# Chapter 49C

# Offering Cross-Border Advisory Services to Non-U.S. Clients

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## § 49C:1 Introduction

In the last decade, while internationalization has swept the investment management industry, the global regulation of investment advisers has not kept pace. U.S. investment advisers seeking to offer advisory services on a cross border basis, either directly to non-U.S. clients in the form of managed or private accounts, or indirectly in the form of investment funds, face special challenges and complexities that are often dictated by a maze of antiquated regulation. For U.S.-based firms, any involvement in the marketing, management, or distribution of investment products to non-U.S. clients will require an evaluation of a number of legal considerations arising under both U.S. law as well as the laws of the jurisdiction of the client's residence or domicile.

Whether a local or national regulator will assert jurisdiction over a U.S. adviser providing advisory services on a cross-border basis from the United States to a resident or entity domiciled in a foreign jurisdiction is a facts-and-circumstances analysis. This chapter will examine the key considerations for U.S.-based registered investment advisers that wish to market and provide cross-border advisory services to non-U.S. clients.

## § 49C:2 Scope of the Investment Advisers Act

### *§ 49C:2.1 Definition of Investment Adviser*

Section 203(a) of the Investment Advisers Act of 1940, as amended (the "Investment Advisers Act") generally provides that it is unlawful for an investment adviser to engage in the business of advising *others* without registering under the Investment Advisers Act, unless an exemption is available.[1] Section 202(a)(11) of the Investment Advisers Act defines the term "investment adviser" to mean:

> "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities."[2]

While each element of the definition of the term investment adviser is described in greater detail in chapter 2, it is important to note the broadness of the definition. The definition of the term "investment adviser" covers both U.S. and non-U.S. based advisers,[3] as well as registered and unregistered entities.[4] It is also important to note

1. *See* 15 U.S.C. § 80b-3 (2011).
2. *See* 15 U.S.C. § 80b-2(a)(11) (2011).
3. *See* In the Matter of Banco Espirito Santo S.A., Investment Advisers Act Release No. 3304 (Oct. 24, 2011).
4. *See* Jane A. Kanter & Steve S. Drachman, *Regulation of Investment Advisers, in* Regulation for Asset Managers Outside the United States 2 (Sweet & Maxwell ed. 2008) [hereinafter Kanter & Drachman] (discussing the breadth of the definition of investment adviser).

that the definition does not make a distinction between the terms "manager," "management company," and "investment adviser" as is the case in many non-U.S. jurisdictions.[5] In addition, the term "investment adviser" applies to both discretionary and non-discretionary investment activities.[6] Finally, the Investment Advisers Act has broad application not only to the relationship between an adviser and its U.S. clients, but also to the relationship between and adviser and its non-U.S. clients as well.[7] The extent to which the Investment Advisers Act governs the relationship between an adviser and its client will often be determined by the principle place of business of the investment adviser, its use of U.S. interstate commerce and its registration status with the U.S. Securities and Exchange Commission (SEC).[8]

## *§ 49C:2.2 Statutory Reach to Non-U.S. Clients*

### [A] Overview

The language of the Investment Advisers Act does not "contain explicit territorial restrictions, except that a number of provisions require the use of jurisdictional means to establish a violation."[9] The SEC, through rulemaking and interpretation, has sought to balance the literal extraterritorial application of the provisions of the Investment Advisers Act over time with the practical realities of internationalization.[10]

Historically, the SEC took the position that, once registered, domestic *or* foreign advisers were generally subject to all of the

5. *See* Kanter & Drachman, *supra* note 4; *cf.* CLAUDE KREMER & ISABELLE LEBBE, COLLECTIVE INVESTMENT SCHEMES IN LUXEMBOURG (Oxford Univ. Press 2009) (discussing the organization, authorization, and responsibilities of a management company).
6. *See* Kanter & Drachman, *supra* note 4.
7. The Investment Advisers Act is silent regarding whether the term "others" refers only to U.S. clients. The SEC takes the position that a U.S. entity providing advice to non-U.S. persons would be subject to the Investment Advisers Act. *See* Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services, Investment Advisers Act Release No. 1092 (Oct. 16, 1987) [hereinafter Release 1092].
8. *See* SEC, Division of Investment Management Report, Protecting Investors: A Half Century of Investment Company Regulation (1992) [hereinafter 1992 Report], at 223 (noting that domestic advisers and foreign advisers are treated differently in many respects under the Investment Advisers Act, including in both the registration context as well as the application of the substantive provisions of the Investment Advisers Act with respect to the relationship between the adviser and its clients).
9. *See id.* at 223.
10. *See id.* at 227.

substantive provisions of the Investment Advisers Act with respect to both their U.S. and non-U.S. clients.[11] This position, which poses a number of practical difficulties, is no longer the view held by the SEC.[12]

### [B] Regulation of Registered Non-U.S. Advisers

A registered, non-U.S. adviser must comply with the substantive provisions of the Investment Advisers Act with respect to the firm's clients who are U.S. persons.[13] However, the Investment Advisers Act does not apply in its entirety to a registered, non-U.S. adviser's management of its non-U.S. clients.[14] In fact, "most of the substantive provisions of the Investment Advisers Act are not applied to the non-U.S. clients of a non-U.S. adviser registered with the Commission."[15] This current position of the SEC staff is very different from the requirements applicable to U.S.-domiciled registered investment advisers that generally require such an adviser comply with all of the provisions of the Investment Advisers Act with respect to its non-U.S. clients.

### [C] Regulation of Registered U.S. Advisers

Unlike investment advisers that are not domiciled in the United States, a registered investment adviser with its principle place of business in the United States must comply with the substantive provisions of the Investment Advisers Act with respect to all clients,

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11. *See* Reavis & McGrath, SEC No-Action Letter (Oct. 29, 1986); *see also* Gim-Seong Seow, SEC No-Action Letter (pub. avail. Nov. 30, 1987); *see also* 1992 Report, *supra* note 8, at 224 (noting that this position was similar to the position the Commission has taken with regard to broker-dealers registered under the Securities Exchange Act of 1934—*i.e.*, once a broker-dealer is registered, it is subject to the full panoply of U.S. broker-dealer regulations).
12. *See* Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, Investment Advisers Act Release No. 3222 (June 22, 2011) [hereinafter 2011 Exemptions Release]; *see also* American Bar Association, SEC Interpretive Letter (Jan. 18, 2012) [hereinafter 2012 ABA Letter].
13. *See* JOHN O'HANLON, REGULATION OF INVESTMENT ADVISERS: COMPLIANCE REQUIREMENTS, REGULATION FOR ASSET MANAGERS OUTSIDE THE UNITED STATES, at 29, 30 (Sweet & Maxwell ed. 2008) [hereinafter O'Hanlon].
14. *See* 2012 ABA Letter, *supra* note 12 (noting that most of the substantive provisions of the Investment Advisers Act are not applied to the non-U.S. clients of a non-U.S. adviser registered with the SEC, but non-U.S. advisers registered with the SEC must comply with the Investment Advisers Act and the SEC's rules thereunder with respect to any U.S. clients (and any prospective U.S. clients) that they may have).
15. *Id.*

including non-U.S. clients.[16] A "place of business" is generally defined as: (i) the office at which the adviser regularly provides investment advisory services or communicates with its clients; and (ii) any other location that is *held out* to the general public as a location at which the adviser provides investment advisory services or communicates with clients.[17] The concept of "holding out" is a concept of voluntary action based on a number of factors.[18] Generally, the SEC staff views an entity as holding itself out as an adviser if (among other things): (i) it advertises itself as an investment adviser or financial planner; (ii) uses letterhead indicating activity as an investment adviser; (iii) maintains a telephone listing or otherwise makes it known that the entity will accept new advisory clients; or (iv) it hires a person to solicit clients on its behalf.[19]

As a result, U.S. registered advisers that market and provide services to non-U.S. clients must be aware of the jurisdictional reach of the Investment Advisers Act with respect to their non-U.S. clients, including with respect to many of the Investment Advisers Act's client relationship rules discussed below.

## § 49C:3 Key Investment Advisers Act Considerations for U.S. Based Advisers When Dealing with Non-U.S. Clients

### *§ 49C:3.1 Overview*

Unlike the laws of many non-U.S. jurisdictions, the Investment Advisers Act does not require minimum requisite experience for investment advisers.[20] U.S. registered investment advisers do owe, however, a fiduciary duty to all of their clients (including their non-U.S. clients), and are required to comply with certain substantive client relation rules, as well as the general anti-fraud rules of the Investment Advisers Act.

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16. *See* 2011 Exemptions Release, *supra* note 12; *see also* 2012 ABA Letter, *supra* note 12; *see also* O'Hanlon, *supra* note 13.
17. *See* Rule 222-1(a) under the Investment Advisers Act, 15 U.S.C. §§ 80b *et seq.* (2011); *see also* 2011 Exemptions Release, *supra* note 12.
18. *See* 2011 Exemptions Release, *supra* note 12; *see also, e.g.*, Brighton Pacific Realty Asset Mgmt. Co., SEC No-Action Letter (Feb. 10, 1992); Weiss, Barton Asset. Mgmt., SEC No-Action Letter (Mar. 12, 1981); Frank T. Hines, SEC No-Action Letter (Nov. 19, 1972).
19. *See* SEC Staff Bulletin No. 11, Applicability of the Advisers Act to Financial Advisers of Municipal Securities Issuers (Sept. 19. 2000); *see also, e.g.*, William Bloor, SEC No-Action Letter (Feb. 15, 1980); Richard J. Shaker, SEC No-Action Letter (Aug. 1, 1977); Al O'Brien, SEC No-Action Letter (Oct. 6, 1973).
20. *See* Amendments to Form ADV, Investment Advisers Act Release No. 2711 (Mar. 3, 2008).

