



**INVESTMENT LAW GROUP**  
OF DAVIS GILLETT MOTTERN & SIMS LLC

**Establishing an RIA:  
*Key Business and Regulatory Issues***



## *Today's Presentation*

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### **Objectives**

- I. Discuss purpose and benefits of forming a registered investment adviser
- II. Outline considerations for departing brokers
- III. Review choice of entity alternatives and key partnership agreement issues
- IV. Discuss ideas for branding and marketing your investment advisory firm
- V. Develop an understanding of the registration process & Form ADV
- VI. Discuss key compliance issues and the development of a compliance program



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## **Counsel to the Investment Management Industry**

Since the mid-1980s, our attorneys have provided legal advice to registered and exempt investment advisers, hedge fund managers, commodity pool operators, private equity fund managers and other financial industry participants with respect to their businesses. Our client's range in size from start-ups to large investment management organizations. The firm regularly advises asset managers with respect to regulatory compliance matters, enforcement matters, legal disputes, investment transactions, corporate transactions and employment, ownership and compensation arrangements, as well as day-to-day legal and compliance issues.

We are intimately familiar with the investment management industry. Our attorneys and compliance professionals include experienced practitioners, former regulators, and former in house counsel and compliance personnel who provide practical advice and guidance on regulatory and compliance matters, ranging from routine trading issues and regulatory examinations to enforcement proceedings.

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## Today's Speaker:

### **Brent S. Gillett, Esq.**

Mr. Gillett counsels clients on a wide variety of regulatory and compliance matters, including preparing and reviewing registration statements, disclosure documents, advisory contracts, codes of ethics, and providing advice on issues such as trading practices, soft dollars, performance advertising and ERISA. He also focuses his practice on legal and compliance matters for commodity trading advisers and commodity pool operators, hedge funds, fund of funds and other types private fund entities, including fund formation and structuring matters for funds organized both in the United States and abroad. In addition, he has represented clients in regulatory investigations, inquiries and examinations before the SEC, NFA, CFTC , and FINRA.

Mr. Gillett previously practiced law at Kilpatrick Townsend, LLP in the firm's investment management practice group. He received his Juris Doctorate from Vanderbilt School of Law in 1995 and his Bachelor of Arts from Duke University in 1991. Mr. Gillett was admitted to the State Bar of Georgia in 1995.



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## Today's Speaker:

### Thomas Hertog

Thomas has worked in the securities, financial services and professional services industries for 25 years. He served as a Chief Financial Officer (CFO) and Chief Compliance Officer (CCO) of a multi-billion dollar investment management, investment research and broker-dealer entity. He has provided leadership and guidance for registered investment advisors, mutual funds, hedge funds and private capital funds. Thomas has passed the FINRA series 7, 24, 28, 55, 66 and 87 exams and is well-versed in compliance matters affecting broker-dealers and their operations. He is also the author of the FINRA series 99 exam Operations Professional textbook.

Prior to serving as CCO he worked for the largest Big 5 accounting and consulting firm where he managed a unit of the Global Best Practices group which provided client solutions to engagement teams serving tax, advisory, assurance and consulting concerns around the world. Most recently he has worked with small to mid-size investment advisors and broker-dealers, assisting them with matters related to the formation and registration of their firms and responding to examination deficiencies from SEC or state regulatory audits. Thomas has helped clients to create and implement compliance programs, develop a framework to operationalize policies and procedures and foster a culture of compliance throughout the organization.



