

# A review of the SEC Participating Affiliate No-Action Letters' relief from Investment Advisers Act of 1940 registration for foreign investment advisers

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## Abstract

**Purpose** – To explain the US Securities and Exchange Commission (the “SEC”) staff’s (the “Staff”) participating affiliate exemption from investment adviser registration for foreign advisers set forth in a line of Staff no-action letters issued between 1992 and 2005 (the “Participating Affiliate Letters”) and to discuss recent guidance issued by the Staff in an information update published in March 2017 (the “Information Update”) with respect to complying with requirements of the Participating Affiliate Letters.

**Design/methodology/approach** – Reviews the development of the Staff’s approach regarding the non-registration of foreign advisers that rely on the Participating Affiliate Letters from prior to the issuance of those letters through the Information Update and sets forth recommendations for registered investment advisers and their participating affiliates.

**Findings** – While there are arguments that the Information Update goes beyond restating established standards and does not clearly explain whether submission of all listed documentation is required, the Information Update will likely standardize the information submitted to the SEC.

**Originality/value** – Practical guidance for advisers relying on the Participating Affiliate Letters from experienced securities and financial services lawyers.

**Keywords** US Securities and Exchange Commission (SEC), Participating affiliate, Registration, Exemption, Foreign investment adviser, Unibanco

**Paper type** Technical paper

In order to provide investment advice to US clients, a foreign investment adviser must be registered with the US Securities and Exchange Commission (the “SEC”) under the Investment Advisers Act of 1940 (the “Advisers Act”) unless an applicable exemption applies[1]. Currently, the only three possible exemptions from Advisers Act registration for foreign investment advisers that seek to provide advice to US clients are the “foreign private adviser exemption”[2], the “private fund adviser exemption”[3], or reliance on positions developed by the SEC staff (the “Staff”) in a line of no-action letters (the “Participating Affiliate Letters”) issued between 1992 and 2005[4]. In March 2017, the Staff issued an information update (the “Information Update”) for foreign investment advisers that rely on the Participating Affiliate Letters. The Information Update provides guidance as to what information should be submitted to the SEC to meet the requirements of the Participating Affiliate Letters and is the first guidance provided by the Staff on the subject since the issuance of the Participating

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Affiliate Letters[5]. This article reviews the development of the Staff's approach regarding the non-registration of foreign advisers that rely on the Participating Affiliate Letters over the period beginning before the Participating Affiliate Letters were issued through the date that the Information Update was published.

## Background of the Participating Affiliate Letters

Prior to the issuance of the Participating Affiliate Letters, absent an applicable exemption, a foreign adviser that wanted to provide investment advice to US clients without registering under the Advisers Act had to form a separate and independent registered affiliate to do so. The determination of whether a foreign adviser should be deemed separate and independent of an affiliated registered adviser turned on several factors enumerated in a series of no-action letters[6]. These factors were eventually consolidated in a five-factor test (the "Integration Test") set forth in a 1981 no-action letter issued in respect of Richard Ellis, Inc. and certain affiliated entities[7]. The Integration Test asks whether each affiliate (i) is adequately capitalized; (ii) has a buffer, such as a board of directors a majority of whose members are independent of the other affiliate, between the personnel of each affiliate; (iii) has employees, officers and directors, who if engaged in providing advice in the day-to-day business of the affiliate, are not engaged in the investment advisory business of the other affiliate; (iv) makes its own decisions as to what investment advice will be communicated or used on behalf of its clients, and uses sources of investment information that are not limited to those of the other affiliate; and (v) keeps its investment advice confidential until such advice is delivered to its clients[8].

The separate personnel requirement of the Integration Test presented considerable difficulties in practice for unregistered foreign investment advisers affiliated with US registered investment advisers because in many instances it would require the two affiliated entities to have duplicate personnel. In its 1992 report, "Protecting Investors: A Half Century of Investment Company Regulation" (the "1992 Report"), the Staff proposed a new approach to regulating foreign advisers called the "conduct and effects" test. Under this approach, the Advisers Act would only apply to a foreign adviser if that adviser's activities occur in the US or produce effects in the US[9]. The Staff also recommended relaxing the Integration Test conditions with respect to foreign advisers that establish registered advisers to advise US clients. Consistent with that recommendation, after the publication of the 1992 Report, the Staff issued the Participating Affiliate Letters, which allow a registered investment adviser to utilize the personnel and resources of an unregistered foreign adviser affiliate ("participating affiliate") in providing portfolio management and discretionary advisory services to US clients. Below we summarize some of the important Participating Affiliate Letters that demonstrate the development of the Staff's position with respect to unregistered foreign investment advisers.