## § 49C:3.2 General Anti-Fraud Considerations

### [A] Direct Advisory Services

Section 206 of the Investment Advisers Act is a general "anti-fraud" provision under which numerous activities of investment advisers are regulated. Section 206 provides that it shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly:

(1) to employ any device, scheme, or artifice to defraud any client or prospective client;

(2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

(3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. The prohibitions of this paragraph (3) shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction; or

(4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The SEC is authorized to adopt rules reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.[21]

As noted above, section 206 applies to all investment advisers and their relationship with both U.S. and non-U.S. clients. In addition, section 207 of the Investment Advisers Act further prohibits any willful misstatement or omission of material fact in any registration application or report filed with the SEC.[22] In marketing and providing services to non-U.S. clients, U.S. advisers should note that section 206 is broad enough to prohibit investment advisers from (1) making false or misleading statements to prospective or actual clients, including those for

21. *See* 15 U.S.C. § 80b-6 (2011).
22. 15 U.S.C. § 80b-7 (2011).

which advisory services are provided indirectly through pooled investment vehicles, or (2) otherwise defrauding those investors.[22.1]

### [B] Considerations for Pooled Vehicles

To the extent an investment adviser provides indirect advisory services to non-U.S. clients through a pooled investment vehicle (whether domiciled onshore or offshore), advisers should consider the implication of Rule 206(4)-8 of the Investment Adviser Act.

Rule 206(4)-8 prohibits registered (and certain unregistered) advisers to pooled investment vehicles from: (i) making false or misleading statements of material fact to current or prospective investors, or (ii) engaging in any other fraudulent conduct with respect to a fund's investors. It should be noted that Rule 206(4)-8 protects prospective investors in funds, and it is broad enough to prohibit misleading statements made in offering circulars or private placement memoranda.

The rule also prohibits, for example, materially false and misleading statements regarding investment strategies the pooled investment vehicle will pursue, the experience and credentials of the adviser and its associated persons, the risks associated with certain investments, the performance of the pool or other funds under advisement, the valuation of the pool or the investor accounts in the pool, and the practices the adviser follows, including how the adviser allocates investment opportunities.

## *§ 49C:3.3 Fiduciary Duty Owed to All Clients*

In addition to the general anti-fraud provisions of section 206 of the Investment Advisers Act, this section has been interpreted by the SEC and U.S. courts to impose a fiduciary duty on investment advisers with respect to all of their clients, including non-U.S. clients.[23] While this fiduciary duty is not specifically set forth in the Investment Advisers Act or in SEC rules, the duty cannot be negotiated or waived

22.1. *See* 15 U.S.C. § 80b-6 (2011).

23. *See* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191–92 (1962) (noting that the Investment Advisers Act reflects a congressional recognition of the delicate fiduciary nature of an investment advisory relationship as well as a congressional intent to eliminate, or at least to expose, all conflicts of interests that might incline an investment adviser—consciously or unconsciously—to render advice that was not disinterested); *see also* Transamerica Mortg. Advisors v. Lewis, 444 U.S. 11 (1979) (noting that the legislative history of the Investment Advisers Act leaves no doubt that Congress intended to impose enforceable fiduciary duties on advisers).

away by contract since the duty is imposed on an investment adviser with respect to all clients by operation of law due to the nature of the relationship between the parties.[24] There are a number of duties that a U.S.-based registered adviser owes to its clients, including non-U.S. clients, that stem from its fiduciary duty.

As a fiduciary, an investment adviser is required to act in good faith solely in the best interests of each of its clients, and to make full and fair disclosure of all material facts.[25] In light of this duty, an adviser is held to a higher standard than mere commercial transactions and is hereby obligated to (i) render disinterested and impartial advice; (ii) make suitable recommendations to clients in light of their needs and investment objectives; (iii) exercise a high degree of care in dealing with client transactions; and (iv) have an adequate basis for its recommendations.[26]

### § 49C:3.4 Disclosure Obligations

Sections 206(1) and (2) of the Investment Advisers Act have been interpreted to broadly require an investment adviser to disclose all material facts, particularly conflicts or potential conflicts of interest where the investment adviser's interests may not be aligned with those of its clients.[27] The Investment Advisers Act is designed to ensure that clients and prospective clients are educated and aware of existing conflicts before hiring the investment manager or seeking alternative advice.[28] These disclosure requirements apply equally to non-U.S. clients and U.S. clients.

An investment adviser is permitted to effect transactions in which it has a personal interest so long as appropriate disclosure has been made to clients (including non-U.S. clients). The adviser must continue to act at all times in the client's best interest and may not effect transactions that benefit the adviser to the detriment of the client. Even where full disclosure of a conflict has been made, it is possible that the SEC and its staff may view material conflicts of interest disclosures inadequate, and, therefore, any client consent based on such disclosure as inappropriate.

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24. *See* In the Matter of Arleen W. Hughes, Exchange Act Release No. 4048 (Feb. 18, 1948); *see also* Morris v. Wachovia Sec., Inc., 277 F. Supp. 2d 622 (E.D. Va. 2003) (noting that section 206(2) of the Investment Advisers Act establishes a fiduciary duty for investment advisers).
25. *See supra* note 22.
26. *See* O'Hanlon, *supra* note 13.
27. *See Capital Gains*, 375 U.S. 180.
28. In the Matter of Arleen W. Hughes, Exchange Act Release No. 4048.

U.S. advisers dealing with non-U.S. clients may also have additional disclosure requirements dictated by the laws of client's local jurisdiction, which may differ significantly from those enumerated by the Investment Advisers Act of the SEC. To the extent a non-U.S. jurisdiction has disclosure requirements that differ from the Investment Advisers Act, a U.S. adviser may be required to do a "gap-analysis" to ensure that non-U.S. clients are provided with mandated disclosures under both U.S. and non-U.S. laws. This is often the case with large European pension funds or regulated pooled products (for example, UCITS[29]) that require an adviser to pay close attention to the local jurisdiction requirements while complying with the requirements of the Investment Advisers Act.

From the perspective of the Investment Advisers Act, an investment adviser has the duty to disclose (among other things) the following to non-U.S. clients:

- the various capacities in which the adviser might act when dealing with any particular client, for example, in dealing with affiliated broker-dealers for the client's account, including any compensation the investment adviser would receive from the broker-dealer in connection with a transaction;
- if utilizing an affiliated broker-dealer, the client's ability to execute recommended transactions through other brokers or dealers;
- if the adviser is employed by a broker-dealer, whether the adviser's advisory activities are independent from the adviser's employment with the broker-dealer;
- any compensation received from the issuer of a security being recommended; and
- if charging a fee that exceeds industry norms, that comparable services may be available elsewhere at a lower fee.[29.1]

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29. UCITS (Undertaking for Collective Investment in Transferable Securities) generally refers to a European domiciled mutual fund formed or organized under the national law of a European Union member state that complies with EU Directive 2009/65, 2009 O.J. (EC), of the European Parliament and the Council of 13 July 2009 on the coordination of laws, regulations, and administrative provisions relating to undertakings for collective investment in transferable securities. Directive 2009/65 of the European Parliament and of the Council of 13 July 2009 on the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities (UCITS), 2009 O.J. (L 302).

29.1. 15 U.S.C. §§ 80b *et seq.* (2011).

These disclosures may be made generally in the adviser's Form ADV Part 2 or brochure, as discussed below, or in the investment management agreement (or, with respect to advisers to investment funds, in a fund's offering document).

## *§ 49C:3.5 Brochure Rule*

### [A] Overview

Rule 204-3 under the Investment Advisers Act ("Brochure Rule") requires that a registered adviser deliver to clients a plain English, narrative brochure containing the information required by Part 2A of Form ADV, as well as a brochure supplement containing the information required by Part 2B of Form ADV.[30] U.S. advisers must deliver this brochure to a client, including those clients located outside of the United States, before or at the time of entering into the advisory contract with such client. With respect to such clients, U.S. advisers must also annually either deliver (i) an updated brochure together with a summary of all material changes, or (ii) a summary of all material changes together with an offer to deliver the full updated brochure upon request.[31] Although the delivery of a brochure may satisfy an adviser's obligation under the Brochure Rule, compliance with the Brochure Rule does not guarantee that an adviser has satisfied its full disclosure obligations under the U.S. anti-fraud rules.[32]

Under the Brochure Rule, a U.S. adviser is not required to deliver a brochure or brochure supplement to any clients (both U.S. and non-U.S.) who receive only impersonal investment advice for which the adviser charges less than $500 per year.[33] With respect to those clients for which an adviser has an obligation to deliver a brochure and brochure supplement under the Brochure Rule, an adviser may satisfy this obligation through electronic delivery.[34] When the adviser is providing advisory services indirectly to non-U.S. clients through a

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30. Part 2A of Form ADV requires the inclusion of information about the adviser's business, conflicts of interest and disciplinary information (if any). Part 2B of Form ADV requires the inclusion of information about the supervised persons with responsibility for providing investment advice on behalf of the adviser. Any brochure (but not the brochure supplement) delivered to the client must also be filed with the SEC.
31. Investment Advisers Act Rule 204-3(b).
32. *See* Form ADV Part 2, n.3.
33. Investment Advisers Act Rule 204-3(c).
34. For a discussion regarding the Commission's guidance on the use of electronic media to fulfill investment adviser disclosure obligations, see Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information, Investment Advisers Act Release No. 1562 (May 9, 1996).

pooled product (for example, a UCITS), an adviser should comply with the Brochure Rule by providing a copy of the brochure to the board of directors or management company of the non-U.S. fund.

