RULES AND REGULATIONS

Title 64—SECURITIES

SECURITIES COMMISSION

[64 PA. CODE CHS. 202, 203, 205, 206, 301—305, 404, 602 AND 603]

Registration of Securities; Investment Adviser Representatives; and Administration

Statutory Authority

The Securities Commission (Commission), under the authority contained in sections 202(g), 203(j), (q) and (r), 205(b), 206(b), 301(b), 302(f), 303(a)—(e), 304(a), (b) and (e), 305(a) and (f), 404(a), 602(f), 603(c) and 609(a) of the Pennsylvania Securities Act of 1972 (70 P. S. §§ 1-202(g), 1-203(j), (q) and (r), 1-205(b), 1-206(b), 1-301(b), 1-302(f), 1-303(a)—(e), 1-304(a), (b) and (e), 1-305(a) and (f), 1-404(a), 1-602(f), 1-603(c) and 1-609(a)) (act) amends and adopts regulations concerning the subject matter of the act.

Publication of Notice of Proposed Rulemaking

Publication of a notice of proposed rulemaking appeared at 30 Pa.B. 2237 (May 6, 2000).

Public Comments

The Commission received comment letters from the Certified Financial Planners Board of Standards (CFP), the Investment Company Institute (ICI), the Financial Planning Association (FPA) and the Investment Counsel Association of America (ICAA). Under section 5(c) of the Regulatory Review Act (71 P. S. § 745.5(c)), comment letters were forwarded within 5 days of receipt to the Independent Regulatory Review Commission (IRRC) and the legislative standing committees. Comments were made with respect to the following regulatory proposals:

§ 303.012. The ICI and FPA commented that the amount specified in subsection (b)(1) should be raised from $500 to $1,200. This dollar figure refers to the amount of funds received by an investment adviser as prepayment of advisory fees 6 months or more in advance of when they are due. An investment adviser applying for registration with the Commission that fell into this category would be required to file an audited balance sheet prepared in accordance with generally accepted accounting principles. This requirement mirrors similar requirements for investment advisers required to be registered with the United States Securities and Exchange Commission (SEC) and uniform model rules adopted by the North American Securities Administrators Association (NASAA) for investment advisers who are regulated exclusively by the states.

In 1996, Congress enacted the National Securities Markets Improvement Act of 1996 (NSMIA). Prior to this legislation, investment advisers conducting business in this Commonwealth had to be registered with the Commission and, if they were engaging in interstate commerce, with SEC. In NSMIA, Congress recognized that there were basically two types of investment advisers—those who were small advisers that provided advice to an exclusively retail clientele and those who were money managers for institutions and individuals with significant assets under management.

In NSMIA, Congress determined that the SEC would have exclusive authority over investment advisers with assets under management of $25 million or more, known as Federally-covered advisers (FCAs) and states would have exclusive authority over investment advisers which had less than $25 million under management, known as state-registered advisers (SRAs). The NSMIA effectively split the universe of investment advisers into two distinct groups regulated by two distinct levels of government—State and Federal. Implicit in the NSMIA was legislative recognition that what may be appropriate regulation for FCAs may not be appropriate for SRAs. The NSMIA, however, did retain state authority over the FCAs with respect to fraudulent or deceptive conduct.

Post-NSMIA, the NASAA adopted a Memorandum of Understanding Concerning Investment Advisers and Investment Adviser Representatives (MOU) on April 27, 1997 (available at www.nasaa.org/iaoversight/iamou). The MOU recognized that uniformity of rules among states concerning investment advisers subject exclusively to state registration was crucial and a working group was established . The Commission subscribed to the MOU and this rulemaking seeks to implement model rules adopted by the NASAA in the context of the MOU (NASAA Model Rules).

Prior to this rulemaking, an applicant described in subsection (b)(1) was not required to file an audit report. To be uniform with the NASAA Model Rule 202(a)-1, the Commission proposed adoption of the requirement that an applicant who receives prepayment of advisory fees of $500 or more per client 6 months or more in advance of when they are due be required to file an audited statement of financial condition. The commentators note that the SEC recently issued a notice of proposed rulemaking to change various requirements for the FCAs and, in the SEC provision analogous to this one, the SEC proposes to raise the aggregate amount from $500 to $1,200. The commentators urged, for Federal/state uniformity, that the Commission do likewise for SRAs.

Although the NASAA Model Rule 202(d)-1 is set at $500, the new SEC provision will be found in Form ADV which is an application form used by both the states and the SEC. Therefore, most applicants will be apprised of the SEC rule allowing up to $1,200 in prepayment of fees and will have to perform further research to determine that the rule is not applicable to the SRAs. Also, the NASAA Model Rule could be changed in the future to reflect the new SEC provision. The Commission adopted the amendment with the $1,200 figure which is consistent with the SEC.

The FPA and ICI also commented about application of this regulation to the SRAs whose principal place of business is not in this Commonwealth. Another part of the NSMIA adopted "home state" treatment with respect to net capital and bonding and books and records. For example, an SRA maintains its principal place of business in Maryland but has 10 retail clients in this Commonwealth which requires registration with the Commission. Under the NSMIA, the Commission is prohibited from requiring the Maryland SRA to comply with the requirements of any Commission regulation concerning net capital and bonding or books and records that exceed the requirements of the Maryland Securities Division if the Maryland SRA is registered or licensed in Maryland and is in compliance with applicable requirements of the Maryland Division of Securities.

Currently, the United States Senate Committee on Banking, Housing and Urban Affairs is drafting legislation known as the Securities Markets Enhancement Act (SMEA). The Commission, through the NASAA, has been actively involved with drafting of the SMEA as have ICI and FPA. One SMEA proposal is to provide "home state" treatment for financial reports. All relevant parties, including the FPA and ICI, have agreed to language to be included in section 222 of the Federal Investment Advisers Act of 1940 (1940 Act) to implement the treatment. The Commission added a provision that mirrors the language proposed to be amended into the 1940 Act by the SMEA.

§ 303.014. The ICI commented that the Commission should clarify that the rule included investment adviser representatives of the FCAs. The Commission agreed and inserted language suggested by the ICI. Another comment was that, in subsection (c), there should be a conjunctive "or" between investment adviser representative (IAR) and investment adviser rather than "and." The apparent theory was that the Commission might be overstepping its authority under the NSMIA by requiring a FCA to file something with the Commission that was not filed with the SEC and the language may result in the Commission receiving duplicative filings.

Form U-4, which is the document which must be maintained current under this regulation, is a uniform form used by state securities regulators and industry for registration of IARs employed by SRAs and FCAs. Under the instructions to Form U-4, the "Appropriate Signatory" is "the individual designated by the . . . investment adviser [SRA or FCA] . . . who is authorized to execute Form U-4 on its behalf." Since Form U-4 must be signed by the employing firm, an IAR cannot file an amendment on his own. Therefore, there is little scope for filing duplication and, in the 8 years since this regulation was last amended, this has not been the case.

The ICI's concern about the FCA's signing amendments to Form U-4 as violative of the NSMIA is misplaced. This regulation requires no more signatures than what currently is required by the instructions to Form U-4. No FCA has declined to sign Form U-4 on behalf of an IAR with a place of business in this Commonwealth or complained about this requirement. If the ICI's belief is sincere, the better course of action would be to request the NASAA and securities industry representatives to revise Form U-4. On this basis, the Commission declined to accept this comment.

§ 303.015. The ICI commented that the regulation should be revised to distinguish initial notice filings from renewal filings. The Commission agreed. Under section 303(a)(iii) of the act, a FCA must file a copy of its Form ADV as filed with SEC prior to acting as a FCA in this Commonwealth and pay a notice filing fee of $300. This is the initial filing requirement. For renewals, the FCA, under section 602(d.1) shall pay an annual notice filing fee of $300. The Commission revised this regulation to address ICI's concerns and also has indicated that renewals may be made through an investment adviser registration depository.

§ 303.021. The ICI urged a clarification to the language in subsection (c). The Commission agreed.

§ 303.032. The ICI, FPA and ICAA commented on this regulation. The CFP also commented. The CFP commented that the designation in proposed § 303.032(c)(1)(ii)(A) should read "Certified Financial Planner Board of Standards, Inc." The Commission accepted this comment and modified the amendment accordingly.

The ICI, FPA and ICAA expressed two identical concerns. The first concern was that there was no provision which exempted an investment adviser or an IAR from taking the required examinations if the investment adviser or an IAR had taken the appropriate examination after January 1, 2000 (which date is important because new Series 65 and Series 66 examinations were implemented on that date), was registered continuously in another state as an investment adviser or an IAR since the date of the examination but applied for registration in this Commonwealth more than 2 years from the date of taking the examination. The Commission agreed with this comment and added subsection (a)(3) which would exempt persons from having to retake an examination if they met either of the criteria in subsection (a)(1) or (2) and had not been out of the business for more than 2 years immediately preceding the filing of an application for registration in this Commonwealth. This parallels an existing provision applicable to agents of broker-dealers in § 303.031.

The second issue raised was automatic waivers of the examination requirement provided in subsection (c) based upon a person possessing a specified designation and not having any disciplinary history requiring an affirmative response to the Disclosure Information section of Form U-4. The commentators argue that this was not part of the NASAA Model Rules even though they recognize that a state securities regulator may want to require additional examinations for any individual found to have violated state or Federal securities laws. The commentators claim that the proposed language is too broad as it would include bankruptcies and customer complaints in addition to Federal or state securities laws violations or proceedings.

The Commission had established criteria for the waiver of exams in §§ 604.014 and 604.016 which is exerciseable by delegated authority under § 606.041(b) upon application. An intent of this amendment was to eliminate the application process and make certain waivers automatic if the applicant had no reportable disciplinary history.

Under the amendment, existence of reportable disciplinary history does not consign the applicant to never being eligible for a waiver of the examination requirement. It just would not make the waiver automatic. A waiver still could be granted on a case-by-case basis and subsection (c)(4) makes it clear that applicants have the ability to petition the Commission for an order waiving the examination requirement.

In recognition of the comments, however, the Commission did modify subsection (c)(1)—(3) to narrow the disciplinary history to an affirmative response to Items 23A-E or H of Form U-4 or successor item thereto. Items 23A and B address criminal convictions; 23C-E deal with proceedings before the SEC, CFTC, state securities regulators and self-regulatory organizations (stock exchanges, NASD) and Item 23H relates to court injunctions. The Commission believes this provides a balanced approach to the concerns of industry and the need to protect investors.

The FPA also commented that the regulation should not afford waivers to certified public accountants (CPAs) or attorneys. In the statement of policy published in § 604.016 in which the Commission expressed its disposition to grant waivers of examination requirements to persons holding certain designations referred to in subsection (c), the Commission also expressed a similar disposition with respect to CPAs and members of the bar who are in good standing. The Commission believes it

would be unfair at this time and, without substantial evidence, to treat CPAs and attorneys differently than the other designations contained in the same statement of policy. Therefore, the Commission declined to accept this comment.

§ 303.042. The ICI commented on this proposal and raised the same issue as was raised with respect to § 303.012. The Commission determined to address this comment in the same manner as the ICI comment raised with respect to § 303.012.

The FPA commented on the proposal that a SRA with discretionary authority over client funds and securities, but without custody, would be required to maintain a minimum net worth of $10,000. The FPA was concerned that this would act as a barrier to entry into the business for first time advisers. The FPA suggested that this requirement be waived if: (1) the SRA had a certain amount of experience and a satisfactory disciplinary record; (2) the SRA provided evidence of errors and omissions insurance sufficient to cover investor losses, such as $100,000 per occurrence with an aggregate amount of coverage based on experience; or (3) the SRA's compensation is a fee based solely on the amount of assets under management, is a retainer or other flat fee, an administrative fee for services rendered under the Employee Retirement Income Security Act of 1974 and the adviser does not receive any other compensation or pecuniary benefit, directly or indirectly, as a result of any purchase or sale in the account.

Under the MOU, the NASAA adopted Model Rule 202(d)-1 which established uniform capital requirements for SRAs (CCH NASAA Reports ¶3529-3). To promote uniformity of regulation among the states, the Commission proposed to substantially lower its current capital requirements of $20,000 minimum net capital or $50,000 tangible net worth to $10,000 net worth contained in the NASAA Model Rule. Adoption of the amendment would provide substantial regulatory relief from the current net worth requirements for approximately 32% of registered investment advisers that have custody. For exceptional circumstances, the Commission does possess the authority to waive the requirements of this regulation on a case-by-case basis upon good cause shown. Therefore, the Commission adopted the amendment as proposed.

§ 304.012. The ICI suggested a minor clarifying amendment which the Commission accepted.

§ 304.022. The ICI again raised the same comments with respect to this section as it did with § 303.012. The Commission addressed the comments in the same manner as § 303.012.

§ 305.011. The ICI expressed two concerns. The first was that the regulation did not have a specific provision which addressed "home state" treatment afforded for books and records under the NSMIA. The second was that, to the extent that this regulation imposed recordkeeping requirements beyond those of the SEC with respect to broker-dealers, there was insufficient recognition that the NSMIA would preempt those provisions for broker-dealers registered under the Securities Exchange Act of 1934 (1934 Act).