## The Participating Affiliate Letters

In the first Participating Affiliate Letter, Uniao de Bancos de Brasileiros S.A. ("Unibanco"), a Brazilian banking organization, requested assurance that the Staff would not recommend enforcement action if its registered foreign subsidiary provided investment advisory services to non-US clients without complying with the substantive provisions of the Advisers Act[10]. Unibanco additionally requested assurance that the Staff would not recommend enforcement action if Unibanco was not registered under the Advisers Act despite the fact that in providing advice to US clients its registered foreign adviser subsidiary would rely mostly on the research of Unibanco, and certain Unibanco employees would also be employees of the registered foreign adviser.

In its no-action response, in reliance on the “conduct and effects” test, the Staff stated that the substantive provisions of the Advisers Act generally do not apply to a registered foreign adviser’s non-US clients, but that the adviser must provide the SEC with access to foreign personnel as to all of its activities, both inside and outside of the US, and keep certain records. Additionally, the Staff determined that Unibanco was sufficiently separate from its registered adviser subsidiary such that Unibanco would not be considered to be indirectly providing services to US clients in violation of the Advisers Act despite the fact that the registered foreign adviser subsidiary would rely mostly on the research of Unibanco and certain Unibanco employees would also be employees of the registered foreign adviser. The Staff stated that separateness would be recognized if: (i) the affiliated companies are separately organized; (ii) the registered adviser employs personnel (located in the US or abroad) who are capable of providing investment advice; (iii) all persons involved in providing advice to US clients are deemed “associated persons”<sup>[11]</sup> of the registered adviser; and (iv) the SEC has adequate access to trading and other records of each affiliate involved in US advisory activities, and to the personnel of each such affiliate, to the extent needed to allow the SEC to identify conduct that may harm US clients or markets<sup>[12]</sup>.

The Staff noted that this position was based on certain representations and undertakings made by Unibanco; specifically that (i) Unibanco would appoint a US agent for service; (ii) the books and records of Unibanco’s registered adviser subsidiary would be kept in English and separate from Unibanco’s books and records; (iii) all Unibanco employees involved in its subsidiary’s US advisory activities would be deemed “associated persons” of the subsidiary and (iv) Unibanco would produce for testimony all employees identified as being involved in the registered subsidiary’s investment advisory services or related securities transactions in response to an administrative subpoena or request for voluntary cooperation.

The Staff expanded the guidance of the Unibanco Letter to cover other fact-specific circumstances such as (i) a registered foreign adviser using the services of portfolio managers employed by its multiple participating affiliates<sup>[13]</sup>; and (ii) a participating affiliate providing investment advice to US clients either directly through a registered foreign adviser or by having the participating affiliate’s personnel participate in the registered foreign adviser’s advisory business without the participating affiliate being required to register under the Advisers Act<sup>[14]</sup>. In connection with these expansions, the Staff required additional representations including, among other things, a representation that (a) any advice given to US persons would be given only through the registered adviser; (b) the participating affiliate would report to the Staff changes in the laws of its jurisdiction that would prevent it from performing any required undertakings; and (c) the registered adviser’s Form ADV would disclose the names and other information required by Form ADV for all “associated persons”. In *Royal Bank of Canada*, the last of the Participating Affiliate Letters, the Staff expanded the required representations to include making clerical and ministerial personnel available for testimony or questioning by the SEC or Staff upon receipt of an administrative subpoena, demand or request for voluntary cooperation made during a routine or special inspection or otherwise.

Each of the Participating Affiliate Letters described a unique set of circumstances and some provided for modifications of the aforementioned representations. For example, under Dutch law, ABN AMRO Bank, a bank incorporated under the laws of the Netherlands, was unable to make some of the representations relating to providing the Staff with access to trading records of its personnel and making personnel available for questioning by the Staff. The Staff agreed not to recommend enforcement

action, and accommodated ABN AMRO Bank by allowing it to make modified representations[15].