## **Investment Advisers**

- Section 202(a)(11) of the Advisers Act generally defines an "investment adviser" as any person or firm that: (1) for compensation; (2) is engaged in the business of; (3) providing advice, making recommendations, issuing reports, or furnishing analyses on securities, either directly or through publications. A person or firm must satisfy all three elements to be regulated under the Advisers Act.
- Provide ongoing management of investments based on the client's objectives
- Clients typically provide the adviser with the discretion and authority to make investment decisions on the client's behalf
- Regulated by either the SEC or state security regulatory depending on the amount of assets under management



## *RIA Market Segmentation*

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### **Wealth Managers**

Deliver advanced financial planning to high net worth individuals, including investment management, estate planning, tax management

### **Money Managers**

Perform active trading and asset management for high net worth and institutional clients

### **Multi Family Offices**

Offer comprehensive investment, wealth, and lifestyle management services for ultra high net worth, multigenerational families with \$10 million or more in assets

### **Financial Planners**

Provide comprehensive planning that includes income planning, estate planning, college planning but do not necessarily oversee investments or otherwise implement the plans they create



## *Motivations for Brokers to become RIAs*

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### **A number of factors continue to drive a large-scale movement of financial advisors to independent channels**

- Desire to provide more personalized services
- Greater long-term financial success (especially given the current trend in payout / commission reductions)
- Autonomy to decide when and who to hire
- Working for oneself
- Ability to charge only asset based fees and align interests with those of the client
- Access to a broader selection of financial products through an increasingly open-architecture
- Availability of hybrid RIA / B-D option
- Ability to start a private investment fund





## *Key Considerations for Brokers*

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### **Steps and considerations for the departing broker**

- Investigate any non-compete / non-solicit agreement you may have with a former employer or firm
- Carefully review all compensation and benefits agreements
- Consider the legal implications of discussing your transition plans with your current clients
- Consider timing issues – it may take months to complete the registration process
- Understand the implications of transitioning from commissions to a fee-based business (e.g., dealing with trailer fees and annuities, your current licenses, etc.)
- Determine whether a hybrid RIA / B-D structure is appropriate
- Consider your clients' portfolios that are invested in proprietary securities, and the tax or liquidation expense implications
- Understand your firm's disassociation protocol and don't discuss your plans in or around your office – you never know who may be listening



## **Choice of Entity Considerations**

- Sole Proprietorship
- General Partnership
- Corporation
- S-Corp
- Limited Liability Company

## **Utilizing an Entity Structure has a Number of Benefits**

- Provide greater protection of personal assets
- Separate personal and business information in the event of an audit
- Potential for sophisticated strategies to reduce taxes
- Ability to develop employee stock ownership plans
- Better succession planning options
- Provides legitimacy in the eyes of prospective clients



## *Developing a Partnership Agreement*

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**Your agreement with your partners should address the following issues:**

- Initial capitalization
- Financial and ownership terms
- Allocation of profits and losses
- Management and voting rights
- Fiduciary duties:
  - Non-competes; non-solicitation agreements
  - Duty of loyalty; duty of disclosure
  - Confidentiality agreements
- Dispute resolution mechanisms
- Buyout of buy-sell provisions



## ***Challenges in Developing a Successful RIA***



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|                  |   |
|------------------|---|
| <b>Time</b>      | Finding time to do it all: client service, business development, management, compliance, operations   |
| <b>Staffing</b>  | Hiring and retaining the right employees at the right time; making the correct outsourcing decision   |
| <b>Marketing</b> | Most small and mid-sized RIAs don't have dedicated marketing staff and are not marketing experts  |
| <b>Capital</b>   | Many RIAs are unable to expand due to budgetary concerns  |
| <b>Branding</b>  | Lack of branding makes it difficult to attract new clients. Your messaging must immediately communicate credibility, trustworthiness and high-touch service                         |
| <b>Process</b>   | As your firm grows, it becomes increasingly critical to develop disciplined processes to set a path for growth, implement best practices and assign accountability to key personnel |



## *Start-Up Cost Checklist*

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### **Consider Initial and Ongoing Costs**

- Salaries, benefits, payroll taxes
- Legal
  - Registration
  - Partnership agreements
  - Separation issues with employer
- State registration fees
- Insurance (general liability, E&O, health)
- Office furniture, art, etc.
- Marketing
  - Collateral materials
  - Website
- Office equipment (computers, telecom, network, server, data backup, IT services)
- Software (Quickbooks, CRM systems, portfolio management software, MS Office)
- Develop a pro-forma to model recurring costs (rent, internet, postage, telecom, compliance, accounting, etc.)