On the first concern, the Commission added language consistent with the "home state" treatment for investment advisers with a principal place of business outside this Commonwealth. On the second concern, the Commission modified the regulation to be consistent with the Rules of Conduct for member firms of the National Association of Securities Dealers (NASD). Because the requirements of this regulation now mirror the NASD Conduct Rules applicable to SEC registered broker-dealers, the regulation does not extend beyond that permitted by the NSMIA. The requirements of subsection (c) parallel those contained in the following NASD Conduct Rules:

Subsection (c)(1)—NASD Conduct Rule 3010(a)(5) and 3010(b).

Subsection (c)(2)—NASD Conduct Rules 3010(a)(6) and (b).

Subsection (c)(3)—NASD Conduct Rules 3010(a), (b), (e) and 3110(c)(1).

Subsection (c)(4)—NASD Conduct Rule 3010(d).

Subsection (c)(5)—NASD Conduct Rule 3010(c).

Subsection (c)(6)—NASD Conduct Rules 3010(a), (b) and 3110(d).

Subsection (c)(7)—NASD Conduct Rules 3010(d) and 3110(c)(3).

Subsection (c)(8)—NASD Conduct Rules 3010(b)—(d).

Subsection (c)(9)—NASD Conduct Rule 3010(a)(7)

Subsection (c)(10)—NASD Conduct Rule 3010(c) and NASD Notice to Members 98-38.

The Commission did modify the amendment to add a new subsection to clarify the length of time records are required to be kept under subsection (c)(9) and (10)(iii) and the manner in which they may be kept. The Commission could find no similar time limitation in the NASD Rules. The relevant NASD rule on inspections states that "Each member shall retain a written record of the dates upon which each review and inspection is conducted." As there appears to be no controlling provision Federally, the Commission does not believe it is constrained by the NSMIA. The Commission's experience is that, in supervision cases, usually 3 years have passed before the investor files a complaint. Therefore, the Commission adopted a requirement to keep any records required by this section for 5 years, the first 2 years in an easily accessible place.

§ 305.019. The ICAA expressed a concern that, since this section covered IARs who may work for a FCA, the Commission may be attempting to regulate conduct of FCAs which is impermissible under the NSMIA (except to the extent that the conduct of a FCA constitutes fraud or deceit). The ICAA suggested that the regulation be limited solely to IARs of SRAs. The Commission disagrees.

The Commission, per the NSMIA and Act 109 of 1998, has no registration authority over FCAs. The purpose of this regulation is to place all registrants under the Commission's jurisdiction (including the SRAs and IARs) on notice as to what types of activity may be deemed "dishonest or unethical" which could form the basis for revocation, suspension or conditioning of their license pursuant to section 305(a)(ix) of the act. Under that section, the Commission only has authority to affect the licenses of persons over whom it has registration jurisdiction.

Even if the SRAs or IARs would engage in conduct described in this regulation, a revocation, suspension or conditioning of a license is not automatic. The Commission must institute a separate proceeding against the registrant. If, in its investigation of an IAR of a FCA for activity described in this regulation, the Commission concluded that the FCA was responsible for the activity and not the IAR, the Commission could proceed against the FCA only by issuance of an Order to Show Cause and

only if the activity constituted fraud or deceit. Under Federal law, the Commission cannot affect the ability of the FCA to conduct advisory business in this Commonwealth.

To adopt the ICAA's proposal would be to leave out an significant number of IAR registrants over which the Commission has full regulatory authority from the ambit of this regulation which would create an unequal playing field between the IARs of FCAs and IARs of SRAs. This is not desirable regulatory policy. To address the ICAA's concern, the Commission, however, did add a new subsection to make it clear that the regulation does not apply to the FCAs unless the conduct otherwise is actionable under section 401(a) or (c) or 404 of the act.

§ 305.061. The ICAA commented that, under the investment adviser registration depository scheme, Form ADV-W only will be used to withdraw the registration of a FCA from SEC. The Commission made changes to this amendment for withdrawing a notice filing by a FCA consistent with this comment. The Commission also added a provision to address withdrawal from registration with the Commission in instances where an SRA becomes a FCA.

§§ 303.012—306.061. The ICAA recommended that all references in these regulations to a central registration depository be replaced with a reference to an investment adviser registration depository. The ICAA was concerned that persons may confuse the registration depository for investment advisers with the Central Registration Depository run by the NASD for broker-dealers and agents. The Commission agreed with the ICAA's comment and changed references.

§ 404.010. The ICAA and ICI both commented on this amendment. Both were concerned about indirect regulation of FCAs. The ICAA asserted that firms, not IARs, advertise. The Commission's experience is otherwise as there have been many instances where a IAR has advertised without the knowledge, consent or authorization of the employing firm. This regulation, which is issued under section 404 of the act makes it clear in subsection (c) that the prohibitions imposed by that section apply to FCAs only to the extent that the prohibited conduct involves fraud or deceit.

Like the similar suggestion made on § 305.019 (the ICI did not raise this comment on § 305.019), to adopt the ICAA's proposed language (and the ICI's with respect to this amendment) would be to leave out a significant number of IAR registrants over which the Commission has full regulatory authority from the ambit of this regulation. This would create uneven regulation between the IARs of FCAs and the IARs of SRAs. That is not desirable regulatory policy. To address this issue, the Commission, however, added a subsection to indicate that this section does not apply to FCAs unless the conduct otherwise is actionable under sections 401(a) or (c) or 404 of the act.

§§ 404.011 and 404.012. The ICI suggested that these two rules more closely conform to the revisions to SEC rules proposed in its recent release on Form ADV. For instance, the SEC proposes to incorporate the wrap fee brochure disclosure into the investment adviser disclosure brochure. The Commission agreed and has incorporated the provisions of § 404.012 into § 404.011 consistent with the SEC proposals. This, of course, necessitated renumbering of §§ 404.013 and 404.014.

In the new Form ADV which is used by the SEC and state securities regulators, the FCAs and SRAs both will have to develop a disclosure brochure as part of completing Form ADV. Therefore, no investment adviser can be registered either with the SEC or with a state unless it has developed a brochure. Under the Commission's proposed rulemaking, an SRA did not have to provide a disclosure brochure to those clients for whom it provided impersonal advisory services requiring a payment of less than $200.

Because Form ADV requires each SRA to create a disclosure brochure as part of the application process, the Commission believes that every client should be entitled to receive the same disclosure about the adviser. This requirement adds no burden to the registrant as it must develop the disclosure brochure anyway as part of the application process. This being the case, the Commission determined to delete the language which appeared in § 404.011(d) in the proposed rulemaking and modify accordingly the language which had appeared in § 404.011(b) and (g).

By letter dated June 26, 2000, Commission staff advised the ICI, FPA and ICAA of the foregoing responses to their comments and provided them with the text of the final-form regulations. By letter dated June 28, 2000, the ICI expressed support for adoption of the final-form regulations as they appear herein. On the same date, representatives of the FPA and ICAA advised Commission staff by telephone that those organizations joined the ICI in their support for adoption of the final-form regulations.

Commission Comments

§ 603.031. The Commission revised subsection (f) to insure that the confidentiality provisions of this section will apply to individuals who are investment advisers doing business as sole proprietors and individuals who are principals of broker-dealer and investment adviser firms.

Comments of the SEC

By letter dated May 30, 2000, and received on June 5, 2000, SEC Chairman Arthur Levitt wrote each state securities administrator urging state regulators to require investment advisers and Federally covered advisers to participate in a Web-based, one-stop electronic filing system for investment advisers known as the Investment Adviser Registration Depository (IARD). Mr. Levitt noted that the SEC has expended $3.2 million in Federal funds to develop the IARD and will be requiring all investment advisers subject to SEC jurisdiction to make filings through that system. Chairperson Levitt explained that full participation by the states to require receipt of notice filings by FCAs through IARD as well as registration applications for SRAs will result in keeping user fees as low as possible for SRAs.

In its proposed form rules and in minor revisions suggested by commentators and included in the final-form regulations, the Commission will have authority to designate, by order, the IARD as the filing depository for the FCAs, SRAs and IARs. As the availability of the IARD for filing by these various groups will be phased in over the next 12-18 months, the Commission envisions issuance of a series of orders at differing times designating the IARD as the filing depository.

The Commission further noted that the United States Senate Banking Committee is considering amendments to the Investment Advisers Act of 1940 which would preempt state jurisdiction over notice filings and fee payments by the FCAs and registration applications and fee payments by out-of-State investment advisers subject to State registration if the Commission did not accept filings

made through the IARD. The Commission agrees with the SEC that compulsory filings with the IARD will provide a more complete database for investor protection and lowering of costs to participants. It also preserves state jurisdiction if Congress enacts the proposed amendments.

Comments of the IRRC

By letter dated July 6, 2000, the Commission received the following comments of IRRC.

§ 303.012. IRRC reiterated the comments of the ICI and FPA with respect to increasing the threshold in subsection (b)(1) from $500 to $1,200 and asked the Commission to consider raising the threshold. In its final form rules, the Commission increased the threshold to $1,200.

IRRC restated the comments of the ICI and FPA concerning the filing of certain statements of financial condition by out-of-State investment advisers. In its final form rules, the Commission adopted subsection (f) that gives "home state" treatment to these financial reports which mirrors a proposed amendment to the 1940 Act being considered by Congress.

IRRC pointed out a typographical error in subsection (b)(2). In its final form rules, the Commission corrected the error.

§ 303.014. IRRC agreed with a comment made by the ICI to clarify the application of subsections (a) and (b) with respect to Federally covered advisers. In its final form rules, the Commission adopted clarifying language.

With respect to the ICI's comment on subsection (b), IRRC requested the Commission to explain its position. As set forth under the Public Comments, the Commission explained why it disagreed with the ICI's assertion that this subsection creates the potency for duplicative filings and demonstrated that, historically, such has not been the case. By letter dated June 28, 2000, the ICI stated its support for the final form rules which, in this respect, were unchanged from the proposed form rules.

§ 303.015. In noting a comment made by the ICI, IRRC asked the Commission to explain the renewal process for the FCAs. In its final-form rules, the Commission substantially revised this section to distinguish initial notice filings and renewals. Section 303(a)(iii) of the act requires the initial notice filing on Form ADV and section 602(d.1) of the act requires an annual notice filing fee. The Commission also would have the authority to require renewals to be made through IARD which basically would consist of electronic transmittal of the annual filing fee to the Commission's depository bank.

§ 303.021. IRRC restated an ICI comment that registered investment advisers should be added to this section. In its final-form rules, the Commission included registered investment advisers.

§ 303.032. With respect to subsection (a)(1) and (2), IRRC reiterated the comments of ICI and FPA concerning application of the 2-year limitation. In its final-form rules, the Commission added a new paragraph (3) to address this issue and resolve the potential problem raised in the ICI and FPA comment letters. By letter dated June 28, 2000, the ICI expressed support for adoption of the final form rules and, on the same day, a representative of the FPA advised Commission staff by telephone that FPA also supported adoption of the Commission's final form rules.

IRRC also noted the FPA's concern about providing waivers of the examination requirement for attorneys and certified public accountants. This explanation has been provided in the Public Comments Section of this Preamble and, on June 28, 2000, a representative of the FPA advised Commission staff by telephone that the FPA supported adoption of the Commission's final form rules.

IRRC further noted a comment from the Certified Financial Planners Board of Standards that the designation contained in the proposed form rules was imprecise. In its final-form regulations, the Commission adopted the designation appropriate to this organization.

§ 303.042. IRRC raised the same comment as the ICI and FPA concerning the $500 or $1,200 threshold issue which also was raised with respect to § 303.012. In its final form rules, the Commission adopted a threshold of $1,200.

With respect to subsection (d), IRRC requested an explanation of the circumstance under which the Commission may require a current appraisal of an asset, the value of which is being submitted to establish the required net worth. For instance, if an investment adviser possessed a work of art which he wanted to assign a value for purposes of calculating the net worth required for an investment adviser under the act and regulations, the Commission may request an apprisal of that object rather than accept the value submitted by the registrant. The same may be true with respect to shares in a closely-held company or a general or limited partnership. In practice, this provision is rarely used as a registrant that must demonstrate a certain net worth usually does so in cash, cash equivalents or marketable securities.

§ 303.051. IRRC requested an explanation of why the Commission used the term "may" instead of "shall" in subsection (a)(1) which deviates from the NASAA model rule. The reason for this deviation was that the Commission wanted to retain discretion as to whether it would allow an investment adviser to make up its net worth deficiency through a surety bond. While the Commission does not necessarily foresee any particular circumstance under which it would not grant such an order, adopting "shall" would forever foreclose the Commission from raising any objection.

With respect to subsection (c), IRRC requested a description of the circumstances under which the Commission would request evidence of existence of a surety bond. One instance is when an investment adviser is filing an annual financial report under § 304.022 which indicates that the adviser is meeting its net worth requirement through a surety bond (assuming original approval was granted by the Commission under § 303.051). The Commission may ask for evidence of the surety bond to insure that it is current and in full effect for the appropriate amount. The Commission conducts routine and for cause examinations of investment adviser and broker-dealer branch offices throughout this Commonwealth. One of the items which is checked during an examination is that the investment adviser has the requisite net worth. Again, if the investment adviser is relying on a surety bond to meet the applicable net worth requirement, the examiner may ask for evidence that it is current and in full effect for the appropriate amount.