### Information to be submitted

The Participating Affiliate Letters require certain documentation and representations to be submitted to the SEC. However, the Staff did not explain in the Participating Affiliate Letters, nor subsequently, how such information should be submitted. The Information Update states that such information should be submitted to the Staff by email at [IMOCC@sec.gov](mailto:IMOCC@sec.gov) with the subject line "Participating Affiliate". In addition, the Information Update suggests that certain additional representations and information that were required by the Participating Affiliate Letters, but that the SEC had not to date actually required to be submitted, should also be submitted to the Staff. Specifically, the Information Update suggests that submitting documentation containing the following representations and undertakings will "most clearly" enable the Staff "to monitor the conduct of participating affiliates":

1. The name of the participating affiliate and registered adviser, and a representation that the participating affiliate is an associated person of the registered adviser within the meaning of Section 202(a)(17) of the Advisers Act.
2. Documentation of the appointment of an agent for service of process by a participating affiliate, including the name and contact information of the agent.
3. A representation that the participating affiliate is under the jurisdiction of US courts for actions arising, directly or indirectly, under US securities laws or the securities laws of any state in connection with any of the following for US clients: (i) investment advisory activities; (ii) related securities activities arising out of or relating to any investment advisory services provided by the participating affiliate through its registered adviser; and (iii) any related transactions. In addition, a representation that the participating affiliate has designated and appointed, without power of revocation, an agent upon whom may be served all process, pleadings, or other papers in:
  - any investigation or administrative proceeding conducted by the SEC; and
  - any civil suit or action brought against the registered adviser or the participating affiliate or in which the participating affiliate has been joined as defendant or respondent, in any appropriate court in any place subject to the jurisdiction of any state, or of the US, or any of its territories or possessions, or the District of Columbia in connection with the activities and transactions enumerated in this paragraph.
4. A representation that any such civil suit or action or administrative proceeding may be commenced by the service of process upon, and service of an administrative subpoena shall be effective service upon, the participating affiliate's appointed agent, and such service shall be taken and held in all courts and administrative tribunals to be valid and binding as if personal service has been made.
5. A representation that the participating affiliate:
  - will appoint a successor agent if the participating affiliate or any person discharges the agent or the agent is unwilling or unable to accept service on behalf of the participating affiliate at any time until six years have elapsed from the date of the last investment advisory activity; and
  - undertakes to advise the SEC promptly of any change to the agent's name or address during the applicable period.

6. A representation that the participating affiliate will promptly, upon receipt of an administrative subpoena, demand or request for voluntary cooperation made during a routine or special inspection or otherwise, provide to the SEC or Staff any and all of the books and records required to be maintained in accordance with Staff guidance, and make available for testimony before, or other questioning by, the SEC or Staff the employees of the participating affiliate (other than clerical or ministerial personnel) involved in the investment advisory activities or related securities transactions, at such place as the SEC may designate in the US or, at the SEC's option, in the country where the records are kept or such personnel reside.
7. A representation that the participating affiliate will produce, pursuant to an administrative subpoena or a request for voluntary cooperation, any documents in accordance with Staff guidance.

The Information Update also states that amendments to any of the above information can also be submitted to the same email address noted above. Although most of the Information Update's guidance mirrors the representations and undertakings required by the Participating Affiliate Letters, it appears to have broadened the interpretation of the Participating Affiliate Letters in that it requires the participating affiliate to represent that it is under the jurisdiction of US courts not only for actions arising under US securities laws but also for actions arising under state securities laws<sup>[16]</sup>.

## Recommendation

While there are legitimate arguments that the Information Update goes beyond merely restating established standards and leaves open questions as to whether submission of all of this documentation is required, the Information Update will presumably standardize the representations used to comply with the Participating Affiliate Letters. Therefore, we recommend that the enumerated information be sent to the SEC for each participating affiliate, and that such information be amended in the event of any material change. Compliance with this Information Update could help avoid needless distractions and expense in a firm's next SEC inspection.

## Notes

1. See Advisers Act Section 203(a) which states: "[e]xcept as provided in subsection (b) and section 203A, it shall be unlawful for any investment adviser, unless registered under this section, to make use of the mails or any means or instrumentality of interstate commerce in connection with his or its business as an investment adviser". Foreign advisers that provide advice to US clients use means or instrumentalities of interstate commerce in providing such advice and, therefore, must be registered as investment advisers unless an applicable exemption applies.
2. The "foreign private adviser exemption" is found in Section 202(a)(30) of the Advisers Act and Rule 202(a)(30)-1 adopted thereunder. This exemption is available to an investment adviser that (i) has no place of business in the US; (ii) has in total fewer than 15 US clients and US investors invested in private funds managed by the investment adviser; (iii) has less than \$25 million in assets under management attributable to such US clients and US investors; and (iv) does not hold itself out to the public in the US as an investment adviser. The \$25 million in assets under management attributable to US clients and US investors is calculated in the same manner as regulatory assets under management as determined under Item 5.F of Form ADV Part 1A.
3. The "private fund adviser exemption" is found in Section 203(m) of the Advisers Act and Rule 203(m)-1 adopted thereunder. Under this exemption, an investment adviser with its principal office and place of business outside of the US is exempt from SEC registration but remains subject to reduced reporting requirements if (i) it has no direct clients that are US persons except for one or more qualifying private funds and (ii) all assets managed by the investment adviser at a place of business in the US are solely attributable to private fund assets, the total