## *RIA Fee Structures*

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### **RIAs can utilize a variety of fee structures**

- Percentage of assets under management
  - Provides the opportunity to tie your compensation directly to the growth of your clients' assets
  - Enables you to establish breakpoints, which can encourage clients to concentrate assets with you
- Performance fees
  - Can significantly increase compensation potential
  - Potential to align your interests with those of your clients
  - Subject to state-specific rules
  - SEC-registered RIAs may only charge performance fees to “qualified clients”
- Flat-rate
- Hourly



## *Developing a Marketing Plan*

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### **“How Do You Plan to Go To Market?”**

- Define your targeted client market
  - Institutional investors
  - Retail
    - All retail investors
    - Mass affluent (individuals with at least \$500,000 in investable assets)
    - High net worth (individuals with at least \$1 million in investable assets)
    - Ultra high net worth (individuals with at least \$20 million in investable assets)
    - Family offices
  - Other RIAs through a sub-adviser structure
  - Hedge funds
  - Mutual funds



## *Developing a Marketing Plan*

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- Determine the types of services that you want to provide your clients
  - Financial planning (may involve use of insurance products)
  - Direct money management (using in-house security selection)
  - Manager of managers
  - Sub-adviser structure
  
- To effectively focus your business activities, clearly define the types of clients you want to work with now and in the future based on relevant factors such as:
  - Investment objectives
  - Minimum required investment
  - Age and geographic location
  - Service requirements





## *Developing a Marketing Plan*

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- Marketing strategies / materials:
  - Seminars
  - Brochures
  - Direct mailing
  - Website
  - Blogs & other forms of social media (Linked-in, Facebook, etc.)
- Ensure that any advertising materials with performance data are reviewed by a compliance professional and properly disclaimed
- Develop a “theme” for all communications and control your messaging
- If your investment strategies will be marketed by registered representatives or investment advisor representatives, you will need to provide those individuals with materials that clearly explain how you manage assets, what clients should expect, and what you expect of clients.



## *State versus SEC Registration*

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- State RIA registration
  - Assets under management are less than \$100 million
  - North American Securities Administrators Association (“NASAA”)
  - FINRA administers IARD system but does not regulate RIAs
- SEC RIA registration
  - Assets under management are greater than \$100 million
  - Assets under management of \$25 million or more and principal place of business is in a state where either:
    - Firm is not required to register as an investment adviser
    - Firm is required to register but is not subject to examination by the state regulator
  - Securities and Exchange Commission ([www.sec.gov](http://www.sec.gov))



## *SEC/Federal-Level RIA Registration*

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### **Advisers with \$100 Million or More in Assets Under Management Must File Form ADV and Brochure Documents with the SEC for Initial Registration**

- Typically “break-away” brokers or advisers from existing firms who bring client assets
- RIAs that adviser funds with assets of more than \$150 million in private funds must file Form PF
- RIAs are subject to periodic examinations by the SEC
- RIAs must submit annual and “other than annual” updates to Form ADV
- No investment adviser representative (IAR) registration at Federal level but States still maintain jurisdiction over IARs



## *State-Level RIA Registration*

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- Exemption
  - Most states do not require RIA registration if the adviser has less than 5 clients in that state
  - Private Fund Adviser exemption available in some states
- Advisers with a place of business or 5 or more clients in a state must register with that state as well as maintain a full and complete compliance program
- State regulators closely scrutinize the initial Form ADV application
- Potential for RIA examination by a state regulator within the first year of registration
- Need to register certain employees of investment adviser as “investment adviser representatives”



