

Investment Adviser Compliance

**Investment Adviser Registration,
Renewal, Amendment
And Post-Registration
Requirements**

Presented by

Office of the Attorney General

Maryland Division of Securities



Registration and Post-Registration Requirements

- Initial Registration Process
- Renewal Process
- Amendment Filing Requirements
- Brochure Delivery Requirements
- Record-keeping Requirements
- Financial Reporting Requirements
- Field Examinations

Initial Registration Process

- File Form ADV with Maryland through the IARD system
 - Choose “Apply for registration as an investment adviser with one or more states” link
 - Must check Maryland box in Item 1 of Form ADV Part 1B
 - For guidance, visit www.iard.com
 - For assistance, contact FINRA Call Center at 240-386-4848 or iard@finra.org
- Registration Fee
 - \$300 for firm
 - \$50 for each investment adviser representative
- Maryland receives notification through the IARD
- Maryland sends form letter requesting additional information to complete the application

Initial Registration Process

- Complete application consists of:
 - Form ADV
 - Part 1A
 - Part 1B – state only section
 - Part 2A firm brochure
 - Part 2B brochures for each supervised person
 - Appendix 1, only if sponsoring wrap fee program
 - Sample copy of each advisory contract used
 - For advisers with custody, copy of most recent balance sheet
 - Evidence that firm's principal satisfies examination requirement
 - Any other information that Commissioner may reasonably require

Initial Registration Process

- Investment Adviser Representatives
 - IA firm must also submit an application on behalf of each Investment Adviser Representative (IAR)
 - Application for IAR consists of:
 - Form U4
 - \$50 registration fee
 - Evidence that individual satisfies examination requirement
 - Application should be filed electronically through the CRD
- Examination Requirement
 - Valid exam (Series 65 or Series 7 and Series 66)
 - Designation in good standing (CFP, PFS, ChFC, CIC, or CFA)
 - Request waiver from exam based upon education/experience

Initial Registration Process

- Once a complete application is received, the Division will review the application
 - 30-day statutory review requirement
 - Application is reviewed for compliance with Maryland law
 - Goal is to ensure that your firm is in compliance on day one
- Review of application typically results in issuance of deficiency letter(s)
 - Sent by e-mail
- Adviser has 30 days to respond to deficiency letter(s)
 - Provide Division with highlighted changes

Initial Registration Process

- Deficiencies may include:
 - Inconsistencies in responses to similar items found on Parts 1 and Part 2 of Form ADV
 - For example,
 - Item 8C of Part 1A indicates that the adviser does not have investment discretion, but the adviser then discusses its discretionary authority in Item 16 of Part 2A
 - Inadequate or incomplete disclosures to Part 2 items
 - For example,
 - In response to Item 11 of Part 2A, adviser discloses that it buys and sells the same securities that it recommends to clients, but does not discuss the conflicts of interest associated with this practice
 - Failing to submit Part 2B brochure(s) for investment adviser representatives
 - Even one person firms must file the information required by Part 2B

Initial Registration Process

- Including prohibited language in client contracts
 - Mandatory arbitration clauses
 - Clauses requiring client to indemnify the adviser
- Failing to include required disclosures in client contracts
 - Every contract must disclose the following:
 - Description of services
 - Terms of the contract
 - Description of fees charged
 - Amount of prepaid fee to be refunded in the event of contract termination
 - Whether contract grants discretionary authority
 - That contract may not be assigned without consent of client

Initial Registration Process

- Upon cure of all deficiencies, application is approved
 - Registration status of firm on the IARD will be changed to approved
 - Effective letter is sent to firm by e-mail
- If firm was transitioning from SEC registration to state registration, once application is approved, adviser should file a Form ADV-W through the IARD to withdraw its registration with the SEC

Renewal Process

- Annual renewal requirement
 - Investment adviser firms and their investment adviser representatives
- Renewal is processed through the IARD
 - Renewal fee must be paid by mid-December of each year
 - \$300 for firm
 - \$50 per investment adviser representative
 - Firm must fund renewal account at FINRA in amount of renewal fees for firm and investment adviser representatives
- Failure to timely pay renewal fees will result in termination of firm's registration