§ 304.012. IRRC reiterated the ICI's comment that an introductory clause should be added to subsection (a) indicating in the forepart of the regulation that the requirements of this section do not apply to persons specified in subsection (j). In its final form rules, the Commission adopted an introductory clause.

In its comments, IRRC asserted that the definition of "investment adviser representative" in this rule was at

variance with the definition of that term in section 102(j.1) of the act. The Commission believes that an individual described in subsection (a)(12)(iv) and (13)(v) would be an investment adviser representative under section 102(j.1) of the act and that it has not gone beyond the statutory definition. In reality, the definition used in paragraphs (12) and (13) is a subset of the statutory definition.

As IRRC noted, this language is consistent with the NASAA Model Rule on this subject. The NASAA (which follows identical statutory language as section 102(j.1) of the act) and the Commission felt that it was important to communicate a more precise nature of a person's activities for whom the investment adviser would have the compliance burden of maintaining books and records. This gives the firm's principals a better, "plain English" understanding than the statutory definition otherwise may impart. The important issue is that the Commission not go beyond the statutory definition and include persons within the ambit of the regulation that the Legislature did not intend. IRRC is appropriately sensitive to this issue as is the Commission.

The Commission is satisfied that the definition contained in paragraphs (12) and (13) does not go beyond the statutory definition. In fact, it explicitly does not include solicitors which are included in the statutory definition of investment adviser in section 102(j.1)(i)(D) of the act. Under section 609(a) of the act, the Commission is authorized to define "any terms, whether or not used in this act, insofar as the definitions are not inconsistent with the act." The Commission posits that the definition of "investment adviser representative" adopted for purposes of paragraphs (12) and (13) are not inconsistent with section 102(j.1) of the act.

The Commission also believes that uniformity, particularly in the area of books and records, is important. This language is taken directly from the relevant NASAA Model Rule. A change in this provision may inject uncertainty for investment advisers and the professionals who counsel them in the interpretation of their legal obligations under the act.

§ 304.052. IRRC requested whether the Commission could specify what constitutes "adequate." In its final-form regulations, the Commission deleted the phrase "adequately disclosed to each client in writing" because the disclosure of compensation is now covered by adoption of § 404.011 which requires delivery of a brochure containing all the information required by Part 2 to Form ADV. Part 2 of Form ADV, which also applies to FCAs, requires disclosure of material information about the firm and its business practices, including fees and compensation. The Commission thinks that the disclosure of fee information is best addressed in § 404.011 and in uniformity with the requirements of Form ADV.

§ 305.011. With respect to subsection (a)(1), IRRC commented on use of the term "timely" and whether a specific period of time should be adopted. The Commission reviewed this section and, in its final rules, adopted language used in NASD Rule of Conduct 3010 upon which it is modeled which does not include use of that term. Revisions were made to subsections (a)(1) and (c).

On subsection (c), IRRC restated the ICI's comment about recordkeeping requirements for out-of-state investment advisers. In its final form rules, the Commission added subsection (e) which addresses this comment in the same fashion as a similar comment raised on § 303.012.

Also on subsection (c), IRRC suggested that the Commission should establish the specific length of time records required under this section need be kept. In its final form rules, the Commission added subsection (d) which specifies 5 years, the first 2 years being in an easily accessible place. This language is taken from a similar provision in the NASD Rules of Conduct.

§ 305.061. IRRC noted the comment made by the ICAA. In its final form rules, the Commission adopted provisions allowing withdrawals from registration through the IARD, including withdrawals from State registration resulting from a registrant becoming a FCA.

§ 404.011. IRRC expressed concern that this section may be inconsistent with Federal rules. In its final-form rulemaking, the Commission adopted this section which is modeled on the Federal rule proposed in the SEC Release on Form ADV. This action included combining (a la the Federal model) proposed rules §§ 404.011 and 404.012. The Commission does not anticipate that the SEC rule proposal will change significantly upon final adoption by the SEC. In the event that the Federal rule would change, the Commission would use its powers under section 609(a) of the act to waive any provision of this section which would be inconsistent with the final Federal rule.

Summary and Purpose of Final-Form Regulations

§ 202.070. The change clarifies when the exemption would be available to certain nonemployes included in compensatory plans or compensatory contracts.

§ 203.101. The change allows attorneys to give a clear legal opinion on the availability of the exemption.

§ 203.171. The change allows attorneys to give a clear legal opinion on the availability of the exemption.

§ 203.185. The change allows attorneys to give a clear legal opinion on the availability of the exemption.

§ 203.186. The change allows attorneys to give a clear legal opinion on the availability of the exemption.

§ 203.192. The new regulation creates a registration exemption for certain rights offerings and exchange tender offers made by foreign private companies to residents of this Commonwealth that are exempt from registration with the SEC.

§ 205.021. The change replaces Form 205 with Form R and eliminates the requirement to file Form R for all issuers applying for registration under section 205 of the act except those relying on SEC Regulation A.

§ 206.010. The change replaces Form 206 with Form R and restricts the requirement to file Form R to issuers making an offering under sections 3(a)(4) or (11) of the Securities Act of 1933, Rule 504 of SEC Regulation D or SEC Regulation A.

§ 301.021. This regulation has been repealed because its provisions have been superseded by a new Web-based electronic transfer program.

§ 302.063. This change codifies a No Action Letter issued by the Commission in 1999 concerning third-party brokerage activities in a limited purpose bank branch office.

§ 303.012. This change anticipates electronic filing through an investment adviser registration depository and eliminates the requirement for investment adviser applicants that do not have custody, possession or discretion over clients' funds or securities to file a statement of financial condition.

§ 303.014. This change utilizes the new term "investment adviser representative" and anticipates electronic filing through an investment adviser registration depository.

§ 303.015. This new regulation implements the notice filing requirement imposed on the FCAs by Act 109 of 1998.

§ 303.021. This change accords the same treatment to notice filings by the FCAs for successor firms as is accorded to registered investment advisers.

§ 303.032. This change repeals the experience requirement for agents and the IARs, adopts new uniform examinations for investment advisers and the IARs, uniform grandfathering provisions and uniform waivers of the examination. These are based upon on a uniform model adopted by the NASAA.

§ 303.042. This change reduces net worth requirements for investment advisers and eliminates the current net worth requirement for investment advisers that do not have custody, possession or discretion over clients' funds or securities. These changes are based on a NASAA model rule and conform to Federal law as provided by the NSMIA.

§ 303.051. This change revises the surety bond requirements to conform to a NASAA Model Rule and the requirements of the NSMIA.

§ 304.012. This change establishes recordkeeping requirements for investment advisers in Subpart C. This change conforms to a NASAA Model Rule and the NSMIA.

§ 304.022. This change requires investment adviser financial reports. It conforms to the NSMIA, a proposed amendment to the NSMIA and a NASAA Model Rule.

§ 304.052. This change recognizes that standardized commission rates charged by National securities exchanges have been eliminated.

§ 305.011. This change expands coverage of this regulation to IARs and incorporates requirements found in the NASD Code of Conduct Rules.

§ 305.019. This change expands coverage of this regulation to IARs and includes failure to comply with investor suitability requirements as a basis for taking action against a person's license.

§ 305.061. This change anticipates electronic filing through an investment adviser registration depository and extends the regulation to withdrawal of notice filings by the FCAs and SRAs who become the FCAs.

§ 404.010. This change extends this regulation to the IARs.

§ 404.011. This new regulation makes it a fraudulent, deceptive or manipulative act or practice within the meaning of section 404 of the act for an investment adviser to fail to furnish a disclosure statement to prospective clients. Also, an investment adviser who sponsors a wrap fee program must furnish a wrap fee disclosure statement to prospective clients. Similar rules apply to the FCAs.

§ 404.012. This new regulation makes it a fraudulent, deceptive or manipulative act or practice within the meaning of section 404 of the act for an investment adviser to make cash payments to persons who solicit business for the investment adviser unless certain requirements are met. A similar provision already applies to FCAs.

§ 404.013. This new regulation makes it a fraudulent, deceptive or manipulative act or practice within the meaning of section 404 of the act for an investment adviser to have custody or possession of clients' funds or securities unless certain requirements are met. This regulation is similar in scope to § 404.020 which is being deleted. A similar provision already applies to the FCAs.

§ 404.020. This regulation was repealed in favor of § 404.013 which codifies current requirements.

§ 602.060. This change deletes the subscription fee for the Commission's Bulletin and Annual Report. These publications are now available to the public free of charge.

§ 603.031. This change would clarify that any record which the Commission deems excluded from the definition of a public record in 65 P. S. § 66.1(2) may be withheld from the public and that confidential treatment would be provided for Social Security numbers, home addresses and dates of birth of individuals appearing on Form U-4, Form BD and Form ADV.

Persons Affected by these Final-Form Regulations

The first eight proposed regulatory actions will affect issuers relying on certain exemptions from registration to issue securities and issuers of securities in registered offerings. The bulk of the remaining proposed regulatory actions will affect, to varying degrees, broker-dealers, agents, the FCAs, SRAs and IARs. These actions are required to implement Act 109 of 1998 and the NSMIA.

Fiscal Impact

Investment Advisers; Federally Covered Advisers. Regulatory actions affecting investment advisers will lower compliance costs by reducing or eliminating net worth requirements, reducing or eliminating required financial reports, waiving examination requirements for certain classes of applicants and conforming Commission rules to uniform NASAA Model Rules and provisions of the NSMIA. The FCAs will benefit from significant cost reductions by being able to make one electronic filing and fee payment to satisfy notice filing and fee payment requirements in every state they transact business.

The final-form regulations permit the Commission to issue orders requiring participation in the IARD. These user fees slightly will offset the significant savings afforded by these final-form regulations to SRAs by the elimination of the current $5,000 net capital/$12,500 tangible net worth requirement for two-thirds of investment advisers registered in this Commonwealth (those without custody or discretion) and a reduction from $20,000 net capital/$50,000 tangible net worth to $10,000 net worth for the other one-third of investment advisers registered in this Commonwealth (those with discretion) versus a projected $125 annual IARD user fee for the SRAs. The final-form rules are expected to save the SRAs a total of $10 million in collective net worth requirements versus collective annual IARD user fees of $58,750.

Development of the IARD by the SEC was mandated by Congress in the NSMIA. Although the SEC has expended $3.2 million in Federal funds to underwrite development costs, the IARD will require payment of a user fee to cover operating costs. This user fee would be in addition to license fees and assessments required under sections 602(d.1) and 602.1 of the act. Nevertheless, all the commentators, which represent the FCAs and SRAs, commented favorably on the final form rules wherein the Commission, by order, can require filings to be made through the IARD.

The exact amount of the user fees has not yet been determined by the SEC, in part because it does not know the level of participation by the SRAs. That is why the SEC Chairperson Arthur Levitt, in his May 30, 2000, letter, urged the widest possible participation by the states because that would result in the lowest possible user fees for SRAs. In the same letter, it was noted that larger, FCAs will pay higher user fees than the SRAs.

The NASAA recently advised the Commission (in an unofficial capacity) that it thought the likely annual user fee would be approximately $125 for SRAs and approximately $50 for IARs. As of July 1, 2000, the Commission has 470 registered investment advisers and 2,333 registered IARs. The vast majority of registered IARs (69%) work for FCAs which will be mandated by the SEC to use IARD.

In return for the IARD user fee, investment advisers can make as many filings by means of the IARD electronic system as they want (registration applications, amendments, filing and updating of disclosure materials). This eliminates duplicate filings with other states, associated mailing costs and issuing separate checks for fee payments. Being Web-based, the investment advisory community will have access to IARD on a 24-hour a day basis. The NASAA further advised that the IARD does provide hardship exemptions for persons who may not have access to Internet or, due to computer problems beyond their control, may not be able to file timely through the IARD. The Commission intends to honor hardship exemptions granted by the IARD.

The Commission understands that the United States Senate Banking Committee is considering amendments to the 1940 Act which would preempt state jurisdiction over notice filings and fee payments by FCAs and registration applications and fee payments by out-of-state investment advisers subject to state registration if the Commission did not accept filings made through the IARD.

Given Congressional support for mandating the IARD in the NSMIA and current Congressional ruminations on mandating state participation in the IARD on pain of preemption; the request of the SEC for state participation in the IARD; support for the IARD by the trade organizations representing the entire spectrum of the investment advisory community; the elimination or substantial reduction of net worth requirement for all investment advisers registered with the Commission; the benefit to investors of having a complete, Web-based data base to consult when looking for investment advisory services; and the time savings to the investment advisory community of making all regulatory filings in one place online, the Commission believes the benefits of participating in the IARD justify the costs of participation to the investment advisory community.

Issuers. Most companies making a registered public offering of securities no longer will have to expend the time and money to file an additional state-specific form with the Commission.

Recordkeeping, supervision, disclosure delivery. The recordkeeping provisions, supervisory requirements and disclosure delivery requirements are similar to what currently is required by the NASD Code of Conduct, existing Commission regulations or Federal law with respect to FCAs. Therefore, the regulatory actions will not impose additional financial burdens on applicants or registrants.

