

IA Examination Program Overview

Maryland Securities Division
200 St. Paul Place
Baltimore, MD 21202

Surprise Examination

This means that we don't schedule your examination in advance and conduct the examination without an appointment.

- Initial Interview
- Document List
- Examination
- Exit interview
- Follow up letter

1. Form ADV, Part 2A and B Delivery Requirement

Common Deficiencies - Regulation .05 (COMAR 02.02.05.05)

- Potential clients
- Actual clients initially
- Actual clients annually with summary of material changes
- Holding out as investment adviser on broker-dealer or CPA letterhead or business card can trigger the brochure rule

2. Custody

Common Deficiencies - Regulations .04, .15, and .17
(COMAR 02.02.05.04, .15 and .17)

- Trustee or power-of-attorney for client
- General manager of a fund and failure to comply with Regulations .04, .15, and .17
- Direct deduction of advisory fee and failure to comply with safeguards
- Investment checks made out to IA firm
- Stock certificates

3. Advisory Fees

Common Deficiencies

- Keep all billing records, including proof of assets under management, especially if you do not bill at calendar quarter end
- Direct deduction
 - ▶ Written permission from client
 - ▶ Notice of invoice to client at the same time as custodian
 - ▶ In notice, show how fee was calculated and time period.
 - ▶ Fee deduction shown on quarterly statement from custodian

4. Financial Books and Records

Common Deficiencies - Regulation .16 (COMAR 02.02.05.16)

- A balance sheet, maintained quarterly
- An income/expense statement (detailing the source of deposits), maintained quarterly
- Bank statements
- Canceled checks, most banks will only maintain them electronically for 12 months, you are required to maintain them for 5 years.
- Bills and receipts

5. IAR Registration Required

Common Deficiencies - Securities Act §11-101 (Corps and Associations Article, Maryland Code)

- Holding out as
 - ▶ Financial Planner or Investment adviser (or similar term)
 - ▶ Professional Designations (CFP, ChFC, PFS, CFA, CIC)
- In Maryland, solicitors are required to register as investment advisers or IARs.
- Assistants who enter trades. (How much discretion as to time of entry and price?)

6. Performance Figures

Common Deficiencies - SEC No Action Letters

- Net of advisory fees
- Indices comparisons
 - ▶ Relevant and Consistent
- Check your math and use actual returns
 - ▶ Account for additions and withdrawals to account
 - ▶ Do not use estimated returns or round numbers
- Check SEC no action letters for advertising rules, (Clover Capital Man.)

7. Arbitration Clause

Common Deficiencies

- Magic Language
 - ▶ “The client is not waving any rights provided under state or federal securities laws to pursue a remedy by other means.”
- And do not limit the forum for arbitration for example to the American Arbitration Association, could violate of your fiduciary duty.
- Do not limit jurisdiction to a state other than Maryland

8. Hedge Clause

Common Deficiencies

- **Magic Language**
 - ▶ “Federal and state securities laws impose liabilities under certain circumstances on persons who act in good faith and therefore, nothing in the advisory agreement shall in any way constitute a waiver or limitation of any rights that the client may have under federal and state securities laws.”
- **Do not use an indemnity clause**

9. Files - Generally

Common Deficiencies - Regulation .16 (COMAR 02.02.05.16)

- All records must be maintain for 5 years, the first 2 years in the appropriate office
- Keep client contract with client files
- Maintain complaint, litigation, and advertising files
- Electronic Records - Maintain off-site backup
- Maintain e-mail correspondence

10. Compliance Manual

Common Deficiencies - Regulation .13 (COMAR 02.02.05.13)

- Firms are required to maintain IA compliance manual, even sole props.
- Firm and representative(s) are required to register with Maryland and renew annually
- Disclosure document (ADV),
 - ▶ Require firm to address all Items and sub-item of Form ADV,
 - ▶ Require initial and annual delivery, and
 - ▶ Require update of material changes with the state (highlight).

10. Compliance Manual

Common Deficiencies

- Advisory contract: No arbitration and hedge clauses, send Division all changes (highlighted) to the contract
- Advisory fees: how they are calculated and billing procedure. If extra disclose is needed for performance fees, solicitation fees, or referral fee describe how it is made

10. Compliance Manual

Common Deficiencies – Regulation .16 (COMAR 02.02.05.16)

- Maintenance of client documentation or files: records to be maintain in their files, correspondence(including e-mails), brokerage statements, invoices, contracts, suitability records
- Book and records requirements: in general, brokerage statements, trade confirms, commission reports

10. Compliance Manual

Common Deficiencies – Regulation .16 (COMAR 02.02.05.05)

- Describe the financial books and records to be maintained, bills for business expenses, deposits, cashed checks, check books, balance sheet, detailed income expense report, bank reconciliation - Maintain these records at least quarterly
- Describe how personal securities transactions will be maintained

10. Compliance Manual

Common Deficiencies – Regulation .16 (COMAR 02.02.05.05)

- Describe insider trading policies
- Describe how advertising and marketing materials will be developed and maintained
- Describe how trades will be made and trade errors detected
- Describe the best execution policy – maintain a records of review

10. Compliance Manual

Common Deficiencies – Regulation .16 (COMAR 02.02.05.05)

- Describe the directed brokerage policy
- Describe the soft dollar policy and disclosure made to clients
- Describe the custody policy
- Describe wrap fees and how wrap fees will be disclosed

10. Compliance Manual

Common Deficiencies – Regulation .16 (COMAR 02.02.05.05)

- Describe how the corporate records will be maintained
- Describe privacy policy
- Address prohibited practices from Regulation .03.
- Books and records Regulations .16

Audit Consequences

- First Violation ➡ Educate
- Second Violation ➡ fines, conditional registrations, or publicly disclosable orders.

Helpful Websites

- Maryland Securities Division
 - ▶ www.oag.state.md.us/Securities/index.htm
- The Maryland Securities Act
 - ▶ www.oag.state.md.us/Securities/SecuritiesAct.pdf
- The Maryland Code of Regulations
 - ▶ www.dsd.state.md.us/comar/subtitle_chapters/02_Chapters.aspx#Subtitle02
- Instructions for Form ADV, Part 2A and B
 - ▶ www.nasaa.org/wp-content/uploads/2011/08/4-Form-ADV-Part-2-Instructions.pdf
- North American Securities Administrators Association (NASAA)
 - ▶ www.nasaa.org
 - ▶ www.nasaa.org/industry-resources/investment-advisers/coordinated-examinations/
 - ▶ www.nasaa.org/1719/ia-switch-resource-center/