### [B] Form ADV Filing Requirements

Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), slightly changed the filing requirements for Form ADV for all registered advisers, including previously registered advisers.[35] A registered investment adviser must update Part 1 and Part 2 (comprised of a Brochure (Part 2A) and one or more brochure supplement(s) (Part (2B)) of its Form ADV on an annual basis, and file its Part 1 and brochure electronically on the SEC's publicly-accessible Investment Adviser Registration Depository (IARD) website within ninety days of its fiscal year-end. The Dodd-Frank Act also changed the format of the brochure considerably. The brochure is now a fully narrative document, and requires a discussion of performance-based fees, a description of investment strategies and related risks, a discussion of any disciplinary information relating to the adviser, a description of limits clients can place on the adviser's investment discretion, and a description of the adviser's proxy voting policies and procedures. In addition, the SEC amended Form ADV on June 22, 2011 to further expand the reporting information required of registered advisers by requiring public disclosure of information regarding: (i) the private funds they advise; (ii) their advisory business and related conflicts of interest; and (iii) their non-advisory activities and financial industry affiliations.[36] Further, each brochure supplement must be maintained in the adviser's records. Form ADV Part 1, the brochure, and the brochure supplement(s) must be promptly updated after any disclosure contained within becomes materially inaccurate.

### [C] Annual Delivery Requirements

The Dodd-Frank Act also imposed additional delivery requirements relating to these filings. A registered adviser's initial brochure must be delivered to all existing clients within sixty days after the adviser's registration becomes effective. In subsequent years, registered advisers must deliver to clients within 120 days of its fiscal year-end a summary of material changes to the brochure as compared to the

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35. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 1571 (July 21, 2010).

36. *See* Rules Implementing Amendments to the Investment Advisers Act of 1940, Release No. IA-3221 (June 22, 2011).

prior year, along with either (i) the updated brochure or (ii) an offer to provide the updated brochure upon request. Additionally, a brochure supplement must also be delivered to a new or prospective client at or before the time at which the relevant person begins providing advisory services to that client. Further, delivery of an updated brochure supplement is required when there is new disclosure of a disciplinary event or a material change to disciplinary information previously disclosed.

### § 49C:3.6 Fees

In connection with charging fees to non-U.S. clients for advisory services, an adviser should be aware of the following:

- *Fee Disclosure*. Standard fees of the adviser must be disclosed in the Part 2 of Form ADV with a statement as to whether they are negotiable.
- *Debiting Fees*. If a U.S.-registered adviser is permitted to debit its fees from the client account, it will be deemed to have "constructive custody" of client assets and must comply with the Investment Advisers Act rule governing custody.[37]
- *Layering of Fees*. Investing a client's managed account assets into a fund or additional strategy also managed by the adviser, where this has the effect of increasing the adviser's fees may raise fiduciary issues.[38] The SEC has also permitted a client's managed account assets to be invested in a non-money market fund managed by the adviser or an affiliate when it could be demonstrated that the dual fees pertained to services provided in different capacities and did not create any special conflicts of interest, and provided further that the adviser obtained the client's informed consent to the transaction and disclosed the arrangement in writing.[39]
- *Performance Fees*. The one area where the SEC has granted relief from the substantive provisions of the Investment Advisers Act with respect to the relationship between a U.S. based registered adviser and a non-U.S. client is the subject of performance fees. A registered adviser may charge performance

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37. Rule 206(4)-2(c)(1)(ii) under the Investment Advisers Act. See discussion at *infra* section 46C:3.9.
38. EF Hutton & Co, Inc., SEC No-Action Letter (Nov. 17, 1983).
39. *See* Neuberger & Berman, SEC No-Action Letter (Mar. 30, 1987).

fees only to its non-U.S. clients,[40] "qualified purchasers,"[41] knowledgeable employees, or certain other sophisticated persons known as "qualified clients."[42] The investment adviser should obtain appropriate representations from the client as to the client's status within the scope of this exemption.

- *Termination Fees*. Generally speaking, termination fees (or penalties) are not permissible if their sole or primary purpose is to cause the client not to fire the investment adviser.[43] However, liquidated damages are permissible in order to reimburse the adviser for efforts already undertaken or fees earned but not vested.[44]

### § 49C:3.7 *Cash Solicitation Rule*

Rule 206(4)-3 under the Investment Advisers Act (the "Cash Solicitation Rule") generally prohibits a registered adviser from paying a fee to a "solicitor" who has obtained clients for the adviser unless certain conditions are met. For purposes of the Cash Solicitation Rule, a "solicitor" is considered to be anyone who, directly or indirectly, solicits any client for, or refers any client to, an adviser, including non-U.S. clients. When utilizing a solicitor, U.S. advisers have an obligation to supervise the solicitor and its activities.[45]

In general, in order to pay a fee to a solicitor: (i) the adviser must be registered under the Investment Advisers Act; (ii) the solicitor may not itself be subject to "statutory disqualification" as an investment adviser under the Investment Advisers Act;[46] (iii) any fees must be

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40. Investment Advisers Act § 205(b)(5).
41. Investment Advisers Act § 205(a). A "qualified purchaser" is a sophisticated investor qualified to invest in commingled funds exempt from U.S. registration. Investment Company Act § 2(a)(51)(A).
42. Investment Advisers Act Rule 205-3(a). This provision does not apply to unregistered advisers. Investment Advisers Act § 205(a).
43. National Deferred Compensation, Inc., SEC No-Action Letter (August 31, 1987) (noting that an adviser may not fulfill its fiduciary obligations if it imposes a fee structure penalizing a client for deciding to terminate the adviser's service or if it imposes an additional fee on a client for choosing to change his investment).
44. *See* Constellation Financial Management, LLC, SEC No-Action Letter (pub. avail. Jan. 9, 2003); Stephenson and Co., SEC No-Action Letter (Dec. 29, 1980).
45. *See* Requirements Governing Payments of Cash Referral Fees by Investment Advisers, Investment Advisers Act Release No. 688 (July 12, 1979).
46. Please note, however, that the SEC staff has indicated that a statutorily disqualified person may act as a solicitor under the Cash Solicitation Rule where certain disclosures are made to the prospective client. *See* Dougherty & Company LLC, SEC No-Action Letter (July 3, 2003).

paid pursuant to a written agreement that, among other things, described the solicitation arrangement and the compensation to be paid; and (iv) the solicitor must provide to any potential client, including a non-U.S. client, at the time of solicitation, copies of both (a) the adviser's current brochure, and (b) a disclosure statement describing the terms of the solicitation agreement between the adviser and the solicitor (including information as to fees paid and compensation received by the solicitor or the adviser).[47] As part of its recordkeeping obligations, the adviser must keep on file the signed, written confirmation that the client has received the disclosure materials.

In offering advisory services indirectly through a pooled investment vehicle, it is important to note that the SEC staff has clarified that the Cash Solicitation Rule does not apply to a registered investment adviser's cash payments to a person soliciting investors solely to invest in an investment pool managed by the investment adviser, such as a hedge fund, a private equity fund or even a UCITS.[48] While the Cash Solicitation Rule may not technically apply to the solicitation of prospective investors in a pooled vehicle, investment advisers should take caution in this area and consider carefully their obligations under the general anti-fraud provisions of the Investment Advisers Act, including Rule 206(4)-8.

### *§ 49C:3.8 Advertising*

Rule 206(4)-1 under the Investment Advisers Act prohibits a registered adviser from using an advertisement that contains any untrue statement of a material fact, or that is otherwise false or misleading.[49] Rule 206(4)-1 applies equally to a U.S. adviser's existing and prospective clients that are located in the United States and abroad.

Under Rule 206(4)-1, an "advertisement" is defined as "any notice circular, letter or other written communication addressed to more than one person, or any notice or other announcement in any publication or by radio or television, which offers (1) any analysis, report or publication concerning securities, or (2) any graph, chart, formula or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (3) any other investment advisory service with regard to securities."[50] The SEC staff has indicated that it does not take the position that a

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47. We note where the solicitor is an employee of the adviser, the solicitor is under no obligation to provide the brochure or additional disclosure statements.
48. *See* Mayer Brown LLP, SEC No-Action Letter (July 15, 2008).
49. Investment Advisers Act Rule 206(4)-1(a)(5).
50. Investment Advisers Act Rule 206(4)-1(b).

written communication by an adviser that does no more than respond to an unsolicited request would constitute an "advertisement" for purposes of Rule 206(4)-1.[51]

In addition to the broad prohibition against false or misleading advertisements noted above, Rule 206(4)-1 specifically prohibits an advertisement from: (i) using a testimonial of any kind concerning the adviser or its advice, analysis, or reports; (ii) referring to past specific recommendations, unless such document includes a list of all recommendations made during the previous year; (iii) containing graphs, charts, formula, or other devices that can in and of themselves be used to determine which securities to buy or sell; and (iv) containing a statement that a report or analysis can be had free of charge, unless the adviser is actually providing such report or analysis entirely free and without any condition or obligation.[52]

With respect to performance advertisements, an adviser may present its historical performance information for its various investment strategies, provided that the performance presented is accurate and that the presentation is not false or misleading. The determination as to whether a particular advertisement is false or misleading depends on the facts and circumstances involved in its use, including: (i) the advertisement's form and content; (ii) the implications or inferences arising out of the advertisement's total context; and (iii) the sophistication of the prospective client.[53] In addition, an advertisement containing performance may be considered misleading if it fails to disclose material facts, the omission of which causes the advertisement to imply something about an adviser's ability or competence.[54] Recently, the SEC staff has indicated that an adviser's use of social media (for example, Twitter) to communicate with clients (both existing and prospective) may implicate Rule 206(4)-1.[55]

U.S. registered advisers that market to non-U.S. clients also should be mindful of the local licensing, advertising, and shareholder protection laws that may exist in the jurisdiction of the potential client or investor. While a U.S. registered adviser may prepare marketing materials that are in accordance with U.S. law, the ability to utilize

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51. Investment Counsel Association of America, SEC No-Action Letter (Mar. 1, 2004).
52. Investment Advisers Act Rule 206(4)-1(a)(1)–(4).
53. *See, e.g.*, Covato/Lipsitz, Inc., SEC No-Action Letter (Oct. 23, 1981).
54. *See* Clover Capital Management, Inc., SEC No-Action Letter (Oct. 28, 1986). For example, an advertisement that fails to disclose the effect of material market or economic conditions is likely to be misleading.
55. *Investment Adviser Use of Social Media*, NAT'L EXAMINATION RISK ALERT, vol. II, issue 1, Jan. 4, 2012, *available at* www.sec.gov/about/offices/ocie/riskalert-socialmedia.pdf.

those same materials in a foreign market may be limited and/or require that the content be changed to satisfy the requirements of local law. Registered advisers should consider on a country-by-country basis what type of materials may be used, what types of investors and/or intermediaries the adviser may target with the materials (if they may be used at all), and the extent to which the use of marketing materials may otherwise impact the adviser's ability to utilize an available exemption that may be premised on no or limited marketing or advertising in that particular jurisdiction.