Paperwork

The Commission has eliminated current Forms 205 and 206 in favor of one new form designated as Commission Form R which will be used by certain issuers making application with the Commission to make a public offering of securities in this Commonwealth. The Commission further reduced substantially the categories of issuers that would be required to file new Form R. With respect to investment advisers, the Commission, in certain cases, has eliminated required financial reports and statements of financial condition that must be filed by applicants or registrants and, in other cases, reduced substantially the required financial reports and statements of financial condition.

Regulatory Review

Under section 5(a) of the Regulatory Review Act (71 P. S. § 745.5(a)), on April 11, 2000, the Commission submitted a copy of proposed rulemaking at 30 Pa.B. 2237 to IRRC and the Chairpersons of the House Committee on Commerce and Economic Development and the Senate Committee on Banking and Insurance for comment and review. In accordance with section 5(b) of the Regulatory Review Act, the Commission provided IRRC and the Committees with a copy of a detailed Regulatory Analysis form prepared in compliance with Executive Order 1996-1, "Regulatory Review and Promulgation." A copy of this material is available upon request.

By letter dated July 6, 2000, IRRC provided the Commission with its comments on the proposed rulemaking. The Commission's response to those comments is contained in this Preamble. In response to a letter from IRRC dated July 24, 2000, recommending tolling of the review period to address certain technical and clarification issues, the Commission, by letter to IRRC dated July 26, 2000, requested tolling and resubmitted revised final-form rules. By letter dated July 27, 2000, IRRC advised the Commission that it did not object to tolling the review period.

In preparing final-form rules, the Commission considered the comments received from the public, the United States Securities and Exchange Commission and IRRC. The final-form rules were submitted on July 12, 2000, to the House Committee on Commerce and Economic Development, the Senate Committee on Banking and Insurance and IRRC. Final-form rules were deemed approved by the House Committee on Commerce and Economic Development and the Senate Committee on Banking and Insurance on August 7, 2000. IRRC met on August 10, 2000, and approved the final-form rules.

Availability in Alternative Formats

This final-form rulemaking may be made available in alternative formats upon request. TDD users should use the AT&T Relay Center (800) 854-5984. To make arrangements for alternative formats, contact Joseph Shepherd, ADA Coordinator, (717) 787-6828.

Contact Person

The contact person for an explanation of these regulations and amendments is G. Philip Rutledge, Deputy Chief Counsel, Pennsylvania Securities Commission, Eastgate Building, 1010 N. Seventh Street, 2nd Floor, Harrisburg, PA 17102-1410, (717) 783-5130.

Order

The Commission, acting under the authorizing statute, orders that:

(a) The regulations of the Commission, 64 Pa. Code Chapters 202, 203, 205, 206, 301, 302, 303, 304, 305, 404, 602 and 603 are amended by amending §§ 202.070, 203.101, 203.171, 203.185, 203.186, 205.021, 206.010, 302.063, 303.051, 404.020 and 602.060 to read as set forth at 30 Pa.B. 2237; by adding § 203.192 to read as set forth at 30 Pa.B. 2237 and by deleting § 301.021 to read as set forth at 30 Pa.B. 2237; by amending §§ 303.012, 303.014, 303.021, 303.032, 303.042, 304.012, 304.022, 304.052, 305.011, 305.019, 305.061, 404.010 and 603.031 to read as set forth in Annex A; and by adding §§ 303.015 and 404.011—404.013 to read as set forth in Annex A, with ellipses referring to the existing text of the regulations.

(b) The Secretary of the Commission shall submit this order, 30 Pa.B. 2237 and Annex A to the Office of Attorney General for approval as to form and legality as required by law.

(c) The Secretary of the Commission shall certify this order, 30 Pa.B. 2237 and Annex A and deposit them with the Legislative Reference Bureau as required by law.

(d) This order shall take effect upon publication in the *Pennsylvania Bulletin*.

M. JOANNA CUMMINGS,
Secretary

(*Editor's Note*: The proposal to add § 404.014 included in the document at 30 Pa.B. 2237, has been withdrawn by the Commission. For the text of the order of the Independent Regulatory Review Commission, relating to this document, see 30 Pa.B. 4480 (August 26, 2000).)

Fiscal Note: Fiscal Note 50-114 remains valid for the final adoption of the subject regulations.

Annex A

TITLE 64. SECURITIES

PART I. SECURITIES COMMISSION

Subpart C. REGISTRATION OF BROKER-DEALERS, AGENTS, INVESTMENT ADVISERS AND INVESTMENT ADVISER REPRESENTATIVES AND NOTICE FILINGS BY FEDERALLY-COVERED ADVISERS

CHAPTER 303. REGISTRATION AND NOTICE FILING PROCEDURE

§ 303.012. Investment adviser registration procedure.

(a) An application for initial registration as an investment adviser shall contain the information requested in and shall be made on the Uniform Application for Investment Adviser Registration (Form ADV), or a successor form. The applicant shall complete and file with the Commission or with an investment adviser registration depository designated by order of the Commission one copy of the form accompanied by the filing fee in section 602(d.1) of the act (70 P. S. § 1-602(d.1)), the compliance assessment in section 602.1(a)(4) of the act and any exhibits required by this section.

(b) Except as set forth in subsection (f), the following statements of financial condition shall accompany an application for initial registration as an investment adviser.

(1) An applicant that has custody of client funds or securities or an applicant that requires payment of advisory fees 6 months or more in advance and in excess of $1,200 per client shall file an audited balance sheet of the applicant prepared in accordance with generally accepted accounting principles and accompanied by a standard audit report containing an unqualified opinion of an independent certified public accountant or an independent public accountant. The accountant shall submit, as a supplementary opinion, comments based upon the audit as to material inadequacies found to exist in the accounting system, the internal accounting controls and the procedures for safeguarding securities and funds and shall indicate corrective action taken or proposed. The balance sheet required by this paragraph shall be as of the end of the applicant's most recent fiscal year. If that balance sheet is as of a date more than 45 days prior to the date of filing the application, the applicant also shall file a subsequent balance sheet prepared in accordance with generally accepted accounting principles as of a date within 45 days of the date of filing. This balance sheet may be unaudited and may be prepared by management of the applicant. If the applicant is a certified public accountant or a public accountant or whose principals include one or more certified public accountants or public accountants, the applicant, in lieu of filing an audit report, may file a report modeled after the management responsibility letter contained in paragraph 9600.22 of the American Institute of Certified Public Accountant's Technical Information Service and signed by a certified public accountant or public accountant who either is the applicant or one of the principals of the applicant.

(2) An applicant that has discretionary authority over client funds or securities, but not custody, shall file a balance sheet which need not be audited but shall be prepared in accordance with generally accepted accounting principles. The balance sheet required by this paragraph shall be as of the end of the applicant's most recent fiscal year. If that balance sheet is as of a date more than 45 days prior to the date of filing the application, the applicant also shall file a subsequent balance sheet, which must be prepared in accordance with generally accepted accounting principles as of a date within 45 days of filing the application. Each balance sheet required by this paragraph may be unaudited and prepared by management of the applicant. Each balance sheet required by this paragraph also shall contain a representation by the applicant that the balance sheet is true and accurate.

(3) An applicant whose proposed activities do not come within paragraph (1) or (2) need not file a statement of financial condition.

(c) As part of the requirements relating to the statements of financial condition set forth in subsection (b), the Commission may require the following:

(1) A list of the securities reflected in the statement of financial condition of the applicant valued at the market.

(2) A description of material contractual commitments of the applicant not otherwise reflected in the statement of financial condition.

(3) In the case of a sole proprietor, whose statement of financial condition includes only those assets and liabilities used in the applicant's investment adviser business, an affirmative statement by the applicant that its liabilities which have not been incurred in the course of business as an investment adviser are not greater than the applicant's assets not used in its investment adviser business.

(d) An investment adviser registered under the act shall take steps necessary to ensure that material information contained in its Form ADV and exhibits remains current and accurate. If a material statement made in Form ADV and exhibits becomes incorrect or inaccurate the investment adviser shall file with the Commission an amendment on Form ADV within 30 days of the occurrence of the event which requires the filing of the amendment.

(e) For purposes of this section, the following terms shall have the following meanings:

Principal—The chairperson, president, chief executive officer, general manager, chief operating officer, chief financial officer, vice president or other officer in charge of a principal business function (including sales, administration, finance, marketing, research and credit), secretary, treasurer, controller and any other natural person who performs similar functions.

Principal place of business—The meaning set forth in 17 CFR 275.203A-3(c) (relating to definitions) promulgated under the Investment Advisers Act of 1940 (15 U.S.C.A. §§ 80b-1—80b-21).

(f) An applicant that maintains its principal place of business in a state other than this Commonwealth need not comply with subsection (a) if the applicant meets the following:

(1) Is registered as an investment adviser in the state in which it maintains its principal place of business.

(2) Is in compliance with the financial reporting requirements of the state in which it maintains its principal place of business.

(3) Has not taken custody of the assets of any client residing in this Commonwealth at any time during the preceding 12-month period.

§ 303.014. Investment adviser representative registration procedures.

(a) An application for initial registration as an investment adviser representative of an investment adviser or Federally-covered adviser shall contain the information requested in and shall be made on the Uniform Application for Securities Industry Registration or Transfer Form (Form U-4), or a successor form. The investment adviser representative and the investment adviser or Federally covered adviser shall complete and file with the Commission or with an investment adviser registration depository designated by order of the Commission one copy of Form U-4 and exhibits thereto accompanied by the filing fee required by section 602(d.1) of the act (70 P. S. § 1-602(d.1)), the compliance assessment required by section 602.1(a)(1) of the act (70 P. S. § 1-602.1(a)(1)) and the results evidencing passage of the examinations required by § 303.032 (relating to qualification of and examination requirement for investment advisers and investment adviser representatives).

(b) An investment adviser representative and an investment adviser or Federally-covered adviser shall take necessary steps to ensure that material information contained in Form U-4 remains current and accurate. If a material statement made in the Form U-4 becomes incorrect or incomplete, the investment adviser representative and the investment adviser or Federally-covered adviser shall file with the Commission an amendment to Form U-4 within 30 days of the occurrence of the event which requires the filing of the amendment.

§ 303.015. Notice filing for Federally-covered advisers.

(a) *Initial filing.* The notice required to be filed by Federally-covered advisers under section 303(a)(iii) of the act (70 P. S. § 1-303(a)(iii)) shall be the uniform application for investment adviser registration (Form ADV) or successor form thereto as filed with the United States Securities and Exchange Commission. Prior to the Federally-covered adviser conducting advisory business in this Commonwealth, a completed Form ADV accompanied by the notice filing fee required by section 602(d.1) of the act (70 P. S. § 1-602(d.1)) shall be filed with the Commission or with an investment adviser registration depository designated by order of the Commission.

(b) *Renewals.* Every Federally-covered adviser conducting advisory business in this Commonwealth annually shall pay a notice filing fee set forth in section 602(d.1) of the act. Payment of the notice filing fee should be made directly with the Commission or with an investment adviser registration depository designated by order of the Commission.

§ 303.021. Registration and notice filing procedures for successors to a broker-dealer, investment adviser or Federally-covered adviser.

(a) The following apply with respect to broker-dealers:

(1) When a broker-dealer is formed or proposed to be formed for the purpose of succeeding to, and continuing the business of, a broker-dealer registered under section 301 of the act (70 P. S. § 1-301) and as a broker or dealer under section 15(b) of the Securities Exchange Act of 1934 (15 U.S.C.A. § 77o(b)) (successor broker-dealer) based solely on a change in the predecessor's date or state of incorporation, form of organization or composition of a partnership, the successor broker-dealer shall comply with the requirements of SEC Rule 15b1-3(a) promulgated under the Securities Exchange Act of 1934, except that the successor broker-dealer shall file the amendments to Form BD with the Commission.

(2) When a broker-dealer is formed or proposed to be formed for the purpose of succeeding to, and continuing the business of, a broker-dealer registered under section 301 of the act and as a broker or dealer under section 15(b) of the Securities Exchange Act of 1934 (successor broker-dealer) for reasons other than a change in the predecessor's date or state of incorporation, form of organization or composition of a partnership, the successor broker-dealer shall comply with the requirements of SEC Rule 15b1-3(b) promulgated under the Securities Exchange Act of 1934, except that the successor shall file Form BD with the Commission.

(b) The following shall apply to investment advisers:

(1) When an investment adviser is formed or proposed to be formed for the purpose of succeeding to, and continuing the business of, an investment adviser registered under section 301 of the act (successor investment adviser) based solely on a change in the predecessor's date or state of incorporation, form of organization or composition of a partnership, the successor investment adviser may file an initial application for registration by amending Form ADV of the predecessor and, under section 303(b) of the act (70 P. S. § 1-303(b)), succeed to the unexpired portion of the predecessor's term of registration.

(2) When an investment adviser is formed or proposed to be formed for the purpose of succeeding to, and continuing the business of, an investment adviser regis-

tered under section 301 of the act for reasons other than a change in the predecessor's date or state of incorporation, form of organization or composition of a partnership, the successor investment adviser shall file Form ADV with the Commission. Upon registration, the successor investment adviser, under section 303(b) of the act, shall succeed to the unexpired portion of the predecessor's term of registration.