## **Investment Adviser Representative Registration**

- Any individual employed by or associate with an investment adviser or federal covered investment adviser and who:
  - Makes any recommendations or otherwise gives investment advice regarding securities
  - Manages accounts or portfolios of clients
  - Determines which recommendation or advice regarding securities should be given
  - Provides investment advice or holds himself or herself out as providing investment advice
  - Receives compensation to solicit, offer, or negotiate for the sale of or for selling investment advice
  - Supervises employees who perform any of the foregoing



## *State-Level RIA Registration*

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### **Additional Documents Required to be Filed with Form ADV by Certain States:**

- Qualifications of firm principals
- Fingerprint cards and background check
- Compliance manual, code of ethics, disclosure of reporting page per Form U-4
- Privacy policy
- Advertising and promotional materials
- Books and records location



## *Preparing Form ADV*

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### **Critical Element in Registration as an SEC or State-Regulated RIA Firm**

➤ Key Components:

- Firm information – address, principals, hours of operation, website
- Legal form of RIA – sole proprietorship, partnership, corporation
- Information about advisory business – advisory services provided, employees, types of clients, fees charged, assets under management
- Types of Investments made
- Conflicts of Interest - financial industry affiliations
- Custody of client assets
- Control persons – officers, directors, direct owners and indirect owners
- Disclosure reporting



## *Preparing Form ADV*

### **Form ADV, Part 2A, Commonly referred to as the “Brochure,” Provides Clients with an Adviser’s Qualifications, Investment Strategies, and Business Practices**

- Advisory business description
- Types of fees charged and compensation
- Types of clients; types of investments made by the adviser
- Methods of analysis, investment strategies, risk of loss
- Disciplinary information
- Other financial industry affiliations and activities
- Code of ethics, participation or interest in client transactions
- Personal trading
- Brokerage practices
- Review of accounts
- Client referrals and other compensation
- Custody
- Investment or brokerage discretion
- Proxy voting policies of the adviser
- Financial information





## *Common Registration Deficiencies*

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### **There is no uniform approach at the State level**

- Mismatched information between brochure and advisory agreements
- Failure to provide all required documentation
- Omit fee calculation details
- Improper material about the adviser on the internet
- Using acronyms “RIA” or “IAR”
- Failure to use state-specific language for performance fees
- Failure to use state-specific language for custody
- Failure to use specific language regarding delivery of reports to clients
- Failure to include disclosure about compliance with Gramm-Leach-Bliley Act
- Names on brochure supplement do not exactly match Form U-4
- Risk factors not specific to advisory business



