



**TRAILHEAD CONSULTING, LLC**  
LEXIE S. PANKRATZ, OWNER

[www.trailheadslp.com](http://www.trailheadslp.com)

*Guiding You on Your Compliance Journey*

---

**DATE:** August 7, 2018

**TO:** Securities and Exchange Commission

**FROM:** Trailhead Consulting, LLC

**RE:** Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation

Our firm works primarily with state-registered investment advisers but has one SEC registered client and several very close to meeting the requirements for SEC registration. The principal offices of most advisers we work with are in Montana. As investment advisers registered with the state of Montana they are subject to Montana Code Annotated Title 30. Trade and Commerce. Chapter 10. Securities Regulation which includes the following and adopts and incorporates certain SEC regulation:

**MCA 30-10-301.** Fraudulent and other prohibited practices.

**(2)(a)** It is unlawful for any person who receives, directly or indirectly, any consideration from another person for advising the other person as to the value of securities or their purchase or sale, whether through the issuance of analysis or reports or otherwise:

- (i) to employ any device, scheme, or artifice to defraud the other person;
- (ii) to engage in any act, practice, or course of business that operates or would operate as a fraud or deceit upon the other person; or
- (iii) without disclosing to the client in writing before the completion of the transaction the capacity in which the person is acting and obtaining the consent of the client to the transaction:

**ARM §6.10.402 FRAUDULENT, UNETHICAL, AND DECEPTIVE PRACTICES PROHIBITED (1)** A person who is a **federal covered adviser** or an investment adviser is a fiduciary and has a duty to act for the benefit of its clients. While the extent and nature of this duty varies according to the nature of the relationship between an investment adviser or a **federal covered adviser** and its clients and the circumstances of each case, an investment adviser or **federal covered adviser** shall not engage in unethical business practices, including the following:

(u) engaging in any act, practice, or course of business which is fraudulent, deceptive or manipulative, or contrary to the provisions of **section 206(4) of the Investment Advisers Act of 1940**, which is adopted and incorporated, notwithstanding the fact that such investment adviser is not registered or required to be registered under section 203 of the Investment Advisers Act of 1940. Section 206(4) of the Investment Advisers Act of 1940 establishes prohibited practices in the investment advisory business, and may be obtained from the Commissioner of Securities, 840 Helena Avenue, Helena, MT 59601;

Therefore, when the SEC issues interpretations of or makes amendments to Section 206 of the Advisers Act, it does affect investment advisers registered with the state of Montana, as well as with many other states who have enacted similar regulation.

## I. COMMISSION'S INTERPRETATION OF AN INVESTMENT ADVISER'S FIDUCIARY DUTY

The Commission requests comment on their proposed interpretation regarding certain aspects of the fiduciary duty under Section 206 of the Advisers Act:

- Does the Commission's proposed interpretation offer sufficient guidance with respect to the fiduciary duty under section 206 of the Advisers Act?
- Are there any significant issues related to an adviser's fiduciary duty that the proposed interpretation has not addressed?
- Would it be beneficial for investors, advisers, or broker-dealers for the Commission to codify any portion of our proposed interpretation of the fiduciary duty under section 206 of the Advisers Act?

**THC Comments:** It is our opinion the proposed interpretation does offer sufficient guidance and will be helpful in developing policies and procedures governing the relationship between the investment adviser and the client. Codifying an investment adviser's fiduciary duty would be difficult as it is a very broad duty.

---

## II. ENHANCING INVESTMENT ADVISER REGULATION

### A. Federal Licensing and Continuing Education

- Should investment adviser representatives be subject to federal continuing education and licensing requirements?

**THC Comments:** It is our opinion requiring individual representatives register with the SEC is unnecessary, however, imposing some continuing education is probably not a bad idea, so long as the regulator will accept the continuing education credits obtained by those with certain designations (CFA, CFP, etc.) as meeting the continuing education requirements. States should uniform the CE requirements.