(c) When a Federally covered adviser is formed or proposed to be formed for the purpose of succeeding to, and continuing the business of, a registered investment adviser or of another Federally-covered adviser (successor Federally-covered adviser), the successor Federally-covered adviser shall file with the Commission either Form ADV or an amendment to Form ADV as required under SEC Release No. IA-1357 (December 28, 1992) and, under section 303(b) of the act, shall succeed to the unexpired portion of the predecessor's notice period.

§ 303.032. Examination requirements for investment advisers and investment adviser representatives.

(a) *Examination requirements.* An individual may not be registered as an investment adviser or investment adviser representative under the act unless the person has met one of the following qualifications:

(1) Received, on or after January 1, 2000, and within 2 years immediately prior to the date of filing an application with the Commission, a passing grade on The Uniform Investment Adviser Law Examination (Series 65), or successor examination.

(2) Received, on or after January 1, 2000, and within 2 years immediately prior to the date of filing an application with the Commission, a passing grade on the General Securities Representative Examination (Series 7) administered by the National Association of Securities Dealers, Inc. and the Uniform Combined State Law Examination (Series 66) or successor examinations.

(3) Received, on or after January 1, 2000, a passing grade on either the Series 65 examination or passing grades on both the Series 7 and Series 66 examinations and has not had a lapse in registration as an investment adviser or investment adviser representative in any state other than this Commonwealth for a period exceeding 2 years immediately prior to the date of filing an application with the Commission.

(b) *Grandfathering.*

(1) Compliance with subsection (a) is waived if the individual meets the following qualifications:

(i) Prior to January 1, 2000, the individual had received a passing grade on the Series 2, 7, 8 or 24 examination for registered representatives or supervisors administered by the National Association of Securities Dealers, Inc. and the Series 65 or Series 66 examinations.

(ii) The individual has not had a lapse in employment as an investment adviser, investment adviser representative or principal or agent of a broker-dealer for any consecutive period exceeding 2 years immediately preceding the date of filing an application with the Commission.

(2) An individual need not comply with subsection (a) if the individual meets the following qualifications:

(i) Prior to January 1, 2000, the individual was registered as an investment adviser or investment adviser representative in any state requiring the licensing, registration or qualification of investment advisers or investment adviser representatives.

(ii) The individual has not had a lapse in registration as an investment adviser or investment adviser representative in another state for any consecutive period exceeding 2 years immediately preceding the date of filing an application with the Commission.

(c) *Waivers of exam requirements.* Compliance with subsection (a) is waived if:

(1) The individual meets the following qualifications:

(i) Has no disciplinary history which requires an affirmative response to Items 23A-E or Item 23H of The Uniform Application for Securities Industry Registration or Transfer (Form U-4) or successor items thereto.

(ii) Has been awarded any of the following designations which, at the time of filing of the application with the Commission, is current and in good standing:

(A) Certified Financial Planner (CFP) awarded by the Certified Financial Planner Board of Standards, Inc.

(B) Chartered Financial Consultant (CFC) or Master of Science and Financial Services (MSFS) awarded by the American College, Bryn Mawr, Pennsylvania.

(C) Chartered Financial Analyst (CFA) awarded by the Institute of Chartered Financial Analysts.

(D) Personal Financial Specialist (PFS) awarded by the American Institute of Certified Public Accountants.

(E) Chartered Investment Counselor (CIC) awarded by the Investment Counsel Association of America, Inc.

(2) The individual is licensed as a certified public accountant, is currently in good standing and has no disciplinary history that requires an affirmative response to Items 23A-E or Item 23H of Form U-4 or successor items thereto.

(3) The individual is licensed as an attorney, is currently in good standing and has no disciplinary history that requires an affirmative response to Items 23A-E or Item 23H of Form U-4 or successor items thereto.

(4) The individual has received an order from the Commission waiving compliance with subsection (a).

§ 303.042. Investment adviser capital requirements.

(a) Every investment adviser registered or required to be registered under section 301 of the act (70 P. S. § 1-301) shall maintain at all times the following net worth requirements:

(1) An investment adviser that has its principal place of business in a state other than this Commonwealth shall maintain the net worth required by the state where the investment adviser maintains its principal place of business if the investment adviser currently is licensed in that state and is in compliance with that state's net worth requirements.

(2) Except as provided in subsection (e), an investment adviser that has its principal place of business in this Commonwealth and also is registered as a broker-dealer under section 301 of the act shall maintain at all times a minimum net capital of $25,000.

(3) An investment adviser that has its principal place of business in this Commonwealth and has custody of client funds or securities shall maintain at all times a minimum net worth of $35,000.

(4) An investment adviser that has its principal place of business in this Commonwealth and has discretionary authority over client funds or securities but does not have custody of client funds or securities shall maintain at all

times a minimum net worth of $10,000. An investment adviser will not be deemed to be exercising discretion and subject to the requirements of this paragraph when it places trade orders with a broker-dealer under a third-party trading agreement if:

(i) The investment adviser has executed a separate investment adviser contract exclusively with its clients that acknowledges that a third-party agreement will be executed to allow the investment adviser to effect securities transactions for the client in the client's broker-dealer account.

(ii) The investment adviser contract specifically states that the client does not grant discretionary authority to the investment adviser and the investment adviser, in fact, does not exercise discretion with respect to the account.

(iii) A third-party trading agreement is executed between the investment adviser, the client and the broker-dealer which specifically limits the investment adviser's authority in the client's broker-dealer account to the placement of trade orders and deduction of investment adviser fees.

(5) An investment adviser that has its principal place of business in this Commonwealth and accepts prepayment of advisory fees of more than 6 months in advance and more than $1,200 per client shall maintain at all times a positive net worth.

(b) As condition of the right to continue to transact business in this Commonwealth, an investment adviser registered under the act shall notify, by the close of business on the next business day, the Commission if the investment adviser's total net worth is less than the minimum required net worth. Within 24 hours after transmitting the notice, the investment adviser shall file a report of its financial condition including the following:

(1) A proof of money balances of ledger accounts in the form of a trial balance.

(2) A computation of net worth.

(3) An analysis of clients' securities and funds which are not segregated.

(4) A computation of the aggregate amount of clients' ledger debit balances.

(5) A computation of the aggregate amount of clients' ledger credit balances.

(6) A statement as to the number of client accounts.

(c) For the purpose of this section, the following terms have the following meanings:

Custody—A person is deemed to have custody of client funds or securities if the person directly or indirectly holds clients funds or securities, has any authority to obtain possession of them or has the ability to appropriate them.

Net capital—The meaning set forth in 17 CFR 240.15c3-1 (relating to net capital requirements for brokers or dealers), promulgated under the Securities Exchange Act of 1934 (15 U.S.C.A. §§ 78a—78kk).

Net worth—The excess of assets over liabilities as determined by generally accepted accounting principles reduced by the following:

(i) Prepaid expenses except items properly classified as current assets under generally accepted accounting principles.

(ii) Deferred charges.

(iii) Goodwill, franchises, organizational expenses, patents, copyrights, marketing rights, unamortized debt discount and expense and all other assets of an intangible nature.

(iv) Home furnishings, automobiles and any other personal items not readily marketable in the case of an individual.

(v) Advances or loans to stockholders and officers in the case of a corporation; members and managers in the case of a limited liability company; and advances or loans to partners in the case of a partnership.

Principal place of business—The meaning set forth in 17 CFR 275.203A-3(c) (relating to definitions) promulgated under the Investment Advisers Act of 1940 (15 U.S.C.A §§ 80b-1—80b-21).

(d) For investment advisers registered or required to be registered under the act, the Commission may require that a current appraisal be submitted to establish the worth of an asset being calculated under the net worth formulation.

(e) The requirements of subsection (a)(2) do not apply to an investment adviser that has its principal place of business in this Commonwealth and also is registered as a broker-dealer under section 15 of the Securities Exchange Act of 1934 (15 U.S.C.A. § 77o) if the broker-dealer is one of the following:

(1) Subject to, and in compliance with, SEC Rule 15c3-1.

(2) A member of a National Securities Exchange whose members are exempt from SEC Rule 15c3-1 under subsection (b)(2) thereof and the broker-dealer is in compliance with all rules and practices of the exchange imposing requirements with respect to financial responsibility and the segregation of funds or securities carried for the account of customers.

CHAPTER 304. POSTREGISTRATION PROVISIONS

§ 304.012. Investment adviser required records.

(a) Except as provided in subsection (j), every investment adviser registered under the act shall make and keep true, accurate and current the following books, ledgers and records:

(1) A journal or journals, including cash receipts and disbursements records, and any other records of original entry forming the basis of entries in any ledger.

(2) General and auxiliary ledgers (or other comparable records) reflecting asset, liability, reserve, capital, income and expense accounts.

(3) A memorandum of each order given by the investment adviser for the purchase or sale of any security, of any instruction received by the investment adviser from the client concerning the purchase, sale, receipt or delivery of a particular security, and of any modification or cancellation of any such order or instruction. The memoranda shall show the terms and conditions of the order, instruction, modification or cancellation; shall identify the person connected with the investment adviser who recommended the transaction to the client and the person who placed the order; and shall show the account for which entered, the date of entry, and the bank, broker-dealer by or through whom executed where appropriate. Orders entered pursuant to the exercise of discretionary power shall be so designated.

(4) All check books, bank statements, canceled checks and cash reconciliations of the investment adviser.

(5) All bills or statements (or copies of), paid or unpaid, relating to the investment adviser's business as an investment adviser.

(6) All trial balances, financial statements, net worth computation, and internal audit working papers relating to the investment adviser's business as an investment adviser. For purposes of this subsection, "financial statements" shall mean a balance sheet prepared in accordance with generally accepted accounting principles, an income statement and a cash flow statement. The net worth computation means the net worth required by § 303.042 (relating to investment adviser capital requirements), if any.

(7) Originals of all written communications received and copies of all written communications sent by the investment adviser relating to one or more of the following:

(i) Any recommendation made or proposed to be made and any advice given or proposed to be given.

(ii) Any receipt, disbursement or delivery of funds or securities.

(iii) The placing or execution of any order to purchase or sell any security, except that an investment adviser:

(A) Is not required to keep any unsolicited market letters and other similar communications of general public distribution not prepared by or for the investment adviser.

(B) With respect to any notice, circular or other advertisement offering any report, analysis, publication or other investment advisory service sent by the investment adviser to more than 10 persons (including transmission by electronic means), the investment adviser is not required to keep a record of the names and addresses of the persons to whom it was sent except, that if the notice, circular or advertisement is distributed to persons named on any list, the investment adviser shall retain with the copy of the notice, circular or advertisement a memorandum describing the list and its source.

(8) A list or other record of all accounts which list identifies the accounts in which the investment adviser is vested with any discretionary power with respect to the funds, securities or transactions of any client.

(9) A copy of all powers of attorney and other evidences of the granting of any discretionary authority by any client to the investment adviser.

(10) A copy in writing of each agreement entered into by the investment adviser with any client, and all other written agreements otherwise relating to the investment adviser's business as an investment adviser.

(11) A file containing a copy of each notice, circular, advertisement, newspaper article, investment letter, bulletin, or other communication including by electronic media that the investment adviser circulates or distributes, directly or indirectly, to two or more persons (other than persons connected with the investment adviser), and if the notice, circular, advertisement, newspaper article, investment letter, bulletin, or other communication including by electronic media recommends the purchase or sale of a specific security and does not state the reasons for the recommendation, a memorandum of the investment adviser indicating the reasons for the recommendation.

(12) Records of transactions as follows:

(i) A record of every transaction in a security in which the investment adviser or investment adviser representative of the investment adviser has, or by reason of any transaction acquires, any direct or indirect beneficial ownership except:

(A) Transactions effected in any account over which neither the investment adviser nor any investment adviser representative of the investment adviser has any direct or indirect influence or control.

(B) Transactions in securities which are direct obligations of the United States. The record shall state:

(I) The title and amount of the security involved; the date and nature of the transaction (that is, purchase, sale or other acquisition or disposition).

(II) The price at which it was effected.

(III) The name of the broker-dealer or bank with or through whom the transaction was effected.

(ii) The record may also contain a statement declaring that the reporting or recording of any transaction will not be construed as an admission that the investment adviser or investment adviser representative has any direct or indirect beneficial ownership in the security.

(iii) A transaction shall be recorded not later than 10 days after the end of the calendar quarter in which the transaction was effected.

(iv) For purposes of this paragraph, the following terms have the following meanings:

(A) *Investment adviser representative*—A partner, officer or director of the investment adviser; any employe who participates in any way in the determination of which recommendations shall be made; any employe of the investment adviser who, in connection with assigned duties, obtains any information concerning which securities are being recommended prior to the effective dissemination of the recommendations; and any of the following persons who obtain information concerning securities recommendations being made by the investment adviser prior to the effective dissemination of the recommendations:

(I) Any person in a control relationship to the investment adviser.

(II) Any affiliated person of a controlling person.

(III) Any affiliated person of an affiliated person.

(B) *Control*—The power to exercise a controlling influence over the management or policies of a company, unless the power is solely the result of an official position with the company. A person who owns beneficially, either directly or through one or more controlled companies, more than 25% of the voting securities of a company shall be presumed to control the company.

(v) An investment adviser shall implement adequate procedures and use reasonable diligence to obtain promptly reports of all transactions required to be recorded.

