## Compliance Corner:
## **Proposed State Regulations** (April 2005)

### By Linda Shirkey

NASAA (National Association of Securities Administrators Association) suggested regulations wholesale. We understand that 40 States have already passed these regulations, so Texas is certainly not alone.

The Government Relations Committee will no doubt keep tabs on the progress of these proposed regulations and will keep us all posted on the progress. Meanwhile, it is worth noting some significant changes that are proposed.

It will be unlawful to borrow or lend money to a client. This means no family member who becomes or may become a client may lend funds to a new Investment Advisor firm.

It will be unlawful to conduct “excessive trading”, to charge “excessive fees” or to recommend recommendations that are not “suitable” for the client. There are no guidelines for what is reasonable, nor what examiners will use as standards. I understand from the current staff that 3% of Assets under Management is considered an excessive fee, but, absent any documentation, there is no guarantee that examiners will be consistent in their measure of what is excessive or suitable. What this DOES mean, however, is that documentation of a client’s ongoing investment objective, financial position, and risk tolerance MUST be maintained. Merely gathering the information at the inception of the relationship is not adequate. The State examiners are looking for annual updates to this information (including annual income, net worth, and tax bracket). They went so far as to ask one firm for the name and address of the current employer of an underlying client.

Proposed regulations also state that it will be unlawful to “disclose the identity, affairs, or investments of any client unless required by law to do so, or unless consented to by the client.” This means that any third party consultants (ahem!!), such as compliance consultants (ahem again!) or IT consultants who are likely to see client names or client investments may be unable to do their work appropriately unless your Client Agreement allows for agents of your firm to view client information. It would be wise to review your Agreements in light of this proposal. Some of my clients are adding language that any third party vendors will sign Third Party Confidentiality Agreements, but your Client still must agree in writing.

I want to be clear that I firmly believe in the role the State Securities Board and its staff (especially the examination staff) play in protecting Texas investors. I just worry that the rules are granting room for examiners to evaluate Investment Advisors based on their own “feel” rather than objective criteria, and, as we have seen already (See article on Page 1 concerning FPA National), Texas examiners already find firms “deficient” in areas that are not yet required. We continue to talk with State staff, to share across the Investment Advisor and Planner worlds what we see happening with current exams, and to be as prepared as possible, while helping our clients run effective and efficient businesses. It continues to be a challenge.

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