value of which is less than \$150 million. A qualifying private fund is an entity that is excluded from the definition of "investment company" pursuant to Sections 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940. The \$150 million in private fund assets is calculated in the same manner as regulatory assets under management as determined under Item 5.F of Form ADV Part 1A.

4. See, e.g., Uniao de Bancos de Brasileiros S.A., SEC No-Action Letter (July 28, 1992) (hereinafter Unibanco Letter); Mercury Asset Management plc, SEC No-Action Letter (April 16, 1993); Kleinwort Benson Investment Management Limited, SEC No-Action Letter (December 15, 1993) (hereinafter Kleinwort); Murray Johnstone Holdings Limited, SEC No-Action Letter (October 7, 1994) (hereinafter Murray Johnstone); ABN AMRO Bank, N.V., SEC No-Action Letter (July 7, 1997); Royal Bank of Canada, SEC No-Action Letter (June 3, 1998); ABA Subcommittee on Private Investment Entities, Staff Letter (December 8, 2005).
5. See *Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than \$150 Million in Assets Under Management, and Foreign Private Advisers*, Release No. IA-3222 (June 22, 2011) (the "2011 Release") where the SEC confirmed that the Participating Affiliate Letters still applied and stated that it expected the Staff to provide guidance regarding the application of the Participating Affiliate Letters in the context of the rules adopted under the 2011 Release including the private fund adviser exemption and the foreign private fund adviser exemption. However, to date, other than the Information Update, which is unrelated to rules adopted in the 2011 Release, there has not been any such guidance.
6. See, e.g., Reliance Group Inc., SEC No-Action Letter (December 15, 1979); Morgan Grenfell Investment Services, SEC No-Action Letter (May 13, 1977).
7. Richard Ellis, Inc., SEC No-Action Letter (August 18, 1981) (hereinafter Richard Ellis Letter). The Integration Test is derived from Section 208(d) of the Advisers Act which states that it "shall be unlawful for any person indirectly, or through or by any other person, to do any act or thing which it would be unlawful for such person to do directly under the [Advisers] Act". Based on Section 208(d), the SEC has stated that an entity cannot circumvent the registration and other requirements of the Advisers Act by separating its business into two entities that are in fact operationally integrated. See the 2011 Release, *supra* note 5 at Section II.D.
8. See Richard Ellis Letter, *supra* note 7.
9. SEC Division of Investment Management, *Protecting Investors: A Half-Century of Investment Company Regulation* (May 1992).
10. Unibanco Letter, *supra* note 4.
11. The term "associated person" is not defined in the Advisers Act, but the term "person associated with an investment adviser" is defined. Presumably, when the Staff used the term "associated person" it meant "person associated with an investment adviser". Section 202(a)(17) of the Advisers Act states that "(t)he term 'person associated with an investment adviser' means any partner, officer, or director of such investment adviser (or any person performing similar functions), or any person directly or indirectly controlling or controlled by such investment adviser, including any employee of such investment adviser", but generally excludes persons whose functions are "clerical or ministerial". By deeming Unibanco's employees involved in its US subsidiary's investment advisory activities as associated persons of the registered adviser, the Staff was subjecting such persons to the supervision of the registered affiliate. See Royal Bank of Canada, *supra* note 4 at n.7.
12. Unibanco Letter, *supra* note 4.
13. Kleinwort, *supra* note 4.
14. Murray Johnstone, *supra* note 4.
15. ABN AMRO Bank, N.V., SEC No-Action Letter (July 7, 1997). ABN AMRO Bank represented, among other things, that it would make a good faith effort to obtain written authorization to provide trading records to the Staff from all persons deemed to be "associated persons", that

it would make redacted trading records available for those “associated persons” for which a written authorization was not in effect, and that it would assist the SEC in enlisting the aid of Dutch regulatory authorities if the SEC determined that it required information not included in the redacted trading records.

16. Additionally, the Information Update requires that the participating affiliate consent to the jurisdiction of US courts for actions arising directly or indirectly under US or state securities laws while the Participating Affiliate Letters do not contain the directly or indirectly language.

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