(13) Records of transactions by investment advisers primarily engaged in a business other than advising clients as follows:

(i) Notwithstanding paragraph (12), when the investment adviser is primarily engaged in a business or businesses other than advising investment advisory clients, a record shall be maintained of every transaction in a security in which the investment adviser or any investment adviser representative of the investment adviser has, or by reason of any transaction acquires, any direct or indirect beneficial ownership, except transactions:

(A) Effected in any account over which neither the investment adviser nor any investment adviser representative of the investment adviser has any direct or indirect influence or control.

(B) In securities which are direct obligations of the United States. The record shall state:

(I) The title and amount of the security involved.

(II) The date and nature of the transaction (that is, purchase, sale, or other acquisition or disposition).

(III) The price at which it was effected, and the name of the broker-dealer or bank with or through whom the transaction was effected.

(ii) The record may also contain a statement declaring that the reporting or recording of any transaction will not be construed as an admission that the investment adviser or investment adviser representative has any direct or indirect beneficial ownership in the security.

(iii) A transaction shall be recorded not later than 10 days after the end of the calendar quarter in which the transaction was effected.

(iv) An investment adviser is "primarily engaged in a business or businesses other than advising investment advisory clients" when, for each of its most recent 3 fiscal years or for the period of time since organization, whichever is lesser, the investment adviser derived, on an unconsolidated basis, more than 50% of the following:

(A) Its total sales and revenues.

(B) Its income (or loss) before income taxes and extraordinary items, from other business or businesses.

(v) For purposes of this paragraph, the following terms have the following meanings:

(A) *Investment adviser representative*—When used in connection with a company primarily engaged in a business or businesses other than advising investment advisory clients, the term means any partner, officer, director or employe of the investment adviser who participates in any way in the determination of which recommendations shall be made; any employe who, in connection with assigned duties, obtains information concerning which securities are being recommended prior to the effective dissemination of the recommendations; and any of the following persons who obtain information concerning securities recommendations being made by the investment adviser prior to the effective dissemination of the recommendations as follows:

(I) Any person in a control relationship to the investment adviser.

(II) Any affiliated person of a controlling person.

(III) Any affiliated person of an affiliated person.

(B) *Control*—The power to exercise a controlling influence over the management or policies of a company, unless the power is solely the result of an official position with company. A person who owns beneficially, either directly or through one or more controlled companies, more than 25% of the voting securities of a company shall be presumed to control the company.

(vi) An investment adviser shall implement adequate procedures and use reasonable diligence to promptly obtain reports of all transactions required to be recorded.

(14) A copy of each written statement and each amendment or revision, given or sent to any client or prospective client of the investment adviser under § 404.011 (relating to investment adviser brochure rule), and a record of the dates that each written statement, and each amendment or revision, was given, or offered to be given, to any client or prospective client who subsequently becomes a client.

(15) For each client that was obtained by the adviser by means of a solicitor to whom a cash fee was paid by the adviser shall maintain the following:

(i) Evidence of a written agreement to which the adviser is a party related to the payment of the fee.

(ii) A signed and dated acknowledgment of receipt from the client evidencing the client's receipt of the investment adviser's disclosure statement and a written disclosure statement of the solicitor.

(iii) A copy of the solicitor's written disclosure statement if required by § 404.012 (relating to cash payment for client solicitation).

(iv) For purposes of this paragraph, the term "solicitor" means any person or entity who, for compensation, directly or indirectly solicits any client for, or refers any client to, an investment adviser.

(16) All accounts, books, internal working papers, and any other records or documents that are necessary to form the basis for, or demonstrate the calculation of, the performance or rate of return of all managed accounts or securities recommendations in any notice, circular, advertisement, newspaper article, investment letter, bulletin, or other communication, including but not limited to, electronic media that the investment adviser circulates or distributes, directly or indirectly, to two or more persons (other than persons connected with the investment adviser) except that, with respect to the performance of managed accounts, the retention of all account statements, if they reflect all debits, credits, and other transactions in a client's account for the period of the statement, and all worksheets necessary to demonstrate the calculation of the performance or rate of return of all managed accounts shall be deemed to satisfy the requirements of this paragraph.

(17) A file containing a copy of all written communications received or sent regarding any litigation involving the investment adviser or any investment adviser representative or employe, and regarding any written customer or client complaint.

(18) Written information about each investment advisory client that is the basis for making any recommendation or providing any investment advice to the client.

(19) Written procedures to supervise the activities of employes and investment adviser representatives that are reasonably designed to achieve compliance with applicable securities laws and regulations.

(20) A file containing a copy of each document (other than any notices of general dissemination) that was filed with or received from any state or Federal agency or self-regulatory organization and that pertains to the registrant or its investment adviser representatives as that term is defined in paragraph (12), which file should contain, but is not limited to, all applications, amendments, renewal filings and correspondence.

(b) If an investment adviser subject to subsection (a) has custody or possession of securities or funds of any client, the records required to be made and kept by subsection (a) also shall include:

(1) A journal or other record showing all purchases, sales, receipts and deliveries of securities (including certificate numbers) for all accounts and all other debits and credits to the accounts.

(2) A separate ledger account for each client showing all purchases, sales, receipts and deliveries of securities, the date and price of each purchase and sale, and all debits and credits.

(3) Copies of confirmations of all transactions effected by or for the account of any client.

(4) A record for each security in which any client has a position, which record shall show the name of each client having any interest in each security, the amount or interest of each client, and the location of each security.

(c) Every investment adviser subject to subsection (a) that renders any investment supervisory or management service to any client shall, with respect to the portfolio being supervised or managed and to the extent that the information is reasonably available to or obtainable by the investment adviser, make and keep true, accurate and current:

(1) Records showing separately for each client the securities purchased and sold, and the date, amount and price of each purchase and sale.

(2) For each security in which any client has a current position, information from which the investment adviser can promptly furnish the name of each client, and the current amount or interest of the client.

(d) Books or records required by this section may be maintained by the investment adviser so that the identity of any client to whom the investment adviser renders investment supervisory services is indicated by numerical or alphabetical code or some similar designation.

(e) Every investment adviser subject to subsection (a) shall preserve the following records in the manner prescribed:

(1) The books and records required to be made under subsections (a), (b) and (c)(1) (except for books and records required to be made under subsection (a)(11) and (a)(16)), shall be maintained and preserved in an easily accessible place for at least 5 years from the end of the fiscal year during which the last entry was made on record, the first 2 years being in the principal office of the investment adviser.

(2) Partnership articles and any amendments, articles of incorporation, charters, minute books, and stock certificate books of the investment adviser and of any predecessor, shall be maintained in the principal office of the investment adviser and preserved until at least 3 years after termination of the enterprise.

(3) Books and records required to be made under subsection (a)(11) and (18) shall be maintained and preserved in an easily accessible place for at least 5 years, the first 2 years being in the principal office of the investment adviser, from the end of the fiscal year during which the investment adviser last published or otherwise disseminated, directly or indirectly, the notice, circular, advertisement, newspaper article, investment letter, bulletin or other communication including by electronic media.

(4) Books and records required to be made under subsection (a)(19) and (22) shall be maintained and preserved in an easily accessible place for at least 5 years, the first 2 years being in the principal office of the investment adviser, from the end of the fiscal year during which the investment adviser last published or otherwise disseminated, directly or indirectly, the notice, circular, advertisement, newspaper article, investment letter, bulletin or other communication including by electronic media.

(5) Notwithstanding other record preservation requirements of this section, the following records or copies shall be required to be maintained at the business location of the investment adviser from which the customer or client is being provided or has been provided with investment advisory services:

(i) Records required to be preserved under subsections (a)(3), (7)—(10), (14)—(15), (17)—(19), (b) and (c).

(ii) Records or copies required under subsection (a)(11) and (16) which records or related records identify the name of the investment adviser representative providing investment advice from that business location, or which identify the business locations' physical address, mailing address, electronic mailing address or telephone number.

(f) An investment adviser subject to subsection (a), before ceasing to do business as an investment adviser, shall arrange and be responsible for the preservation of the books and records required to be maintained and preserved under this section for the remainder of the period specified in this section, and shall notify the Commission in writing of the exact address where the books and records will be maintained during the period.

(g) The requirements for the storage of records are as follows:

(1) Records required to be maintained and preserved under this section may be immediately produced or reproduced by photograph on film or, as provided in paragraph (2) on magnetic disk, tape or other computer storage medium, and be maintained and preserved for the required time in that form. If records are produced or reproduced by photographic film or computer storage medium, the investment adviser shall:

(i) Arrange the records and index the films or computer storage medium so as to permit the immediate location of any particular record.

(ii) Be ready at all times to provide, and promptly provide, any facsimile enlargement of film or computer printout or copy of the computer storage medium which the Commission by its examiners or other representatives may request.

(iii) Store separately from the original one other copy of the film or computer storage medium for the time required.

(iv) With respect to records stored on computer storage medium, maintain procedures for maintenance and preservation of, and access to, records so as to reasonably safeguard records from loss, alteration or destruction.

(v) With respect to records stored on photographic film, at all times have available for the Commission's examination of its records under section 304(a) of the act (70 P. S. § 1-304(a)) facilities for immediate, easily readable projection of the film and for producing easily readable facsimile enlargements.

(2) An investment adviser may maintain and preserve on computer tape or disk or other computer storage medium records which, in the ordinary course of the adviser's business, are created by the adviser on electronic media or are received by the adviser solely on electronic media or by electronic data transmission.

(h) For purposes of this section, the following terms have the following meanings:

(i) *Client*—Any person to whom the investment adviser has given investment advice for which the investment adviser has received compensation.

(ii) *Investment supervisory services*—The giving of continuous advice as to the investment of funds on the basis

of the individual needs of each client. Discretionary power does not include discretion as to the price at which or the time when a transaction is or is to be effected, if, before the order is given by the investment adviser, the client has directed or approved the purchase or sale of a definite amount of the particular security.

(iii) *Principal place of business*—The meaning set forth in 17 CFR 275.203A-3(c) (relating to definitions) promulgated under the Investment Advisers Act of 1940 (15 U.S.C.A. §§ 80b-1—80b-21).

(i) Any book or other record made, kept, maintained and preserved in compliance with Rules 17a-3 (17 CFR 240.17a-3) (relating to records to be made by certain exchange members, brokers and dealers) and 17a-4 (17 CFR 240.17a-4) (relating to records to be preserved by certain exchange members, brokers and dealers) under the Securities Exchange Act of 1934 (15 U.S.C.A. §§ 78a—78kk), which is substantially the same as the book or other record required to be made, kept, maintained and preserved under this section, shall be deemed to be made, kept, maintained and preserved in compliance with this section.

(j) The requirements of this section do not apply to an investment adviser registered under section 301 of the act that meets the following conditions:

(1) Has its principal place of business in a state other than this Commonwealth.

(2) Is licensed as an investment adviser in the state where it has its principal place of business.

(3) Is in compliance with the recordkeeping requirements of the state in which it has its principal place of business.

§ 304.022. Investment adviser required financial reports.

(a) Except as provided in subsection (b), the following investment advisers registered under section 301 of the act (70 P. S. § 1-301) shall file the following reports of financial condition with the Commission within 120 days of the investment adviser's fiscal year end:

(1) An investment adviser that has custody of client funds or securities or requires prepayment of advisory fees 6 months or more in advance and in excess of $1,200 per client shall file with the Commission an audited balance sheet as of the end of its fiscal year. The balance sheet shall be prepared in accordance with generally accepted accounting principles and contain an unqualified opinion of an independent certified public accountant or independent public accountant. The accountant shall submit, as a supplementary opinion, comments based on the audit as to material inadequacies found to exist in the accounting system, the internal accounting controls and procedures for safeguarding securities and funds, and shall indicate corrective action taken or proposed. If the investment adviser is a certified public accountant or a public accountant or whose principals include one or more certified public accountants or public accountants, the investment adviser, in lieu of filing an audit report, may file a report modeled after the management responsibility letter contained in paragraph 9600.22 of the American Institute of Certified Public Accountant's Technical Information Service signed by a certified public accountant or public accountant or one of the principals of the investment adviser.

(2) An investment adviser who has discretionary authority over client funds or securities, but not custody, shall file with the Commission a balance sheet as of the end of its fiscal year. The balance sheet need not be audited but shall be prepared in accordance with generally accepted accounting principles. The balance sheet shall contain a representation by the investment adviser that it is true and accurate.

(b) The requirements of subsection (a) do not apply to an investment adviser registered under section 301 of the act whose principal place of business is in a state other than this Commonwealth if the investment adviser meets the following conditions:

(1) Is registered in the state in which it maintains its principal place of business.

(2) Is in compliance with the financial reporting requirements of the state in which it maintains its principal place of business.

(3) Has not taken custody of assets of any client residing in this Commonwealth at any time during the preceding 12 month period.

(c) For purposes of this section, the following terms have the following meanings:

Principal—The chair, president, chief executive officer, general manager, chief operating officer, chief financial officer, vice president or other officer in charge of a principal business function (including sales, administration, finance, marketing, research and credit), secretary, treasurer, controller and any other natural person who performs similar functions.

Principal place of business—The meaning set forth in 17 CFR 275-203A-3(c) (relating to definitions) promulgated under the Investment Advisers Act of 1940 (15 U.S.C.A. §§ 80b-1—80b-21).

§ 304.052. Investment adviser compensation.