## *§ 49C:3.9 Suitability*

As fiduciaries, investment advisers owe their clients a duty to provide only suitable investment advice. This duty generally requires an investment adviser to determine that the investment advice it gives to a client is suitable for the client, taking into consideration the client's financial situation, investment experience, and investment objectives.[56] Advisers should consider at all times the suitability of an investment product for a non-U.S. client, including whether the product is tax efficient. Advisers should also consider suitability obligations that may apply under the local law of the client's or investor's residence or domicile.

## *§ 49C:3.10 Custody*

### [A] Overview

Rule 206(4)-2 under the Investment Advisers Act (the "Custody Rule") details how client funds and securities in the custody of a registered adviser must be held, and requires an adviser with "custody" to implement certain safekeeping requirements including providing specified information to clients.

In 2003, the SEC amended the Custody Rule to reflect modern custodial practices and to clarify when an adviser has custody of client assets, and is therefore subject to the provisions of the Custody Rule.[57] In 2009, following the much publicized scandal involving Bernard L. Madoff Investment Securities LLC, the SEC adopted significant substantive amendments to the Custody Rule.[58]

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56. Investment Advisers Act Release No. 1406 (Mar. 16, 1994).
57. *See* Custody of Funds or Securities of Clients by Investment Advisers, Investment Advisers Act Release No. 2176 (Sept. 25, 2003) [hereinafter 2003 Custody Adopting Release].
58. *See* Custody of Funds or Securities of Clients by Investment Advisers, Investment Advisers Act Release No. 2968 (Dec. 30, 2009) [hereinafter 2009 Custody Adopting Release].

### [B] Definition of Custody

The Custody Rule defines custody as "holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them."[59] The Custody Rule further provides that custody includes, in pertinent part, (i) any arrangement (including a general power of attorney) under which an adviser is authorized or permitted to withdraw client funds or securities maintained with a custodian upon instruction to the custodian; and (ii) any capacity (such as general partner of a limited partnership, managing member of a limited liability company or a comparable position for another type of pooled investment vehicle, or trustee of a trust) that gives the adviser or its supervised person legal ownership of or access to client funds or securities.

Certain of these concepts were explained in the SEC's release relating to the Custody Rule. In the 2003 Custody Adopting Release, the SEC noted that it deems an adviser to have custody if it has the *authority to withdraw funds or securities from a client's account.* For this reason, an adviser that is authorized to deduct advisory fees or other expenses directly from a client's account is considered to have custody of client funds and securities in that account. The SEC noted that, while these advisers might not have possession of client assets, they have the authority to obtain possession. The SEC has made it clear, however, that an adviser's authority to instruct a custodian to disburse client assets on a "delivery versus payment" basis would not give rise to custody.[60]

In another example in the 2003 Custody Adopting Release, the SEC attempted to clarify that an adviser has custody if it acts in any capacity that gives the adviser legal ownership of, or access to, the client's funds or securities. The SEC noted in this example that a firm acting as both general partner and investment adviser to a limited partnership has custody for purposes of the Custody Rule. The SEC noted that by virtue of its position as general partner, the adviser generally has broad authority to dispose of funds and securities in the limited partnership's account, and thus has custody of client assets.

As a result, the Custody Rule has broad extraterritorial reach that may have unintended consequences for advisers that manage non-U.S. assets directly or within pooled products.

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59. *See* Investment Advisers Act Rule 206(4)-2.
60. 2003 Custody Adopting Release, note 57.

### [C] Attribution to Adviser of Custody of a Related Person

The Custody Rule also attributes custody to an adviser where a related person of the adviser has custody. Specifically, the Custody Rule provides that an adviser has custody if a related person holds, directly or indirectly, client funds or securities, or has any authority to obtain possession of them, in connection with advisory services the adviser provides to clients.[61]

For purposes of the Custody Rule, a related person is "any person, directly or indirectly, controlling or controlled by you, and any person that is under common control with you,"[62] where control is defined as "the power, directly or indirectly, to direct the management or policies of a person, whether through ownership of securities, by contract, or otherwise."[63] Thus, if a related person of an adviser has the ability to withdraw funds, or acts as a general partner or in a similar capacity, in either case, with respect to a client of the adviser in connection with the adviser's services, the custody of the related person is considered to be attributed to the adviser.[64]

As a result, an adviser might be considered to have custody of client assets if one of its related persons (such as an affiliated management company that uses one of its officers or employees) acting for a management company or a board of directors, is considered to have custody in connection with the adviser's services to a client or collective investment fund client.[65] This may arise as a result of such related person's authority to withdraw client assets from a custodial account or as a result of such person having a role equivalent to that of a general partner of the client entity. A limited exemption is available from certain substantive provisions of the Custody Rule provided for advisers that

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61. Investment Advisers Act Rule 206(4)-2(d)(2).
62. Investment Advisers Act Rule 206(4)-2(d)(7).
63. Investment Advisers Act Rule 206(4)-2(d)(1).
64. This attribution concept, provided for in the 2009 amendments to the Custody Rule, substantially changed the staff's previous position, set forth in several no-action letters, that custody would not be attributed to an adviser by virtue of a related person's custody of client assets if the two were operationally independent. *See, e.g.*, Crocker Investment Management Corp., SEC No-Action Letter (Apr. 14, 1987). The rule as amended attributes custody even to an adviser that is operationally independent but provides limited exemption from certain substantive requirements, as discussed below.
65. Note that if the related person has custody of assets of an adviser's client's in a context unrelated to (*i.e.*, not "in connection with") the adviser's advisory services to that client the attribution of custody does not arise.

are deemed to have custody solely because a related person is deemed to have custody of that adviser's clients if the adviser can demonstrate that the adviser and the related person are "operationally independent."[65.1]

### [D] Implications for Having Custody

Advisers that are deemed to have "custody" with respect to certain accounts are expected to comply with a number of requirements, including: (i) if the client does not appoint its own qualified custodian, appointing a qualified custodian to maintain client funds and securities, and providing notification to clients regarding the appointment of that custodian by the adviser; (ii) assuring that the qualified custodian provides quarterly account statements to clients showing all holdings and transactions in the relevant account; and (iii) undergoing independent "surprise" verification by an independent public accountant on an annual basis.[66]

### [E] Special Provision for Pooled Investment Vehicles

In the case of clients that are pooled investment vehicles,[67] the Custody Rule provides an exemption from the notice and account statement requirements and deems the independent surprise verification requirement satisfied if the relevant pooled vehicle provides to its investors within 120 days of the end of the vehicle's fiscal year audited financial statements prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") and certified by an independent public accountant registered with the Public Company Accounting Standards Board (PCAOB). By means of a staff no-action position of industry-wide application, the financial statements need not be prepared in accordance with U.S. GAAP if they nevertheless contain information substantially similar to that contained in U.S. GAAP financial statements, and any material differences are reconciled, in financial statements given to U.S. persons, under generally accepted auditing standards ("U.S. GAAS").[68] Many non-U.S. funds for which a U.S. registered investment adviser may provide portfolio

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65.1. For a discussion of "operationally independent," see *infra* section 49C:3.10[F].

66. *See* Investment Advisers Act Rule 206(4)-2(a).

67. As noted below, the SEC appeared here to contemplate a "limited partnership," or "limited liability company" or similar foreign or domestic private fund trust but also used this phrase "or another type of pooled investment vehicle".

68. *See* 2003 Custody Adopting Release, *supra* note 57. *See also* Staff Responses to Questions About the Custody Rule (updated as of Apr. 1, 2011) [hereinafter FAQ], at VI.5 and VI.6.

management services do not comply with U.S. GAAP (for example, UCITS).

### [F] Operationally Independent Advisers

As noted above, the Custody Rule provides an exception from compliance with the independent surprise verification requirement (but, significantly, not the account statement requirement) for an adviser that has custody solely because its related person has custody if that related person is "operationally independent" of the adviser.[69] An adviser establishes operational independence by meeting the following conditions: (i) client assets in the custody of the related person are not subject to the claims of the adviser's creditors; (ii) advisory personnel do not have custody or possession of, or direct or indirect access to client assets of which the related person has custody, or the power to control the disposition of such client assets to third parties for the benefit of the adviser or its related persons, or otherwise have the opportunity to misappropriate such client assets; (iii) advisory personnel and personnel of the related person are not under common supervision; and (iv) advisory personnel do not hold any position with the related person or share premises with the related person.[70]

## § 49C:3.11 Books and Records

Section 204 of the Investment Advisers Act and Rule 204-2 thereunder require that registered investment advisers maintain and preserve specified books and records, and make them available to SEC examiners for inspection. Rule 204-2 permits investment advisers, under certain conditions, to maintain books and records on microfilm and magnetic disk, tape, or other computer recordkeeping devices. These rules apply equally to U.S. and non-U.S. clients of a U.S. registered adviser.

Rule 204-2 requires every registered investment adviser to retain copies of all advertisements and other communications (collectively, "advertisements") that the adviser has circulated, directly or indirectly, to ten or more persons (excluding persons connected with the adviser). Generally, the adviser also must create and retain all documents necessary to substantiate any performance information contained in advertisements. With respect to the advertisement of performance information for managed accounts, an adviser need retain only (1) all account statements, if they reflect all debits, credits, and other transactions in a client's account for the period of the statement;

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69. Investment Advisers Act Rule 206(4)-2(b)(6).
70. Investment Advisers Act Rule 206(4)-2(d)(5).

and (2) all worksheets necessary to demonstrate the calculation of the performance or rate of return.

