

## Massachusetts Adopts New Regulation on the Use of Expert Network Services

On August 8, 2011, the Massachusetts Secretary of State's Securities Division (the "Securities Division") issued a new final regulation on the use of expert network services.<sup>1</sup> The new regulation takes effect on December 1, 2011 and will require certain investment advisers who retain consulting services, for compensation that is paid either directly to the consultant or indirectly through a firm providing expert-network services, to obtain a signed certification from the consultant that (i) describes all confidentiality restrictions that the consultant has, or reasonably expects to have, regarding confidential information and (ii) affirmatively states that the consultant will not provide confidential information to the adviser. The Securities Division indicated that the new regulation is intended to address "the rising use of expert network firms by investment advisers to facilitate paid consultations between investment advisers and industry experts."

The regulation will apply to investment advisers that are registered or required to be registered with Massachusetts. While the regulation does not explicitly address the issue, the Securities Division has provided informal assurance that the regulation will not apply to investment advisers excluded from the Massachusetts investment adviser registration requirements.<sup>2</sup> Such excluded investment advisers include federally-registered advisers, advisers whose only clients in Massachusetts are institutional clients, and advisers without a place of business in Massachusetts and with fewer than six non-institutional Massachusetts resident clients. However, the regulation will apply to "exempt reporting" advisers within the meaning of Rules 203(l)-1 and 203(m)-1 under the *Investment Advisers Act of 1940* to the extent such advisers are not otherwise excluded from the Massachusetts investment adviser registration requirements.

It bears mention that Massachusetts has proposed amendments to the exemption from state registration relied upon by many private fund advisers whose only clients in Massachusetts are "institutional buyers." The proposed amendments would revise the definition of "institutional buyer" such that it would no longer include accredited investors. To the extent such amendments are adopted and have an effective date prior to March 30, 2012, it is possible that there will be a short time period during which private fund advisers with a place of business in Massachusetts who have not yet registered with the U.S. Securities and Exchange Commission may be subject to the Massachusetts regulation on the use of expert networks, as well as Massachusetts registration requirements more generally. Limited grandfathering provisions may apply during this period. Massachusetts has not announced a timeline for the proposed amendment to the definition of "institutional buyer."

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<sup>1</sup> On the same day, the Securities Division also adopted a regulation prohibiting advisers that are registered or required to be registered with Massachusetts from collecting performance-based fees except those collected in compliance with Rule 205-3 under the *Investment Advisers Act of 1940*, as amended, which provides an exception to the general prohibition on performance-based fees if the client is a "qualified client." This regulation went into effect on August 19, 2011.

<sup>2</sup> This interpretation is further supported by analysis of the statutory provision to which the new regulation relates (which deals principally with the Massachusetts Secretary of State's power to deny or revoke registrations or impose other penalties against Massachusetts-registered investment advisers and broker-dealers and applicants for registration) and the preemption of state regulation of the registration, licensing or qualification of federally-registered advisers under the *National Securities Markets Improvement Act of 1996* ("NSMIA").