No investment adviser registered under the act may charge or receive commissions or other compensation in connection with the giving of investment advice unless the compensation is fair and reasonable and is determined on an equitable basis.

CHAPTER 305. DENIAL, SUSPENSION, REVOCATION AND CONDITIONING OF REGISTRATION

§ 305.011. Supervision of agents, investment adviser representatives and employes.

(a) Every broker-dealer and investment adviser registered under section 301 of the act (70 P. S. § 1-301) shall exercise diligent supervision over the securities activities and securities related activities of its agents, investment adviser representatives and employes.

(1) Each broker-dealer and investment adviser, in exercising diligent supervision, shall establish and maintain written procedures and a system for applying and enforcing those written procedures which are reasonably designed to achieve compliance with the act and this title and to detect and prevent any violations of statutes, rules, regulations or orders described in section 305(a)(v) and (ix) of the act (70 P. S. § 1-305(a)(v) and (ix)), the Conduct Rules of the National Association of Securities Dealers, Inc., or any applicable fair practice or ethical standard promulgated by the United States Securities and Exchange Commission or by a National Securities Exchange registered under the Securities Exchange Act of 1934 (15 U.S.C.A. §§ 78a—78kk).

(2) Final responsibility for proper supervision shall rest with the broker-dealer and investment adviser.

(b) Every issuer who employs agents registered under section 301 of the act shall be subject to the supervision requirements of subsection (a) with respect to those agents.

(c) As evidence of compliance with the supervisory obligations imposed by this section, every broker-dealer and investment adviser shall implement written procedures, a copy of which shall be kept in each location at which the broker-dealer or investment adviser conducts business, and shall establish, maintain and enforce those written procedures designed to achieve compliance with the act and this title and to detect and prevent violations described in subsection (a). These written procedures, at a minimum, shall address:

(1) The supervision of every agent, investment adviser representative, employe and supervisor by a designated qualified supervisor.

(2) Methods to be used to determine that all supervisory personnel are qualified by virtue of character, experience and training to carry out their assigned responsibilities.

(3) Methods to be used to determine the good character, business repute, qualifications, and experience of any person prior to making application for registration of that person with the Commission and hiring that person.

(4) The review and written approval by the designated supervisor of the opening of each new customer account.

(5) The frequent examination of customer accounts to detect and prevent violations, irregularities or abuses.

(6) The prompt review and written approval of the handling of customer complaints.

(7) The prompt review and written approval by the designated supervisor of all securities transactions and all correspondence pertaining to the solicitation or execution of all securities transactions.

(8) The review and written approval by the designated supervisor of the delegation by a customer of discretionary authority with respect to the customer's account and frequent examination of discretionary accounts to prevent violations, irregularities or abuses.

(9) The participation of each agent and investment adviser representative either individually or collectively, no less than annually, in an interview or meeting conducted by persons designated by the broker-dealer or investment adviser at which compliance matters relevant to the activities of the agents and investment adviser representatives are discussed. Written records shall be maintained reflecting the interview or meeting.

(10) The periodic inspection of each location in this Commonwealth from which business is conducted to ensure that the written procedures and systems are enforced. In establishing an inspection cycle, the broker-dealer and investment adviser shall give consideration to the nature and complexity of the securities activities for which the location is responsible, the volume of business done and the number of agents or investment adviser representatives assigned to the location.

(i) The obligation of diligent supervision required by this section may require that one or more locations in this Commonwealth receive more than one inspection per year and that one or more of these inspections be unannounced.

(ii) It is the responsibility of the broker-dealer or investment adviser to determine the required number of inspections each location is to receive each year to ensure that the written procedures and systems are enforced and the supervisory obligations imposed by this section are being honored.

(iii) Written records shall be maintained reflecting each inspection conducted.

(d) Records required to be maintained under this section shall be maintained for 5 years, the first 2 years being in an easily accessible place. The retention and preservation of records may be on microfilm, computer disks or tapes or other electronic medium if adequate facilities are maintained for examination of facsimiles.

(e) To the extent that this section imposes any recordkeeping requirement on an investment adviser registered under section 301 of the act (70 P. S. § 1-301), the recordkeeping requirement does not apply if the investment adviser meets the following conditions:

(1) Has its principle place of business in a state other than this Commonwealth.

(2) Is licensed as an investment adviser in the state where it has its principal place of business.

(3) Is in compliance with the recordkeeping requirements of the state in which it has its principal place of business.

§ 305.019. Dishonest and unethical practices.

* * * * *

(b) Under section 305(a)(ix) of the act (70 P. S. § 1-305(a)(ix)), the Commission may deny, suspend, condition or revoke a broker-dealer, agent, investment adviser or investment adviser representative registration or censure a broker-dealer, agent, investment adviser or investment adviser representative registrant if the registrant or applicant, or in the case of any broker-dealer or investment adviser, any affiliate thereof, has engaged in dishonest or unethical practices in the securities business or has taken unfair advantage of a customer.

(c) The Commission, for purposes of section 305(a)(ix) of the act, will consider the actions in paragraphs (1)—(3) to constitute dishonest or unethical practices in the securities business or taking unfair advantage of a customer. The conduct described in paragraphs (1)—(3) is not exclusive. Engaging in other conduct inconsistent with the standards in subsection (a), such as forgery, embezzlement, nondisclosure, incomplete disclosure or misstatement of material facts, or manipulative or deceptive practices or taking unfair advantage of a customer or former customer in any aspect of a tender offer also constitute grounds for denial, suspension, conditioning or revocation of any registration or application for registration of a broker-dealer, agent, investment adviser or investment adviser representative.

(1) *Broker-dealers.* Includes the following actions:

* * * * *

(xxii) Failing to comply with investor suitability standards imposed as a condition of the registration of securities under section 205 or 206 of the act (70 P. S. § 1-205 or § 1-206) in connection with the offer, sale or purchase of a security in this Commonwealth.

(2) *Agents.* Includes the following actions:

* * * * *

(vi) Engaging in conduct specified in paragraph (1)(ii)—(vi), (ix), (x), (xiv)—(xvii), (xxi) and (xxii).

(3) *Investment advisers and investment adviser representatives.* Includes the following actions:

(i) Recommending to a client to whom investment supervisory, management or consulting services are provided the purchase, sale or exchange of a security without reasonable grounds to believe that the recommendation is suitable for the client on the basis of information furnished by the client after reasonable inquiry concerning the client's investment objectives, financial situation and needs, and any other information known by the investment adviser or investment adviser representative.

(ii) Exercising any discretionary power in placing an order for the purchase or sale of securities for a client without obtaining written discretionary authority from the client within 10 business days after the date of the first transaction placed under oral discretionary authority, unless the discretionary power relates solely to the price at which, or the time when, an order involving a definite amount of a specified security shall be executed, or both.

* * * * *

(viii) Misrepresenting to an advisory client, or prospective advisory client, the qualifications of the investment adviser, investment adviser representative or an employe of the investment adviser or misrepresenting the nature of the advisory services being offered or fees to be charged for the service, or to omit to state a material fact necessary to make the statements made regarding qualifications, services or fees, in light of the circumstances under which they are made, not misleading.

(ix) Providing a report or recommendation to an advisory client prepared by someone other than the investment adviser or investment adviser representative without disclosing that fact. This prohibition does not apply to a situation where the investment adviser or investment adviser representative uses published research reports or statistical analyses to render advice or where an investment adviser or investment adviser representative orders the report in the normal course of providing advice.

* * * * *

(xi) Failing to disclose to clients in writing before advice is rendered a material conflict of interest relating to the investment adviser, the investment adviser representative or an employe of the investment adviser which could reasonably be expected to impair the rendering of unbiased and objective advice including:

* * * * *

(B) Charging a client an advisory fee for rendering advice when a commission for executing securities transactions pursuant to the advice will be received by the investment adviser, the investment adviser representative or an employe of the investment adviser.

* * * * *

(xv) Taking an action, directly or indirectly, with respect to those securities or funds in which a client has a beneficial interest, where the investment adviser has custody or possession of the securities or funds when the adviser's action is subject to, and does not comply with, the requirements of § 404.013 (relating to investment adviser custody or possession of funds or securities of clients).

(xvii) Failing to establish, maintain and enforce written policies and procedures reasonably designed to prevent the misuse of material nonpublic information contrary to the provisions of section 204a of the Investment Advisers Act of 1940 (15 U.S.C.A. § 80b-4a) and the rules and regulations of the United States Securities and Exchange Commission promulgated thereunder.

(xviii) Entering into, extending, or renewing any advisory contract contrary to the provisions of section 205 of the Investment Advisers Act of 1940 (15 U.S.C.A. § 80b-5) and the rules and regulations of the United States Securities and Exchange Commission promulgated thereunder. This applies to all investment advisers and investment adviser representatives registered under section 301 of the act (70 P. S. § 1-301) notwithstanding whether the investment adviser is exempt from registration with the United States Securities and Exchange Commission under section 203(b) of the Investment Advisers Act of 1940 (15 U.S.C.A. § 80b-3).

(xix) To indicate, in an advisory contract, any condition, stipulation or provision binding any person to waive compliance with any provision of the act.

(xx) 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 (15 U.S.C.A. § 80b-6(4)) and the rules and regulations of the United States Securities and Exchange Commission promulgated thereunder. This applies to all investment advisers and investment adviser representatives registered under section 301 of the act notwithstanding whether the investment adviser is exempt from registration with the United States Securities and Exchange Commission under section 203(b) of the Investment Advisers Act of 1940.

(xxi) Engaging in conduct or committing any act, directly, indirectly or through or by another person, which would be unlawful for the person to do directly under the provisions of this act or any rule, regulation or order issued thereunder.

(d) This section does not apply to Federally covered advisers unless the conduct otherwise is actionable under section 401(a) or (c) or 404 of the act (70 P. S. § 1-401(a) or (c) or 1-404).

§ 305.061. Withdrawal of registration or notice filing.

(a) The following applies to investment advisers that want to withdraw from registration as an investment adviser registered under section 301 of the act (70 P. S. § 1-301):

(1) For an investment adviser that seeks to withdraw from registration under section 301 of the act because the investment adviser has become a Federally covered adviser subject to exclusive registration with the United States Securities and Exchange Commission, the investment adviser shall file an amendment to the uniform application for investment adviser registration (Form ADV) or successor form thereto with the Commission or with an investment adviser registration depository designated by order of the Commission.

(2) For an investment adviser that seeks to withdraw from registration under section 301 of the act because the investment adviser no longer transacts business in this Commonwealth as an investment adviser, the investment adviser shall file a notice of withdrawal from registration as an investment adviser form (Form ADV-W), or a successor form with the Commission or with an investment adviser registration depository designated by order of the Commission.

(b) An application to withdraw from registration as a broker-dealer shall contain the information requested in

and shall be made on Uniform Request for Withdrawal from Registration as a Broker-Dealer Form (Form BDW) or a successor form.

(c) To withdraw from registration as investment adviser representative, the investment adviser or Federally covered adviser for whom the investment adviser representative was employed shall file the Uniform Termination Notice for Securities/Futures Industry Registration (Form U-5) or a successor form thereto with the Commission or with an investment adviser registration depository designated by order of the Commission within 30 days from the date of termination.

(d) To withdraw from registration as an agent of a broker-dealer or an issuer, the broker-dealer or issuer shall file Form U-5 or successor form thereto with the Commission within 30 days from the date of termination.

(e) To withdraw a notice filing, a Federally covered adviser shall file a notice with the Commission or with an investment adviser registration depository designated by order of the Commission.

Subpart D. FRAUDULENT AND PROHIBITED PRACTICES

CHAPTER 404. PROHIBITED ACTIVITIES; INVESTMENT ADVISERS AND INVESTMENT ADVISER REPRESENTATIVES

§ 404.010. Advertisements by investment advisers and investment adviser representatives.

(a) It shall constitute a fraudulent, deceptive or manipulative act, practice or course of conduct within the meaning of section 404 of the act (70 P. S. § 1-404), for any investment adviser or investment adviser representative, directly or indirectly, to publish, circulate or distribute any advertisement:

(1) Which refers, directly or indirectly, to any testimonial of any kind by any customer concerning the investment adviser or investment adviser representative concerning any advice, analysis, report or other service rendered to the customer by the investment adviser or investment adviser representative.

(2) Which refers, directly or indirectly, to past specific recommendations of the investment adviser or investment adviser representative which were or would have been profitable to any person; provided, however, that this does not prohibit an advertisement which sets forth or offers to furnish a list of all recommendations made by the investment adviser or investment adviser representative for the 12 month period immediately preceding the date of the publication of the advertisement, and which:

(i) Includes the name of each such security recommended, the date and nature of each such recommendation (for example, whether to buy, sell or hold,) the market price at the time, the price at which the recommendation was to be acted upon, and the current market price of each such security.

(ii) Contains the following cautionary legend prominently displayed on the first page thereof in print or type as large as the largest print or type used in the body or text stating: "IT SHOULD NOT BE ASSUMED THAT RECOMMENDATIONS MADE IN THE FUTURE WILL BE PROFITABLE OR WILL EQUAL THE PERFORMANCE OF THE SECURITIES IN THIS LIST."