### *§ 49C:3.12 Wrap Fee Programs*

Many advisers participate in wrap fee programs, including those with non-U.S. person participants. Rule 204-3(f) under the Investment Advisers Act requires a sponsor of a wrap fee program to prepare a "wrap fee brochure" that provides, in narrative form, a full explanation of the program and its sponsor, and to deliver the wrap fee brochure to wrap fee clients. A "wrap fee program" for purposes of the rule is a program under which investment advisory and brokerage execution services are provided for a single "wrapped" fee that is not based on the transactions in a client's account.[71] An investment advisory program under which all clients pay traditional, transaction-based commissions is not a wrap fee program. Similarly, a program under which client assets are allocated among mutual funds is not a wrap fee program because normally there is no payment for brokerage execution.

Many U.S. registered advisers participate in global wrap fee programs. Registered investment advisers should consider on a facts-and-circumstances basis whether accepting a mandate to manage assets for a non-U.S. client participant in a global wrap fee program will otherwise subject the adviser to registration or authorization in the non-U.S. jurisdiction of the participant. This country-by-country analysis will often be dictated by the type of wrap account program, the level of contact that may exist between the U.S.-registered adviser and the wrap account participant, and whether the adviser has contractual privity with the wrap account participant (in addition to the wrap account sponsor). As a result of a number of hybrid wrap account programs, this country-by-country analysis can be complex.

### *§ 49C:3.13 Use of Adviser Performance Record*

A U.S.-based adviser marketing advisory services, either directly in the form of a managed account or indirectly in the form of a pooled investment vehicle, may wish to use the performance record of the adviser in targeting non-U.S. clients. U.S.-registered advisers will need to determine whether and to what extent any presentation of its past performance record in this context comports with the antifraud provisions of the Investment Advisers Act and with a series of SEC no-action letters governing the content of adviser advertising.[72] In addition,

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71. *See* Investment Company Act Release No. 22,579 (Mar. 24, 1997).

72. *See, e.g.*, Growth Stock Outlook Trust, SEC No-Action Letter (Apr. 15, 1986); Clover Capital Mgmt., Inc., SEC No-Action Letter (Oct. 27, 1986); Inv. Co. Inst., SEC No-Action Letter (Aug. 24, 1987); Nicholas-Applegate

an adviser should consider the local laws of the client's jurisdiction and whether such laws require any additional registration, licensing, or notice filing.

### § 49C:3.14 Contract Issues

While the Investment Advisers Act does not specifically require an investment management agreement be in writing, general commercial considerations will dictate that a U.S. registered adviser have a contract to provide cross-border advisory services for a non-U.S. client.

Often, the non-U.S. client will provide a form of agreement to be utilized in formalizing the relationship. U.S. registered advisers should carefully consider the type of non-U.S. client (for example, a sovereign wealth fund) in evaluating the contractual terms of any investment management agreement, including contractual terms relating to choice of law, conflicts of law, forum, service of process, indemnification, compliance with applicable law, and dispute resolution. Careful drafting will help define the rules of the game with respect to the validity and enforceability of the investment management agreement to the extent that a dispute arises.

It is also important to note that the Investment Advisers Act requires that an advisory contract with a registered investment adviser state that the adviser shall not "assign" the investment management agreement without the client's consent.[73] This provision applies equally to non-U.S. clients.

## § 49C:4 Navigating Global Regulatory Requirements

### § 49C:4.1 Overview

Any U.S. firm that wishes to offer advisory services on a cross-border basis should have a basic understanding of the laws that apply throughout the client relationship in the client's home jurisdiction. This often requires an adviser to conduct global blue-sky diligence to determine the regulatory impact on the adviser's business of managing assets for that client. In order to determine the extent of the application of regulation to a U.S. adviser's activities, a firm must determine (among other things):

- what type of advisory product is being provided and in what form (for example, direct managed account, single purpose

Mutual Funds, SEC No-Action Letter (Aug. 6, 1996); Bramwell Growth Fund, SEC No-Action Letter (Aug. 7, 1996); and Nicholas-Applegate Mutual Funds, SEC No-Action Letter (Feb. 7, 1997); *see also* Investment Advisers Act Rule 206(4)-8.

73. *See* Investment Advisers Act § 205(a)(2).

managed account in a "pooled" form, model advisory account, sub-advisory account, collective investment fund, etc.);

- who will be responsible for contracting with the client (regardless of whether that entity will provide actual portfolio management services);
- who will be responsible for managing the advisory account, in terms of providing investment advisory expertise;
- where the actual portfolio management will take place (for example, from the United States);
- who will market the advisory services and in what form;
- to whom the advisory services will be marketed (retail individual, high net worth individual, corporate, pension, sovereign wealth fund, etc.);
- if an entity, how is that prospective client organized and how is it regulated;
- where are the assets to be invested held in custody and who has discretion over those assets; and
- whether the U.S. adviser has locally licensed affiliates that can provide marketing or advisory resources outside of the United States.

The answer to these questions (among others) will determine the extent to which the regulatory regime in the client's (or prospective client's) home jurisdiction will apply to a U.S.-based registered adviser. The following will examine in more detail the key issues for a U.S. manager to consider when marketing and providing cross-border advisory services to non-U.S. clients.

## *§ 49C:4.2 Non-U.S. Considerations in Offering Advisory Services*

There are a number of key considerations under the laws of the jurisdiction in which the client or prospective client is resident or domiciled that should be considered by a U.S. investment adviser when marketing to, providing advisory services for, and conducting client servicing of non-U.S. clients, as described more fully below.

### [A] Licensing Considerations

In connection with considering whether to provide services to a non-U.S. client, a U.S. adviser should first consider whether the adviser is required to obtain a license or otherwise be authorized to provide portfolio management services to the client. This analysis needs to be conducted on a country-by-country basis and may vary depending on the nature of the product being advised (for example, direct separate account, wrap account, pooled investment product, etc.).

### *[A][1] Managed Accounts*

In performing this licensing analysis with respect to the ability to offer a separate or managed account to a non-U.S. client, an adviser should consider the following in determining whether licensing or authorization is required to manage the assets:

- Is the adviser required to be registered in the local jurisdiction to provide cross-border portfolio management services on a separate account basis?
- Is the adviser providing services directly or indirectly in a sub-advisory capacity?
- Do the local requirements differ if contact was unsolicited?
- Is there an exemption under local law depending on the type of client (for example, an institutional client)? If so, what is it?
- Can the portfolio management take place if on a non-discretionary basis (for example, asset allocation or modeling approach)?
- Can the portfolio management take place if the client contracts with a licensed entity (for example, an affiliate) and discretionary asset management is delegated to the U.S. adviser? If so, are there any restrictions on the delegation to the U.S. adviser?
- Are there any tax implications to the U.S. adviser or the client as a result of the provision of investment management services?
- Do the requirements differ with respect to investments in the client's account (for example, options, futures, commodities or other securities)?

The answer to these questions will determine whether the U.S.-registered adviser may provide portfolio management services without being licensed in the client's home jurisdiction, how services may be performed, and if there is any impact on portfolio management other than what is to be agreed to within the investment management agreement.

### *[A][2] Commingled Funds*

To the extent that a U.S.-registered adviser offers advisory services to non-U.S. clients through a commingled fund, there are a number of separate considerations under the laws of the jurisdiction in which the client is resident that should be considered by a U.S. investment adviser when marketing to, providing advisory services for, and conducting client servicing of non-U.S. clients in commingled funds, including:

- Is the adviser providing services directly or indirectly in a sub-advisory capacity?
- Is the adviser required to be registered or authorized to manage the pooled product?
- Are there any restrictions on managing the asset as a result of the product wrapper and the laws that govern the pooled vehicle?

### [B] Marketing Considerations

In connection with marketing advisory services on a cross-border basis to non-U.S. clients, a U.S. adviser should first consider whether the adviser is required to obtain a license or otherwise be authorized to market such services in the jurisdiction of the residence of the investor (in addition to being registered or authorized to actually provide portfolio management services). In addition, investment advisers should have a basic understanding of the limitations placed on the adviser by local law in marketing either on a cross-border basis or directly in country.

In marketing its portfolio management services to potential non-U.S. clients, whether directly in the form of managed accounts or indirectly in the form of a pooled product, a U.S. adviser should consider the following questions to determine the scope of permissible marketing activities:

- Are there any "broker-dealer" type registration requirements in connection with the marketing by a U.S. adviser of portfolio management services or a fund product?
- Does the product need to be registered to offer the product on a solicited basis (for example, UCITS, private fund, collective investment trust, etc.) or through a sponsor (for example, wrap account sponsor)?
- Are there any additional marketing regulations?
- May a U.S. adviser respond to an unsolicited Request for Proposal (RFP)?
- May representatives of a U.S. adviser conduct in-person marketing visits in the client's jurisdiction?
- May representatives of a U.S. adviser conduct in-person marketing visits offshore (that is, outside the client's jurisdiction)?

- Is sending unsolicited direct mail permitted?
- Is cold-calling permitted?
- Can marketing be done by way of a website?
- Can marketing be done by means of other electronic communications (for example, e-mail)?
- May representatives of a U.S. adviser speak at industry conferences?
- Do the laws and regulations of the potential client's jurisdiction impose any requirements with respect to the language of marketing materials?
- Are any prescribed disclosures in marketing materials required?
- Are marketing materials required to be pre-approved?
- Are there any restrictions as to the scope of potential investors to whom portfolio management services may be marketed?
- Are there any exemptions that can be utilized (for example, direct reverse inquiry, cross-border exemption, etc.)?
- How are consultants and financial intermediaries treated with respect to the licensing of marketing in a particular jurisdiction?

While the answers to these questions will provide a U.S. registered adviser with a roadmap to permissible marketing activities, the map must be constructed on a country-by-country basis. In Europe, it is possible to streamline this country-by-country approach by appointing a locally domiciled affiliate (for example, in the United Kingdom) that is licensed under the Markets in Financial Instruments Directive ("MiFID") to facilitate marketing on behalf of the U.S. adviser. While this does streamline the approach from a licensing perspective, it creates tax and employment issues, which may become complex depending on the scope of the involvement of both U.S. personnel and the U.S. registered adviser in marketing.