## *Ongoing Filing Requirements*

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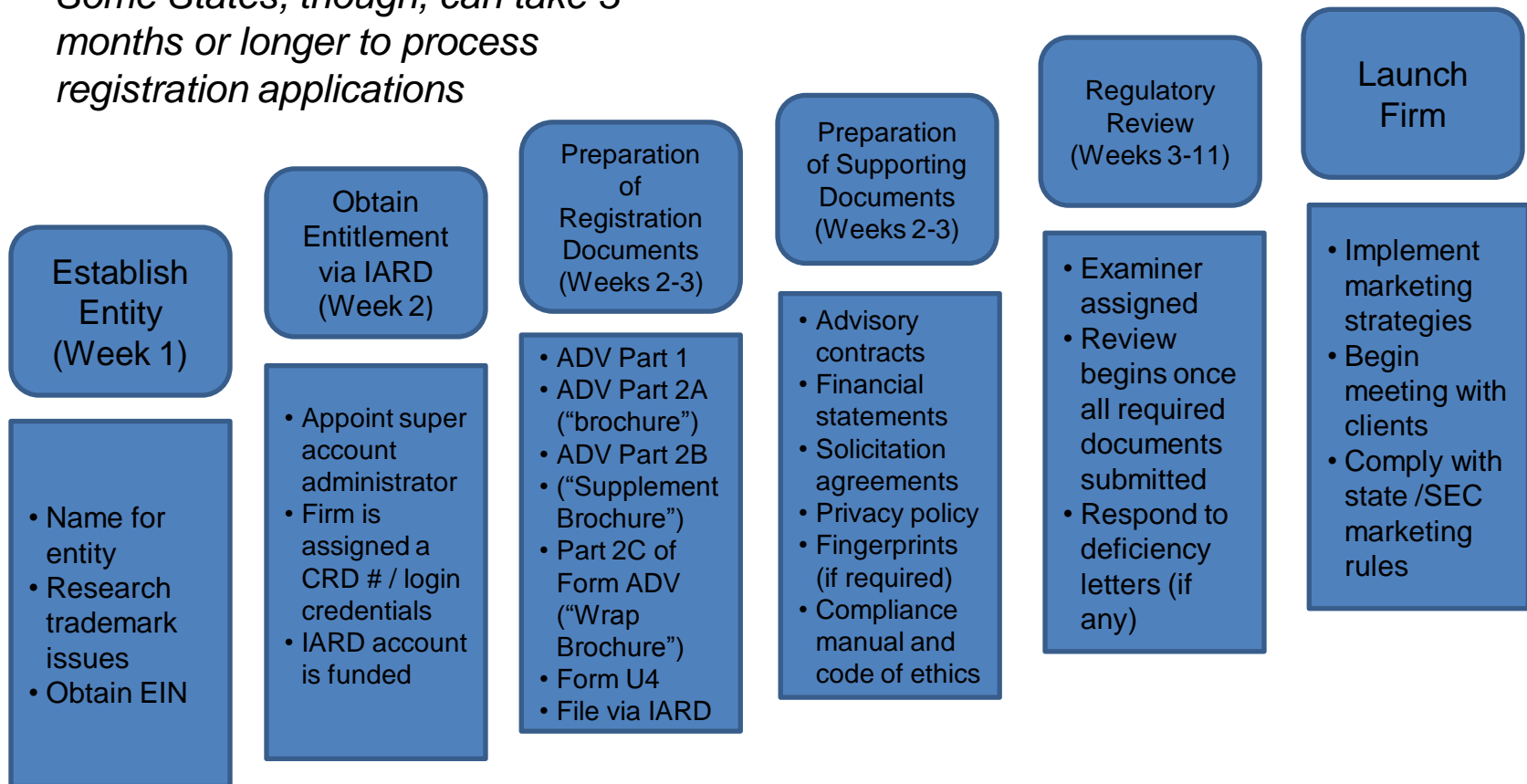
### **Annual Update Requirement for Form ADV**

- File Form ADV each year with any and all material changes since the last filing
- File via IARD online system by March 31<sup>st</sup> of each year
- SEC-registered RIAs must complete an annual Rule 206(4)-7 compliance certification
- Annual reviews of compliance policies and procedures required in some states



## Registration Timeline

- *SEC registrations typically take 45 days or less.*
- *Some States, though, can take 3 months or longer to process registration applications*





## *State Regulator Activity*

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### **Recent Statistics:**

- NASAA has reported a 51% increase in state-regulated enforcement actions
- Out of 7,000 investigations conducted, 3,000 resulted in enforcement actions taken against RIAs
- Hot Button Issues:
  - Form ADV and brochure
  - Suitability
  - Books and records rule
  - Complaint file
  - Compliance manual
  - Written advisory agreements
  - Advertising and performance claims
  - Custody rule compliance
  - Financial statements



## *Preparing for an SEC / State Examination*

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### **Types of Examinations**

- Routine
- For cause
- Sweep

### **Best Ways to Prepare**

- Ensure compliance program and its implementation are proper
- Stage a mock examination
- Review and strengthen the compliance culture of senior management
- Address previously noted deficiencies
- Disciplined recordkeeping
- Focus your compliance program through a thorough risk assessment



## *Elements of a Compliance Program*

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### **Compliance is an Ongoing Process, Not a “One-Time Destination”**