- Which advisory personnel should be included in these requirements? For example, should persons whose functions are solely clerical or ministerial be excluded, similar to

the exclusion in the FINRA rules regarding broker-dealer registered representatives? Should a subset of registered investment adviser personnel (such as supervised persons, individuals for whom an adviser must deliver a Form ADV brochure supplement, “investment adviser representatives” as defined in the Advisers Act, or some other group) be required to comply with such requirements?

**THC Comments:** Those representatives for which a Part 2B supplement is prepared should be required to obtain continuing education credits.

- How should the continuing education requirement be structured? How frequent should the certification be? How many hours of education should be required? Who should determine what qualifies as an authorized continuing education class?

**THC Comments:** The CE requirement should be structured as it is for broker-dealer representatives.

The certification should be every 3 years.

Who determines what qualifies as an authorized continuing education class for broker-dealer representatives? Is that a logical “authority” to delegate this to?

An investment adviser representative should not be required to begin pursuing continuing education until they have been employed as an investment adviser representative for 2 years because turnover happens. Before an advisory firm is required to invest in the representative it would be beneficial for the firm to have some time to assess whether that individual is a good fit and is going to stay.

- How could unnecessary duplication of any existing continuing education requirement be avoided?

**THC Comments:** Accept the continuing education credits obtained by those with certain designations (CFA, CFP, etc.) as meeting the continuing education requirements. States should uniform the CE requirements. Other designations should be included for continuing education purposes, regardless of whether those designations are accepted in lieu of certain examinations for initial registration purposes.

Many advisers we work with hold certain insurance licenses however they are not producers of any insurance companies as that presents a conflict for them. However, they continue to meet

the continuing education requirements for insurance license holders because they do not want to let the license expire and want to remain knowledgeable on insurance matters. Any CE obtained to maintain any insurance license should also be accepted as CE for investment adviser representatives.

- Should these individuals be required to register with the Commission? What information should these individuals be required to disclose on any registration form? Should the registration requirements mirror the requirements of existing Form U4 or require additional information? Should such registration requirements apply to individuals provide advice on behalf of SEC-registered investment advisers but fall outside the definition of “investment adviser representative” in rule 203A-3 (because, for example, they have five or fewer clients who are natural persons, they provide impersonal investment advice, or ten percent or less of their clients are individuals other than qualified clients)? Should these individuals be required to pass examinations, such as the Series 65 exam required by most states, or to hold certain designations, as part of any registration requirements? Should other steps be required as well, such as a background check or fingerprinting? Would a competency or other examination be a meritorious basis upon which to determine competency and proficiency? Would a competency or other examination requirement provide a false sense of security to advisory clients of competency or proficiency?

**THC Comments:** It is our opinion requiring individual representatives register with the SEC is unnecessary, however states should adopt uniform continuing education requirements.

- If continuing education requirements are a part of any licensing requirements, should specific topics or types of training be required? For example, these individuals could be required to complete a certain amount of training dedicated to ethics, regulatory requirements or the firm’s compliance program.

**THC Comments:** Investment Adviser Representative CE subjects should include any type of class or seminar that promotes facilitating their duty of care and loyalty to the client. That could include how to collect information/what information to collect to construct a client’s investment profile, how to analyze an investment account’s costs, how to conduct a reasonable investment investigation (to ensure information gathered is accurate and complete); what it means to be a fiduciary; wealth management courses; financial planning courses; portfolio structure theory courses; etc.

States waive some examination requirements if the applicant holds certain designations. All CE obtained to maintain those designations should be sufficient to meet any continuing education imposed by the states for investment adviser representatives to keep their registrations

effective. Other designations should be included for continuing education purposes, regardless of whether those designations are accepted in lieu of certain examinations for initial registration purposes. Exactly which additional professional designation(s) CE should be accepted is a topic for the next discussion.

- What would the expected benefits of continuing education and licensing be? Would it be an effective way to increase the quality of advice provided to investors? Would it provide better visibility into the qualifications and education of personnel of SEC-registered investment advisers?