### [C] Client Servicing Considerations

In providing client servicing to any non-U.S. resident client (whether in a managed account or in a pooled investment vehicle), a U.S. adviser should consider the following in conducting its licensing analysis:

- May a U.S. adviser service clients onshore or is a local licensed intermediary required to service the client?
- May a U.S. adviser service clients from offshore?

- May a U.S. adviser service clients from offshore via an onshore affiliate?
- Are there any reporting requirements under local law with respect to the client relationship?

While an exemption may exist on which a U.S. registered investment adviser may provide cross-border portfolio management services without being licensed in the client's home jurisdiction, a separate exemption may not be available to "service" the client in its home country.

### [D] Other Considerations

A U.S. adviser also should consider other material issues that may impact its ability to market to or provide cross-border advisory services to non-U.S. clients or service those clients, including the following:

- Are there any prescribed disclosures or specific terms to be contained in the investment management contract under which services are supplied?
- Are there any ongoing regulatory requirements or other rules that are applicable?
- Are there any requirements as to the governing law of the agreement?
- Are there any requirements as to the language of the agreement?
- Are there any "doing business" requirements in the client's jurisdiction (that is, where "doing business" means holding out to the public and conducting activities within the jurisdiction in question that may be seen as creating a permanent establishment in the jurisdiction)?
- Are there any visa requirements that would prohibit the U.S. adviser from entering a country to market or provide client services (for example, visa requirements to enter China or another jurisdiction to service an existing client)?
- Are there foreign exchange control restrictions that would impact the client's ability to invest outside of its own country?
- Are there requirements that would restrict a U.S. adviser from buying certain securities within the client's account that would otherwise not be contained in the investment management agreement?

- Are there any applicable requirements governing investment advisory agreements, including any formalities required for a client to confer investment discretionary authority?
- Would a U.S. adviser be subject to local laws and regulations in connection with its services for persons outside of its home jurisdiction (for example, a Singapore investor resident in New York that invests from New York)?

## § 49C:5 Other Material Considerations

In addition to U.S. and foreign licensing, authorization, and substantive compliance laws, rules, and regulations that are applicable to U.S. registered advisers managing assets for non-U.S. clients, investment advisers should also be mindful of a number of other material considerations that may impact the client relationship, including applicable global anti-money laundering (AML) obligations, global shareholder reporting obligations, and anti-bribery statutes.

### *§ 49C:5.1 Know-Your-Customer Obligations*

Investment firms are responsible for complying with all AML requirements to which they are subject in dealing with clients. When offering advisory services globally to non-U.S. clients, an adviser should focus on its compliance obligations with know-your-customer requirements under both U.S. law as well as the laws of the client's jurisdiction to the extent applicable. Failure to do could subject an investment adviser to severe reputational harm as well as civil and criminal penalties.

#### [A] Application of U.S. Bank Secrecy Laws

On October 26, 2001, President George W. Bush signed into law the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act (the "USA PATRIOT Act").[74] Title III of the USA PATRIOT Act included a significant number of amendments designed to enhance and strengthen the Bank Secrecy Act of 1970, as amended (BSA), the statute that serves as the primary basis for most AML reporting and recordkeeping requirements for financial institutions in the United States.[75] Section 352 of the USA PATRIOT Act requires all "financial institutions," as such term is defined in the BSA, to implement an AML program that includes:

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74. USA PATRIOT Act, Pub. L. No. 107-56, 115 Stat. 272 (Oct. 26, 2001).
75. Currency and Foreign Transactions Reporting Act of 1970, Pub. L. 91-508, 84 Stat. 1118 tit. II (Oct. 26, 1970).

(i) development of internal policies, procedures and controls; (ii) the designation of a compliance officer; (iii) an ongoing employee training program; and (iv) an independent audit function to test the program.[76]

The BSA's definition of "financial institution" is extremely broad, and includes a number of entities that may be subject to AML program obligations under section 352 of the USA PATRIOT Act. The definition includes, among other things, banks, trust companies, investment companies, currency exchanges, operators of credit card systems, loan and finance companies—and even automobile dealers. However, the BSA's definition of "financial institution" does not include investment advisers.

The BSA nevertheless authorizes the Secretary of the Treasury to include additional types of entities within the definition of "financial institution" if the Secretary determines that they engage in an activity "similar to, related to, or a substitute for" an activity of an entity listed in the statutory definition. In 2003, Treasury Department's Financial Crimes Enforcement Network ("FinCEN") invoked this authority to propose an AML program rule that would have covered certain types of federally-regulated and state-regulated investment advisers. However, the proposed rule, along with a related rule that would have required "unregistered investment companies" to implement AML programs, raised numerous concerns from industry representatives—principally because the proposals attempted to create new definitions of "investment advisers" and "unregistered investment companies" that were not recognized under the federal securities laws. Accordingly, FinCEN formally withdrew the proposed rules in 2008, noting that FinCEN would continue to consider "whether and to what extent it should impose requirements under the BSA on investment advisers and similar entities."

FinCEN recently has announced an intention to issue proposed rules that would require certain investment advisers to implement an AML program that complies with the BSA, and to file suspicious activity reports with FinCEN.[77] These proposed rules are likely to require new or enhanced know-your-customer policies and procedures for U.S.-registered investment advisers.

### [B] Application of Foreign Law

A U.S. investment adviser should always consider whether local AML legislation applies to its activities with respect to its non-U.S.

76. 31 U.S.C. § 5318(h).
77. Regulatory Information Service Center, Introduction to the Unified Agenda of Federal Regulatory and Deregulatory Actions, 77 Fed. Reg. 7664, 7818 (Feb. 13, 2012).

clients.[78] This is particularly true if the adviser is managing assets for one or more non-U.S. clients in a pooled investment vehicle that may be governed by the AML laws in place of the fund's formation or organization.

## *§ 49C:5.2 Data Privacy*

Across the United States and within the EU, advisers must be aware of existing data privacy requirements in place to prevent the dissemination of consumers' private information.

### [A] Application of Regulation S-P

Regulation S-P ("Reg S-P") was adopted by the SEC to address certain privacy concerns. Investment advisers have an affirmative and continuing obligation to keep confidential and secure their clients' non-public personal information. Reg S-P protects the privacy of individuals (not institutional investors) that purchase from the investment adviser either financial services or products primarily for personal or familial purposes.[78.1]

Advisers that share clients' nonpublic information with non-affiliated third parties are limited in doing so under Reg S-P, and must provide all clients with its annual privacy policies and procedures, as well as the ability to "opt out" of the arrangement. An adviser who does not share client information as a part of its business are nevertheless required to provide clients with a policy statement regarding the protection of information upon the establishment of a relationship and annually thereto.

An adviser's initial and annual privacy notices must contain the following:

- the categories of non-public personal information the adviser collects;
- the categories of non-public personal information the adviser may disclose;
- the categories of affiliates and non-affiliated third parties to which the adviser discloses non-public personal information;

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78. There are a number of international conventions on money laundering, including, among others, those of the Council of Europe, the EU, the Financial Action Task Force (FATF), the International Organization of Securities Commissions (IOSCO), the International Association of Insurance Supervisors (IAIS), the Organization for Cooperation and Economic Development (OECD) and the Basel Committee's Task Force on International Money Laundering.

78.1. 17 C.F.R. § 248.3 (2012).

- the categories of non-public personal information about former clients that the adviser discloses and the categories of affiliates and non-affiliates third parties to which the adviser discloses this information;
- an explanation of the client's right to opt out of the disclosure of non-public personal information to the non-affiliated third parties, and the methods by which a client may opt out; and
- a description of the adviser's policies and practices for protecting the confidentiality and security of non-public personal information.[78.2]

### [B] Application of EU Law

Generally under EU Data Protection Directive 95/46/EC ("Privacy Directive"), a company established in the EU may transfer or make accessible personal data to a company outside the EU only if an "adequate level" of data protection is ensured by the recipient. Organizations outside the EU receiving personal data from companies in the EU are required to ensure an adequate level of data protection. Accordingly, to the extent an adviser is either (i) a company established in the EU or (ii) an affiliate of an EU-based company, it must take precautions when sharing personal data with, and receiving the same from, its affiliates.

## *§ 49C:5.3 Shareholder Reporting Obligations*

Many jurisdictions, including the United States, have enacted laws, rules, and regulations designed to require investment advisers that invest in public companies, including those within certain protected industries, above certain thresholds to report those holdings to (among others) the issuer, the exchange, and/or the regulatory agency charged with oversight of a particular industry or market.

### [A] U.S. Reporting Obligations

In the United States, sections 13 and 16 of the U.S. Securities and Exchange Act of 1934, as amended (the "Exchange Act") are the principal provisions that govern that applicable ownership reporting requirements. It is important to note that these provisions apply irrespective of whether the assets managed by an adviser are for U.S. or non-U.S. clients.

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78.2. 17 C.F.R. § 248.6 (2012).

#### *[A][1] Section 13(d) and Section 13(g) of the Exchange Act*

Section 13(d) of the Exchange Act requires investment advisers who "beneficially own," directly or indirectly, more than 5% of a class of voting securities registered under the Exchange Act to submit a notice of filing to the SEC.[79] This requirement applies regardless of whether the investment adviser is located within the United States or outside the United States, or whether the adviser is registered with the SEC. In addition, section 13 of the Exchange Act does not distinguish between assets that are managed by an investment adviser for a U.S. person or a non-U.S. person. These disclosures are intended to signal to the market an attempt by a person to takeover, or otherwise acquire a controlling interest in, an issuer in a single transaction or a series of transactions. Such disclosures must be made on Schedule 13D or 13G (as appropriate) filed with the SEC.