- Customized compliance procedures
- Annually review and revise policies and procedures
- Appoint a qualified Chief Compliance Officer
- Maintain Form ADV Parts 1 and 2
- Maintain books and records (SEC Rule 204-2)
- Register and maintain filings for IARs
- Foster a “culture of compliance” throughout the RIA
- Review and approval of marketing materials (SEC Rule 206(4)-1)
- Privacy policy and RIA handling of customer information
- Solicitor agreements
- Outside business activities

***For More Information***



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# **Investment Law Group**

**of Davis Gillett Mottern & Sims LLC**

**Brent S. Gillett, Esq.**

**Managing Partner**

**+1 (404) 607-6940**

**[bgillett@investmentlawgroup.com](mailto:bgillett@investmentlawgroup.com)**

**Atlanta**

**New York**

**Los Angeles**

**San Francisco**

**[www.investmentlawgroup.com](http://www.investmentlawgroup.com)**



Interactive Brokers has a complete turnkey solution for *Advisors* that provides trading, clearing, and reporting capability for advisors of all sizes



IB Advisor accounts let Professional Registered Investment Advisors (RIAs) and Commodity Trading Advisors (CTAs) execute and allocate trades among multiple clients from a single order management interface.





# Advisors Enjoy these Benefits

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- Automate multi-client [trade allocations](#) and [portfolio rebalancing](#).
- Create professional, client-ready performance presentations with [PortfolioAnalyst](#).
- [White Brand](#) statements, customer registration and other informational materials with your own organization's identity.
- Advisors can provide clients with the ability to directly fund, view statements and trade.



# Key Features

- **Model Portfolios** – offer Advisors an efficient, organized approach to investing client assets. Simplify the tasks of managing and investing multiple client accounts by creating groupings of instruments based on specific investment themes
- **Allocation Features** – Professional Advisors can use Pre-Trade Allocations to allocate block trades with a single mouse click to multiple client accounts.
- **Stock Yield Enhancement** – extra yield on fully-paid stocks by allowing IB to borrow shares in exchange for cash collateral. IB will lend the shares to traders who want to sell short and are willing to pay a fee to borrow them. Each day that your stock is on loan, you will be paid a loan fee based on market rates.
- **Financing Tiers** – low cost and best execution - Rated Low Cost Broker for 9 years in a row by Barron's.



# Risk Management

Our sophisticated [risk-assessment technology](#) helps you manage your risk in dynamic markets.



## **Risk Navigator<sup>SM</sup>**

A real-time market-risk management platform provides a measure of risk exposure across multiple asset classes.



## **Credit Manager**

Advanced risk management technology working behind the scenes to manage risk and enforce credit-related regulations.



## **Real Time Activity Monitor**

lets you monitor every aspect of your account activity, including the values used in IB's margin calculations.



# IB Money Manager Marketplace



IB's Money Manager Marketplace is the first electronic forum designed to connect Wealth Manager & Money Manager Advisors:

Where Advisors can focus on marketing and gathering customer assets while taking advantage of specific trading expertise of registered Money Managers



## Strength and Security Facts about Interactive Brokers Group

- On a consolidated basis, Interactive Brokers Group (IBG) exceeds \$4.8 billion in equity capital.
- IBG has reported solidly positive earnings for the past 18 consecutive years.
- IBG holds no material positions in over-the-counter securities or derivatives.
- IBG holds no CDOs, MBS or CDS.
- The gross amount of IBG's portfolio of debt securities, with the exception of U.S. government securities, is less than 10% of our equity capital.
- Interactive Brokers LLC is rated 'A-/A-2'; Outlook Stable by Standard & Poor's.
- Interactive Brokers LLC's Real-Time Margin system continuously enforces trading limits



## Contact Information

William L. Katts

(203) 554-6709

[wkatts@interactivebrokers.com](mailto:wkatts@interactivebrokers.com)

**Interactive Brokers Corp.**

8 Greenwich Office Park

Greenwich, CT 06831