**THC Comments:** Continuing education requirements will encourage the representative to hone their skills, seek specialties in areas that interest them, and become a true financial professional.

Yes, requiring continuing education will be an effective way to increase the quality of advice provided to investors.

- What would the expected costs of continuing education and licensing be? How expensive would it be to obtain the continuing education or procure the license? Do those costs scale, or would they fall more heavily on smaller advisers? Would these requirements result in a barrier to entry that could decrease the number of advisers and advisory personnel (and thus potentially increase the cost of advice)?

**THC Comments:** Requiring investment adviser representatives obtain continuing education credits will increase the cost to the investment advisers we work with, but as stated below, many investment advisers we work with already hold significant designations and are incurring these costs anyway. However, this may hinder these investment advisers from hiring additional registered personnel as their costs will increase to maintain them. That said, advisers who invest in their personnel may see less turnover, more employee satisfaction, and increased employee commitment to their firm.

- What would the effects be of continuing education and licensing for investment adviser personnel in the market for investment advice (*i.e.*, as compared to broker-dealers)?

**THC Comments:** It is our experience most investment adviser personnel already hold significant designations but requiring continuing education will encourage those who are already registered and who do not hold certain designation to develop their skills to offer better advice and become a strong asset for the investment advisory firm.

- What other types of qualification requirements should be considered, such as minimum experience requirements or standards regarding an individual's fitness for serving as an investment adviser representative?

**THC Comments:** The current requirements for registering as an investment adviser representative are sufficient. The continuing education requirements will encourage the representative to hone their skills, seek specialties in areas that interest them, and become a true financial professional.

## B. Provision Of Account Statements

**THC Comments:** It is our opinion requiring advisers prepare and deliver account statements does not achieve the objective it appears the SEC is trying to achieve here. Maybe to better align state-registered adviser requirements or expectations with SEC registered advisers, perhaps the SEC should require SEC registered investment advisers prepare and send *invoices* to their clients prior to notifying the custodian of the fee to be withdrawn from the client's account.

That said, the investment advisers we work with prominently disclose their fees in the Form ADV Part 2 Brochure, the investment advisory agreement details the fee the client has agreed to, and the custodian brokerage statement also clearly identifies the investment advisory fee deducted from their account. What more can advisers do to disclose their fees to the client? It is our opinion investment advisory clients are well aware of the fees they are paying for investment advice and the transaction fees they pay for investment purchases and sales.

## C. Financial Responsibility

**THC Comments:** It does seem odd that state registered advisers (depending upon the state(s) registered in) are subject to minimum net worth requirements, but yet, larger investment advisers registered with the SEC are not. It appears reasonable to require SEC registered investment advisers maintain a minimum net worth and/or obtain professional liability insurance which in and of itself is a better business practice. Montana's minimum net worth requirements require an adviser who does not maintain the minimum net worth "be bonded in the amount of the net worth deficiency rounded up to the nearest \$5,000." We have sought such a bond in the past and the insurance companies we contacted have never underwritten a bond to meet a net worth deficiency. It appears obtaining such a bond is more difficult than you would think.

Many investment advisers we work with already obtain Professional Liability/Errors and Omissions Insurance. They do not need a rule requiring this.

Some states do require the submission of unaudited financial statements with the registration application and annually. Regardless, it is our opinion SEC investment advisers should NOT be required to submit annual audited financial statements to the SEC. If the SEC does ultimately require the submission of financial statements, these financial statements should not be made public. Currently, investment advisers who have discretionary authority or custody of client funds, or who require prepayment of more than \$1,200 (generally this is \$500 for state-registered investment advisers) in fees per client, six months or more in advance, are required to disclose any financial condition that is reasonably likely to impair the adviser's ability to meet contractual commitments to clients. If an adviser does fold because it cannot continue operations, did not disclose this to its clients, and this causes harm to a client – the investor and the SEC (or state regulator) already have recourse.