A "beneficial owner" of a security includes any person who, directly or indirectly, through any contract, arrangement, understanding, or relationship or otherwise, either alone or together with other persons, has (i) voting power over such security (including the power to vote or direct the voting of such security), or (ii) investment power over such security (including the power to dispose or direct the disposition of such security). For instance, an investment adviser may be deemed to be a beneficial owner of equity securities held in client accounts if it has the power to vote or sell such securities.

As a result, U.S. registered investment advisers should be mindful of their section 13(d) obligations with respect to both U.S. and non-U.S. assets managed by the adviser.

#### *[A][2] Section 13(f) of the Exchange Act*

Section 13(f) of the Exchange Act requires an "institutional investment manager" that uses the U.S. mail (or other means or instrumentality of interstate commerce) in the course of its business, and exercises investment discretion over $100 million or more in section 13(f) securities (that is, publicly traded equity securities set forth on the Official List of section 13(f) securities, as published by the SEC on a quarterly basis), to report its holdings on Form 13F with the SEC. An institutional investment manager is an entity that either invests in, or buys and sells, securities for its own account.[80] The SEC

79. *See* Filing and Disclosure Requirements Relating to Beneficial Ownership, Release No. 34-17353 (Dec. 4, 1998).

80. *See* SEC, Division of Investment Management, Frequently Asked Questions About Form 13F (Sept. 2011) (noting that institutional investment

staff considers an investment adviser that manages private accounts, mutual fund assets, or pension plan assets as an institutional investment manager, and also considers the trust department of a bank as an institutional investment manager.

The SEC monitors section 13(f) reporting and has, in the recent past, conducted a review of the section 13(f) reporting process.[81] Consequently, the SEC has found an investment adviser to have violated section 13(f) and has also found an adviser's executives to have aided and abetted such a violation.[82]

#### *[A][3] Section 13(h) of the Exchange Act*

Under Rule 13(h)-1, certain large traders of U.S. securities will be required to make periodic filings with the SEC on Form 13H.[83] The term "large trader" includes any person who directly or indirectly, in exercising investment discretion over one or more accounts, effects transactions for the purchase or sale of NMS securities (that is, all securities listed on a U.S. exchange, including equities and options that are traded through any facility of a U.S. national securities exchange, as well as U.S. and non-U.S. over-the-counter markets and after-hours systems) for or on behalf of such accounts, by or through one or more registered broker-dealers, in an aggregate amount equal to or greater than: (1) during a calendar day, either two million shares or shares with a fair market value of U.S. $20 million; or (2) during a

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managers include (among others) banks, insurance companies, broker/dealers, corporations, pension funds that manage their own investment portfolios, natural persons or entities that exercise investment discretion over the account of any other natural person or entity).

81. *See* SEC, Office of Inspector General, Office of Audits, Review of the Commission's Section 13(f) Reporting Requirements, Report No. 480 (2010) (noting 12 recommendations for improving the section 13(f) reporting process, which include improvements to the substantive requirements (*e.g.*, reporting thresholds) and the technology used to produce and file the Form 13F).

82. *See, e.g., In re* Quattro Global Capital, LLC, Investment Advisers Act Release No. 2634 (Aug. 15, 2007) (noting that Quattro willfully violated section 13(f)(1) for failing to file any quarterly 13F forms, as included in the manager's compliance manual and advised by outside counsel and auditors, from February 2002 when assets exceeded the $100 million threshold until July 2005 in response to inspection staff's inquiry); s*ee also In re* Joel R. Mogy Investment Counsel, Inc., Investment Advisers Act Release No. 1941 (May 7, 2001) (noting that Mogy, as president and 100% owner of an adviser, willfully aided and abetted such adviser's willful violation of 13(f)(1) of the Exchange Act and Rule 13f-1 thereunder for failing to file 13F forms between February 1994 and August 2000).

83. *See* Large Trader Reporting Rule, Exchange Act Release No. 64,976 (July 27, 2011).

calendar month, either twenty million shares or shares with a fair market value of U.S. $200 million.[84]

The requirements of this rule do not distinguish among large traders on the basis of their location, nor on the basis of whether the assets are managed for a U.S. or non-U.S. client. As a result, a non-U.S. person or entity meeting the definition of large trader (that is, trading in U.S. NMS securities with U.S.-registered broker-dealers in amounts exceeding the reporting threshold) is required to comply with the rule requirements, even if the large trader is only acting for non-U.S. accounts.

#### *[A][4] Section 16 of the Exchange Act*

Directors, officers and greater than 10% shareholders of issuers of securities registered under the Exchange Act (and certain other types of securities) are subject to reporting requirements with respect to ownership and transactions in such securities.[85] Shares held by institutions (including investment advisers) are generally not counted towards the 10% threshold to the extent such shares are held for clients in a fiduciary capacity, in the ordinary course of business, and not with the purpose or effect of changing or influencing control of the issuer. Persons subject to the section 16 reporting requirements are required to disgorge profits from sales and purchases of such securities within a six-month period. Section 16 of the Exchange Act applies equally to non-U.S. clients of a U.S. registered adviser.

## *§ 49C:5.4 Anti-Bribery Legislation*

In addition to the myriad of U.S. and foreign securities laws, rules, and regulations that any U.S.-based investment adviser must consider when dealing with non-U.S. clients, there are significant anti-bribery laws that an adviser should pay close attention to when marketing investment products directly or indirectly through the use of a subsidiary or third-party service provider, such as sub-distributors or placement agents, to prospective non-U.S. clients.

### [A] The Foreign Corrupt Practices Act

The Foreign Corrupt Practices Act (FCPA) is a piece of U.S. legislation that was initially adopted by Congress in 1977 in response to a series of scandals involving bribes by U.S. public companies to foreign governments.[86] Over thirty years later, it remains more

84. *Id.*
85. *See* Exchange Act § 16.
86. Foreign Corrupt Practices Act of 1977, 15 U.S.C.§§ 78dd-1 *et seq.* (1977).

important than ever to have in place a compliance program that addresses FCPA concerns, as evidenced by the recent increase in the number of investigations by the U.S. Department of Justice (DOJ) and SEC into violations of the FCPA.[87] Because of the origins of the FCPA, however, there is a common misconception—shared by many investment advisers—that the FCPA applies *exclusively* to public companies. In fact, the FCPA has a much broader scope and applies to both U.S. investment advisers and their business partners seeking investments from foreign government entities.[88]

The FCPA's anti-bribery provisions are implicated when, among other things, an investment adviser or its partners give money or "anything of value" to three categories of recipients: (i) a foreign official; (ii) a "foreign political party or official thereof or any candidate for foreign political office;" or (iii) any third party, while knowing that the third party, such as a placement agent or finder, will forward the money or thing of value to a recipient in category (1) or (2) above.[89]

Under the FCPA, an investment adviser cannot provide money or anything of value to a recipient in one of the three categories listed above with the "purpose" of: (i) "influencing any act or decision" of a foreign official, foreign political party, or official, or any candidate for

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87. *See, e.g.*, SEC v. Oracle Corp., No. CV-12-4310 CRB (N.D. Cal. Aug. 16, 2012); *In re* Diageo, plc, SEC Release No. 64,978 (July 27, 2011); Press Release, SEC, Tenaris to Pay $5.4 Million in SEC's First-Ever Deferred Prosecution Agreement (May 17, 2011), *available at* http://sec.gov/news/press/2011/2011-112.htm; SEC v. Int'l Bus. Machs. Corp., No. 1:11-CV-00563 (D.D.C. Mar. 18, 2011); and SEC v. Elles, No. 1:10-CV-4118 (N.D. Ga. Dec. 20, 2010).

88. *See, e.g.*, Edward L. Pittman, Cheryl A. Krause & Thomas C. Bogle, *Recent SEC Sweep Highlights the Need for U.S. Investment Advisers Seeking Business from Sovereign Wealth Funds to Develop Policies for FCPA Compliance*, J. OF INV. COMPLIANCE (June 22, 2011).

89. 15 U.S.C. §§ 78dd-1(a)(1)–(3), 78dd-2(a)(1)–(3), and 78dd-3(a)(1)–(3). There is ongoing debate over whether the FCPA's definition of "foreign official" encompasses officers or employees of state-owned or state-controlled corporations, although recent cases seem to imply so. *See, e.g.*, United States v. Noriega, No. 10-1031(A)-AHM (C.D. Cal. Apr. 20, 2011).

The FCPA also contains so-called "books and records" accounting provisions. The FCPA's books and records provisions would require advisers that are part of public companies to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer," and to "devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that" transactions are properly executed and recorded, and that asset access is limited. *See* 15 U.S.C. § 78m(b)(2)(A) and (B).

foreign office; (ii) "inducing [any of the above individuals] to do or omit to do any act in violation of [a] lawful duty;" or (iii) otherwise "securing any improper advantage," or inducing the individual to use his influence with a foreign government or government instrumentality to effect any action.[90]

Per the above definition, anytime an investment adviser seeks a direct or indirect benefit from a foreign official, they come under the purview of the FCPA. For example, the FCPA applies when an investment adviser seeks an investment from a sovereign wealth fund.[91] One risk in seeking such investments is that absent adequate controls, an employee, business partner, or third-party placement agent of the investment adviser might seek to encourage the investment through improper or illegal means. In such a situation, the investment adviser may be subject to prosecution for violating the FCPA, even if the investment adviser itself had no knowledge of or involvement in such activities being conducted by other parties.[92] To protect against the possibility of such an occurrence, investment advisers should have in place adequate policies and procedures to reduce the risk of FCPA violations. Such procedures should closely follow the guidance developed by the DOJ, the SEC, and the U.S. Sentencing Commission.[93]

In addition to U.S. legislation such as the FCPA, advisers seeking business opportunities outside the United States must be attuned to both local licensing requirements and local ethics laws.

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90. 15 U.S.C. §§ 78dd-1(a)(1)–(3), 78dd-2(a)(1)–(3), and 78dd-3(a)(1)–(3).

