

LOCAL INVESTING

resource center

Investing Locally: What Compliance Needs to Know

The Sustainable, Responsible, Impact (SRI) investing market has grown to over \$50 trillion (according to [US SIF](#)) in recent years, with the Community Investing (referred to as *local investing* in this handout) subset within that market growing at the fastest pace of all other subsets. This market's growth has been fueled by campaigns encouraging investors to move their money to credit unions and CDFIs (Community Development Finance Institutions), the passing of Regulation Crowdfunding (*Reg CF*, per the JOBS Act), and legislative action that put guard rails on *Intrastate Securities Exemptions* in over half of U.S. states, unlocking nonaccredited investor potential for the first time in nearly a century.

Due to the continued growth of investment opportunities and a desire from investors to positively impact their local or regional economy with their investment dollars, firms' advisors and clients may already be wanting to discuss how these types of assets fit within investor portfolios. As with all topics related to financial planning and investment management, it behooves advisors and firms to become knowledgeable enough to help guide clients in their journey, leading to higher retention and client satisfaction rates. This is especially true of next generation clients and inheritors, who have proven to be more values-driven than prior generations with [86% claiming in surveys](#) that values-alignment is critical to their investing decisions.

While advisors and investors may be interested or even excited about investing for local impact, firms' compliance officers will always have their eye on risk management and upholding the firm's obligation to *always do what is in the client's best interest*. To help in that journey, we have outlined key topics in this handout to help shape policies and procedures.

Think alternative investments, but a little different

Local investments can come in the form of private equity, private fixed income, or a hybrid structure like a revenue-sharing or royalty agreement. Not all local investments are equity offerings; in fact, they have so far been split equally between debt and equity. That being said, most firms are familiar with the risks associated with private equity funds, which is the most closely related asset class that compliance officers can look to as they seek to understand more about this new *local investing* asset class.

Risks in this new asset class can be both systematic and unsystematic. Most notably, local investments carry liquidity, reinvestment, counterparty, management, and default risks, among others that may be specifically called out in the investor package. Additionally, for investment offerings that are providing below market rate returns investors may face inflation risk. These risks must be carefully considered on a client-by-client basis as advisors seek to help clients navigate this new asset class.

Concerns about fraud

One of the biggest concerns by both regulators, compliance officers, and advisors is the possibility of investors being defrauded. Since privately held companies do not have the same reporting standards as publicly held companies, there is a perception that they have a greater ability to fool investors and advisors alike.

While this is a very valid concern that is not to be sidelined, there have so far been very few incidences of fraud in the local investing asset class, according to a [report issued by the SEC](#) in September 2019. While fraud has not yet been prevalent, it is still possible. Just like in publicly traded markets, however, fraud is best managed through *diversification* and *asset allocation* policies and decisions outlined in the investor's Investment Policy Statement (IPS) designed to limit exposure to any one investment. The old adage, "Don't invest more than you can afford to lose," is sage advice when helping clients navigate this new asset class.

Continuing education

Local investing is a growing asset class that is evolving in real time, however, there is still little industry guidance or formal education to help firms and their advisors navigate this changing landscape. Once firms have decided how involved their advisors can become (see the *Welcome* video on the <http://localinvesting.org> page for Advisors), firms may find the best solution to be an internally produced CE program to keep advisors up to date on trends, best practices, and firm policies.

To help firms navigate the available information, the Local Investing Resource Center has included links below to currently available regulatory bulletins and industry coursework.

Taking next steps

Compliance may not be the most exciting aspect of the financial services industry, but it is perhaps the most critical for ensuring investor safety. If this evolving asset class is of interest to the firm, its advisors, and its clients, then the Local Investing Resource Center recommends the following action steps:

- ☐ **Explore** the Local Investing Resource Center, including the Advisor Resource Kit, to learn more about this new asset class
- ☐ **Meet** with your firm's legal counsel to discuss the topic, **discover** best practices that your firm can follow, and [learn](#) about your firms' registered states' current intrastate securities laws
- ☐ **Develop** a firm policy that outlines how advisors can serve interested clients while protecting the investors and the firm
- ☐ **Host** an initial CE session to introduce advisors to the topic, resources, firm policies, and to discuss how and when to approach clients with this available asset class
- ☐ **Advocate** for the topic to be covered at industry conferences for case study roundtables and panel discussions about lessons learned from those who are already engaging on the front lines

Helpful Industry Resources

- [SEC Investor Bulletin: Crowdfunding for Investors](#)
- [SEC Investor Bulletin: 10 Red Flags That an Unregistered Offering May Be a Scam](#)
- [SEC Investor Bulletin: Be Cautious of SAFEs in Crowdfunding](#)
- [FINRA e-Learning course catalog](#)
 - *Private Placements: Conducting Reasonable Investigations for Regulation D Offerings EL-ELC186*
 - *Private Securities Transactions EL-ELC241*
- [College for Financial Planning: Chartered SRI Counselor Designation](#)
 - *Module 3, Chapter 3: Community Investing*
- [Essential Knowledge For Transition Online Course](#)
 - *Towards Aware and No-Harm Investing*
- [Locavesting website: tools, sector news, regulatory updates](#)

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