Amendment Filings

- All investment advisers are required to annually file an updated Form ADV
 - Amendment must be filed through the IARD within 90 days of firm's fiscal year end
 - If there are no changes to Form ADV, investment adviser still must confirm current Form ADV
- In addition to annual amendment, investment adviser must file amendments to Form ADV or other filings, such as client contracts, within 30 days of any material changes

Brochure Delivery Requirements

- Item 2 of Instructions to Part 2A provides that an investment adviser must annually:
 - deliver to each client an updated brochure with a summary of material changes
 - Must be delivered within 120 days of the adviser's fiscal year end

OR

- deliver to each client a summary of material changes that includes
 - an offer to provide a copy of the updated brochure, and
 - information on how a client may obtain the brochure

Record-keeping Requirements

- Pursuant to section 11-411(a)(3) of Maryland Securities Act, a registered investment adviser must maintain certain books and records
- Regulation 02.02.05.16 of Code of Maryland Regulations sets forth the required books and records
- Records must be maintained for a period of 5 years, and maintained in principal place of business for first two years

Record-keeping Requirements

- There are three categories of books and records
- Category One applies to all investment advisers
- Category Two applies to investment advisers who have custody of client assets and are in addition to Category One
- Category Three applies to investment advisers who manage client assets and are in addition to Category One

Books and Records – Category One

- Transaction journals, incl. cash receipts and disbursements journals
- General ledgers
- Financial statements, incl. income statement and balance sheet
- Bank records, incl. statements and canceled checks
- Bills and statements relating to advisory business
- Order memorandum
- Written communications relating to advice provided

Books and Records – Category One

- List of all accounts over which adviser has discretion
- Copies of all powers of attorney granting discretion to adviser
- All written agreements relating to advisory business
- Copies of all advertising material
- Records of personal securities transactions for adviser's personnel
- Copies of all versions of disclosure documents given to clients, and records of delivery
- Records supporting calculations for performance claims/performance advertising

Books and Records – Category Two

- In addition to Category One records, advisers with custody must maintain additional records:
 - Journal or record of all securities transactions
 - Buys, sells, receipt and delivery of securities
 - For each client, a separate ledger showing all securities transactions
 - Copies of all confirmations
 - For each security, a record showing each client's interest in security

Books and Records – Category Three

- In addition to Category One records, advisers who manage assets must maintain additional records:
 - For each client, a record of all purchases and sales, incl. date, amount and price
 - For each security, a record showing each client's position

Books and Records

- Unlike the SEC's rule, Maryland does not currently have a Pay-to-play or Code of Ethics rule; thus, not required to maintain such records
- However, similar to the SEC's policies and procedures rule, Maryland has a rule that requires each adviser to maintain supervisory guidelines that are reasonably designed to:
 - supervise the adviser's supervised persons to achieve compliance with the Securities Act, and
 - to achieve compliance by the adviser with the Securities Act

Financial Requirements

- If investment adviser has custody of client assets or collects fees of \$500 or more at least six months or more in advance, the adviser must:
 - Comply with net capital requirements, and
 - File financial reports with the Division

Financial Requirements - Net Capital

- Adviser must either:
 - Maintain at all times a minimum net capital of \$20,000, or minimum tangible net assets of \$35,000, or
 - Be bonded in the amount of \$10,000

Financial Requirements – Financial Reporting

- Current rule requires the annual filing of both:
 - an audited balance sheet, and
 - a surprise examination of client funds report
- Division intends to adopt a version of NASAA's custody model rule which is very similar to the SEC's custody rule
 - Surprise examination report for most advisers with custody
 - For hedge fund advisers, an annual audit of the fund by PCAOB CPA
 - Advisers that use a custodian that is affiliated with the adviser must engage PCAOB CPA to prepare an Internal Control report
 - Other safeguards

Field Examinations

- Pursuant to section 11-411 of Maryland Securities Act, the books and records that are required to be maintained by investment advisers are subject to reasonable periodic, special, or other examinations
- Examinations may be for cause, but the vast majority are routine
- Exams are always unannounced