91. *See, e.g.*, Dionne Searcey & Randall Smith, *SEC Probes Banks, Buyout Shops over Dealings with Sovereign Funds*, WALL ST. J., Jan. 14, 2011; Peter Lattman & Michael J. De La Merced; *SEC Looking into Deals with Sovereign Funds*, N.Y. TIMES DEALBOOK BLOG, Jan. 13, 2011. *See also* U.S. v. Noriega, No. 10-1031(A)-AHM.

92. The first FCPA Advisory Opinion was issued in 2011, in which the DOJ addressed the scope of the FCPA's "promotional expenses" exemption under the FCPA. *See* U.S. Dep't of Justice, Foreign Corrupt Practices Act Opinion Procedure Release 11-01 (June 30, 2011) (the "Opinion"). The DOJ ultimately found that a U.S. "domestic concern" (the "Requestor"), which sought to pay for the travel of representatives from two foreign agencies to learn about the adoption services provided by the Requestor, had acted "reasonably" under the circumstances. The Opinion is helpful in clarifying the circumstances under which companies can benefit from an exception to FCPA liability for payment of the reasonable travel, food, and entertainment expenses of "foreign officials."

93. *See* Dep't of Justice, Foreign Corrupt Practices Act Review Opinion Procedure Release 04-02 (July 12, 2004); U.S. SENTENCING COMMISSION, GUIDELINES MANUAL, ch. 8 (Nov. 2011); SEC ENFORCEMENT MANUAL, § 6.1.2.

### [B] UK Bribery Act of 2010

One such recently-enacted law is the UK Bribery Act of 2010 (the "UK Bribery Act"), which came into effect on July 1, 2011. The UK Bribery Act creates four new criminal offenses with broad extra-territorial effect. While the act applies to UK citizens, residents, and companies established under UK law, non-UK companies can be held liable for a failure to prevent bribery if they do business in the United Kingdom. Additionally, a relevant person or company can be prosecuted for the crimes outlined below, even if the crimes are committed outside of the United Kingdom, and, similar to the FCPA, companies can be liable for bribery committed for their benefit by their employees or other associated persons.[94]

Section 1 of the UK Bribery Act generally prohibits bribing another person, which is classified as an "active" offense. A section 1 offense is committed if a person offers, promises, or gives a financial, or other, advantage to another person with either (i) the intention of inducing that person to perform, or rewarding that person for performing, a relevant function or activity improperly; or (ii) knowing that the acceptance of the advantage would itself constitute the improper performance of a relevant function or activity.[95] Section 2 of the UK Bribery Act prohibits the inverse—being bribed—and is classified as a "passive" offense. [96]

Section 6 of the UK Bribery Act prohibits the bribery of foreign public officials (FPOs). Such type of bribery is committed where a person offers, promises, or gives a financial or other advantage to another with the intention of influencing that person in their capacity as an FPO in an effort to obtain business or an advantage in the conduct of business.[97] An FPO is defined in the UK Bribery Act as an individual who: (i) holds a legislative, administrative or judicial position of any kind of a country or territory outside the United Kingdom (or any subdivision of such a country or territory); (ii) exercises a public function for or on behalf of a country or territory outside the United Kingdom (or any subdivision of such a country or territory) or for any public agency or public enterprise of that country or territory (or subdivision); or (iii) is an official or agent of a public international organization.[98]

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94. For a brief summary of its extra-territorial applicability, see the UK Bribery Act (June 2, 2011), *available at* http://www.fco.gov.uk/en/global-issues/conflict-minerals/legally-binding-process/uk-bribery-act.
95. Bribery Act, 2010, c. 23, § 1 (U.K.).
96. Bribery Act, 2010, c. 23, § 2 (U.K.).
97. Bribery Act, 2010, c. 23, §§ 6(1)–(4) (U.K.).
98. Bribery Act, 2010, c. 23, § 6(5) (U.K.).

Section 7 of the UK Bribery Act creates a strict liability offense for commercial organizations. This offense is implicated when a commercial organization fails to prevent bribery being committed on its behalf. A section 7 offense is committed by a commercial organization if a person, who is associated with the commercial organization, bribes another person intending to obtain or retain for the commercial organization business or an advantage in the conduct of business.[99]

The United Kingdom's first successful prosecution under the UK Bribery Act occurred in October of 2011 when the Crown Prosecution Service (CPS) prosecuted a case against an administrative clerk to a Magistrates Court, Mr. Munir Patel.[100] In August 2011, Mr. Patel promised an individual summoned for a motoring offense that he could influence the course of criminal proceedings in exchange for a sum of £500. Under the CPS prosecution, Mr. Patel faced the possibility of imprisonment for up to ten years, and/or an unlimited fine.

Additionally, the CPS has the ability to bring confiscation or civil recovery proceedings under the Proceeds of Crime Act 2002 to recover the value of the bribe Mr. Patel received. The Patel case demonstrates that the application of the UK Bribery Act extends beyond illegally paying overseas government officials. The act applies equally in both the domestic and commercial contexts, and to both the receipt and payment of bribes.

### § 49C:5.5 Use of Affiliates

As noted above, many U.S. registered advisers attempt to utilize resources of affiliates when marketing to, and managing assets for, non-U.S. clients. In addition, many global advisory organizations seek to integrate their operations and utilize the expertise of a non-U.S. entity in providing advice to U.S. clients and the expertise of the U.S. registered adviser in providing advice to non-U.S. clients. The use of affiliated resources creates a number of regulatory issues under the laws of the jurisdiction in which the affiliate has its principle place of business and under foreign law as well.

#### [A] Taxation Considerations

Often a registered adviser, with its principal place of business in the United States, wishes to second on a temporary basis a research analyst, portfolio manager, or sales associate to its non-U.S. affiliate (for example, in the United Kingdom). Often the U.S. employee will travel periodically between the U.S. office and the foreign office to conduct business.

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99. Bribery Act, 2010, c. 23, § 7 (U.K.).
100. R v. Patel [2012] EWCA Crim 1243.

In addition to the regulatory considerations noted below, the U.S. registered adviser should consider whether the activities of its employees seconded to its non-U.S. affiliate will create a presumption that the U.S.-registered adviser is "doing business" in the jurisdiction of its affiliate or is otherwise creating a "permanent establishment" in the foreign jurisdiction based on the activities of its U.S. employees. A permanent establishment could subject the entire U.S.-registered adviser entity to taxation in the foreign jurisdiction of its affiliate and or otherwise create a de facto branch of the U.S. entity for local tax purposes.

To limit the scope of the employees' activities and to allocate the taxation liability among the affiliates, a U.S. registered adviser will often enter into a service level agreement with its non-U.S. affiliate to compensate/reimburse the affiliate for any services the U.S. employees perform for the affiliate based on a transfer pricing method. While the transfer pricing method is often the subject of discussion, a U.S. registered adviser should always first consider the tax implications of the use of its employees in a foreign jurisdiction through the use of a non-U.S. affiliate.

### [B] Non-U.S. Regulatory Considerations

In addition to the tax considerations noted above, a U.S.-registered adviser should consider the regulatory implications to the U.S. adviser and its affiliates of utilizing affiliate resources or its own personnel in a foreign jurisdiction. To the extent that a U.S. employee seconded to an affiliate is deemed to be holding himself out as an employee of the U.S. adviser in the foreign jurisdiction, a local regulator could take the position that the U.S.-registered adviser has effectively created a branch or permanent establishment for regulatory purposes and, thus, is required to be licensed to conduct business in the jurisdiction. Careful consideration should be given to the structuring of the use of U.S.-based employees in non-U.S. offices, including with respect to employment issues, immigration issues, pension issues, as well as licensing and authorization issues.

As noted above, many U.S. advisers do, however, enlist their non-U.S. affiliates to assist in marketing investment services to non-U.S. investors. In Europe, it is very common for a U.S.-registered adviser to appoint a European domiciled affiliate or otherwise to establish a European based marketing affiliate, which is appropriately licensed under the Markets in Financial Instruments Directive 2004/39/EC (known as "MiFID"[101]), to offer investment products to European

101. Markets in Financial Instruments Directive 2004/39, 2004 O.J. (EC).

investors. MiFID is a EU law that provides harmonized regulation for investment services across the thirty member states of the European Economic Area (the twenty-seven member states of the European Union plus Iceland, Norway, and Liechtenstein).

Firms covered by MiFID are authorized and regulated in their "home state" (that is, the country in which they have their registered office). Once a firm has been authorized in its home state, it is able to use the MiFID "passport" to provide investment services to customers in other EU member states without further full authorization in the host state.

These investment services include:

(1) reception and transmission of orders in relation to financial instruments;

(2) execution of orders on behalf of clients (in U.S. terms, acting as "broker");

(3) dealing on own account (that is, acting as a "dealer");

(4) portfolio management;

(5) investment advice;

(6) underwriting and/or placing of financial instruments on a firm commitment basis;

(7) placing of financial instruments without a firm commitment basis; and

(8) operation of multilateral trading facilities (MTF), a multilateral system that brings together third parties buying and selling interests in financial instruments, but that (although required to be regulated under MiFID) does not have the status of a regulated market.

While MiFID often assists in eliminating the country-by-country blue sky approach to regulation with respect to offering managed accounts and/or funds to European investors, it does come with a number of requirements. First, most firms that fall within the scope of MiFID also have to comply with requirements under the Capital Adequacy Directive, which is part of the Basel II framework. It contains detailed regulatory capital requirements that EEA investment firms are required to satisfy in order to be authorized.

To the extent that a U.S. firm wishes its affiliate to contract to provide portfolio management services to eliminate a licensing issue for the U.S.-registered adviser or to otherwise meet the needs of a client, the net capital requirement of the affiliate under the Capital

Adequacy Directive would be much higher than it would if it was simply marketing the managed account product and not contracting to provide services (and delegated those services back to the United States). In addition, depending on the nature of the activities to be performed by the affiliate for the U.S.-registered adviser, the local regulator may require increased human resources on the ground in the jurisdiction to provide for a proper level of oversight.