisor customers. To learn more, please go to the News and Events section of our website at www.thesutrogroup.com...**
- **The Sutro Group Blog features our analysis of the most important regulatory and compliance issues effecting the securities industry. To access, please go to www.thesutrogroup.blogspot.com...**
- **Maria McGarry, a noted expert in hedge fund and '40 Act compliance, joins The Sutro Group as a Special Partner. To learn more, please go to The Sutro Team section of our website at www.thesutrogroup.com...**

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