(3) Which represents, directly or indirectly, that any graph, chart, formula or other device being offered can in and of itself be used to determine which securities to buy or sell, or when to buy or sell them; or which represents, directly or indirectly, that any graph, chart, formula or other device being offered will assist any person in making decisions as to which securities to buy or sell, or when to buy or sell them, without prominently disclosing in the advertisement the limitations thereof and the difficulties with respect to its use.

(4) Which contains any statement to the effect that any report, analysis or other service will be furnished free or without charge, unless the report, analysis or other service actually is or will be furnished absolutely without condition or obligation.

(5) Which contains any untrue statement of a material fact, or which is otherwise false or misleading in any material respect, including the failure to disclose compensation (including free or discounted securities) received directly or indirectly in connection with making a recommendation concerning a specific security.

(6) Which recommends the purchase or sale of any security unless the investment adviser or investment adviser representative simultaneously offers to furnish to any person upon request a tabular presentation of:

(i) The total number of shares or other units of the security held by the investment adviser or investment adviser representative for its own account or for the account of officers, directors, trustees, partners or affiliates of the investment adviser or for discretionary accounts of the investment adviser or investment adviser representative maintained for clients.

(ii) The price or price range at which the securities listed in subparagraph (i) were purchased.

(iii) The date or range of dates during which the securities listed in response to subparagraph (i) were purchased.

(b) For the purpose of this section, the term "advertisement" includes any notice, circular, letter or other written communication addressed to more than one person or any notice or other announcement in any publication, by radio or television, or by electronic means, which offers:

(1) Any analysis, report or publication concerning securities, or which is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell.

(2) Any graph, chart, formula or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell.

(3) Any other investment advisory service with regard to securities.

(c) For the purpose of this section, the term "client" means any person to whom the investment adviser or investment adviser representative has given investment advice for which the investment adviser or investment adviser representative has received compensation.

(d) This section does not apply to Federally covered advisers unless the conduct otherwise is actionable under section 401(a) or (c) or 404 of the act (70 P. S. § 1-401(a) or (c) or 1-404).

§ 404.011. Investment adviser brochure disclosure.

(a) Failure of an investment adviser to provide each advisory client or prospective advisory client the disclosure required by this section shall constitute a fraudulent, deceptive or manipulative act, practice or course of business, within the meaning of section 404 of the act (70 P. S. § 1-404).

(b) An investment adviser registered under section 301 of the act (70 P. S. § 1-301) shall offer and deliver to each client and prospective client a current firm brochure and one or more supplements as required by this section. The brochure and supplements shall contain the information required by Part 2 of Form ADV (CFR 279.1).

(c) An investment adviser shall deliver to each client and prospective client all of the following:

(1) A current firm brochure.

(2) Current brochure supplements for each investment adviser representative who will provide advisory services to a client.

(d) The firm brochure and one or more supplements required by this section shall be delivered in compliance with one of the following:

(1) Not less than 48 hours prior to entering into any investment advisory contract with the client or prospective client.

(2) At the time of entering into a contract, if the advisory client has a right to terminate the contract without penalty within 5 business days after entering into the contract.

(e) An investment adviser shall, at least once a year, without charge, deliver or offer in writing to deliver to each of its clients the current brochure and any current brochure supplements required by subsection (b). If a client accepts a written offer, the investment adviser shall send to that client the current brochure and supplements within 7 days after the investment adviser is notified of the acceptance.

(f) If, as an investment adviser, the adviser is the general partner of a limited partnership, the manager of a limited liability company, or the trustee of a trust, then for purposes of this section the investment adviser shall treat each of the partnership's limited partners, the company's members or the trust's beneficial owners as a client. For the purposes of this section, a limited liability partnership or limited liability limited partnership is a "limited partnership."

(g) If an investment adviser renders substantially different types of investment advisory services to different clients, the investment adviser may provide them with different brochures, so long as each client receives all applicable information about services and fees. The brochure delivered to a client may omit any information required by Part 2A of Form ADV if the information is applicable only to a type of investment advisory service or fee which is not rendered or charged, or proposed to be rendered or charged, to that client or prospective client.

(h) Except as provided by paragraph (1), if the investment adviser is a sponsor of a wrap fee program, the brochure required to be delivered by subsection (b) to a client or prospective client of the wrap fee program shall be a wrap fee brochure containing all the information required by Form ADV. Any additional information in a wrap fee brochure shall be limited to information applicable to wrap fee programs that the investment adviser sponsors.

(1) The investment adviser does not have to offer or deliver a wrap fee brochure if another sponsor of the wrap fee program offers or delivers to the client or prospective client of the wrap fee program a wrap fee program brochure containing all the information specified in Part 2A Appendix 1 to Form ADV.

(2) A wrap fee brochure does not take the place of any brochure supplements that the investment adviser is required to deliver under this section.

(i) In accordance with Part 2 of Form ADV, the investment adviser shall amend its brochure and any brochure supplement and deliver the amendments to clients promptly when any information contained in the brochure or brochure supplement becomes materially inaccurate. The amendments shall be promptly filed with the Commission or with an investment adviser registration depository designated by the Commission.

(j) Delivering a brochure or supplement in compliance with this section does not relieve the investment adviser of any other disclosure obligations which the investment adviser may have to its clients or prospective clients under the act or this title.

(k) For the purposes of this section, the following terms have the following meanings:

(1) *Client*—A person to whom the investment adviser has given investment advice and for which the investment adviser has received compensation.

(2) *Entering into*—In reference to an investment advisory contract, the term does not include an extension or renewal without material change of the contract which is in effect immediately prior to the extension or renewal.

(3) *Portfolio manager*—The process of determining or recommending securities transactions for any portion of a client's portfolio.

(4) *Sponsor*—An investment adviser that is compensated under a wrap fee program for administering, organizing or sponsoring the program, or for selecting or providing advice to clients regarding the selection of other investment advisers in the program.

(5) *Wrap fee program*—A program under which a client is charged a specified fee or fees not based directly on transactions in a client's account for investment advisory services (which may include portfolio management or advice concerning the selection of other investment advisers) and execution of client transactions.

§ 404.012. Cash payment for client solicitation.

(a) Failure of an investment adviser to comply with the requirements of this section concerning cash payments for client solicitation constitutes a fraudulent, deceptive or manipulative act, practice or course of business, within the meaning of section 404 of the act (70 P. S. § 1-404).

(b) An investment adviser may not pay a cash fee, directly or indirectly, to a solicitor with respect to solicitation activities unless:

(1) The investment adviser is registered under the act.

(2) The solicitor, unless exempted, is registered under the act.

(3) The cash fee is paid pursuant to a written agreement to which the investment adviser is a party.

(4) The written agreement required by paragraph (3) shall:

(i) Describe the solicitation activities to be engaged in by the solicitor on behalf of the investment adviser and the compensation to be received therefor.

(ii) Contain an undertaking by the solicitor to perform its duties under the agreement in a manner consistent with the instructions of the investment adviser and the provisions of the act and the rules thereunder.

(iii) Require that the solicitor, at the time of any solicitation activities for which compensation is paid or to be paid by the investment adviser, provide the client with a current copy of the following:

(A) The investment adviser's written disclosure statement required by § 404.011 (relating to investment adviser brochure disclosure).

(B) A separate written disclosure document which contains the following:

(I) The name of the solicitor.

(II) The name of the investment adviser.

(III) The nature of the relationship, including any affiliation, between the solicitor and the investment adviser.

(IV) A statement that the solicitor will be compensated for his solicitation services by the investment adviser.

(V) The terms of the compensation arrangement, including a description of the compensation paid or to be paid to the solicitor.

(VI) The amount, if any, for the cost of obtaining his account the client will be charged in addition to the advisory fee, and the differential, if any, among clients with respect to the amount or level of the advisory fees charged by the investment adviser if the differential is attributable to the existence of any arrangement pursuant to which the investment adviser has agreed to compensate the solicitor for soliciting clients for, or referring clients to, the investment adviser.

(5) The investment adviser receives from the client prior to, or at the time of, entering into any written or oral investment advisory contract with the client, a signed and dated acknowledgment of receipt of the investment adviser's written disclosure statement required by § 404.011 and the solicitor's written disclosure document required by paragraph (4)(iii)(B).

(c) For purposes of subsection (b)(4), this section does not apply to an investment adviser when the cash fee is paid to a solicitor as follows:

(1) With respect to solicitation activities for the provision of impersonal advisory services only.

(2) A solicitor who is one of the following:

(i) A partner, officer, director or employe of the investment adviser.

(ii) A partner, officer, director or employe of a person which controls, is controlled by, or is under common control with the investment adviser if the status of the solicitor as a partner, officer, director or employe of the investment adviser or other person, is disclosed to the client at the time of the solicitation or referral.

(d) Nothing in this section relieves a person of a fiduciary or other obligation to which the person may be subject under the law.

(e) For purposes of this section, the following terms have the following meanings:

(1) *Client*—Any prospective client.

(2) *Impersonal advisory services*—Investment advisory services provided solely by means of one of the following:

(i) Written materials or oral statements which do not purport to meet the objectives or needs of the specific client.

(ii) Statistical information containing no expressions of opinions as to the investment merits of particular securities.

(iii) Any combination of the foregoing services.

(3) *Solicitor*—A person or entity who, for compensation, directly or indirectly, solicits a client for, or refers a client to, an investment adviser.

§ 404.013. Investment adviser custody or possession of funds or securities of clients.

(a) Failure of an investment adviser not registered as a broker dealer that has custody or possession of funds or securities in which any client has a beneficial interest to comply with the requirements of this section shall constitute a fraudulent, deceptive or manipulative act, practice or course of business, within the meaning of section 404 of the act (70 P. S. § 1-404).

(b) An investment adviser registered under section 301 of the act (70 P. S. § 1-301) that has custody or possession of funds or securities in which any client has any beneficial interest shall:

(1) Notify the Commission in writing that the investment adviser has or may have custody. The notification shall be given on Form ADV.

(2) Segregate the securities of each client marked to identify the particular client having the beneficial interest therein and held in safekeeping in some place reasonably free from risk of destruction or other loss.

(3) Deposit all client funds, in one or more bank accounts containing only clients funds.

(4) Maintain the accounts described in paragraph (3) in the name of the investment adviser as agent or trustee for the clients.

(5) Maintain a separate record for each account described in paragraph (3) showing the name and address of the bank where the account is maintained, the dates and amounts of deposits in and withdrawals from the account, and the exact amount of each client's beneficial interest in the account.

(6) Immediately after accepting custody or possession of funds or securities from a client, notify the client in writing of the place where and the manner in which the funds and securities will be maintained and subsequently, if and when there is a change in the place where or the manner in which the funds or securities are maintained, the investment adviser gives written notice thereof to the client.

(7) At least once every 3 months, send each client an itemized statement showing the funds and securities in the investment adviser's custody at the end of each period and all debits, credits and transactions in the client's account during that period.

(8) At least once every calendar year, engage an independent certified public accountant or independent public accountant to verify all client funds and securities by actual examination at a time chosen by the accountant without prior notice to the investment adviser. A report stating that an accountant has made an examination of the client funds and securities, and describing the nature and extent of the examination, shall be filed with the Commission within 30 days after each examination.

(c) For purposes of this section, a person will be deemed to have custody if the person directly or indirectly

holds client funds or securities, has any authority to obtain possession of them, or has the ability to appropriate them.

Subpart F. ADMINISTRATION

CHAPTER 603. ADMINISTRATIVE FILES

§ 603.031. Public inspection of records.

(a) During the regular business hours of the Commission, members of the public may, upon written request to do so, inspect at the Commission's Harrisburg Office those documents which are public records. The written request required by this subsection shall set forth the public records to be inspected.

(b) The Commission may withhold from public inspection those records which it determines are excluded from the definition of public records in section 1 of the act of June 21, 1957 (P. L. 390, No. 212) (65 P. S. § 66.1(2)), known as the Right-to-Know Law.

(c) A request for the confidential treatment of information contained in a statement, application, notice or report submitted to the Commission may accompany the statement, application, notice or report and specify the reasons for the request; the material which is the subject of the request should be separated from other parts of the filing. Upon proper showing, the Commission will treat as confidential the material which is the subject of the request.

(d) Nothing in this section may be deemed to make available for public inspection books, papers, correspondence, memoranda agreements or other documents or records contained in an investigative file maintained by the Commission. In addition, no minutes, documents or other memoranda of the Commission or of the staff which deal with or concern the institution, maintenance or termination of an investigation may be available for public inspection.

(e) Except as set forth in paragraphs (1) and (2), financial statements required to be filed under §§ 303.011, 303.012, 304.021 and 304.022 shall be public.

(1) Statements of income required to be filed under §§ 303.011 and 304.021 (relating to broker-dealer registration procedures; and broker-dealer required financial reports) and nonrequired statements of income filed under §§ 303.011, 303.012, 304.021 and 304.022 shall be confidential if the income statements are bound separately from the accountant's report, the statement of financial condition and the accompanying notes.

(2) Financial statements which are deemed confidential under paragraph (1) shall be available for official use by an official or employe of the government of the United States or a state, by a National Securities Exchange or registered National securities association of which the person filing the financial statements is a member, and by other persons whom the Commission authorizes disclosure of the information as being in the public interest. Nothing in this subsection may be deemed to be in derogation of the rules of a registered National Securities Exchange or registered National securities association which give customers of a member broker or dealer the right, upon request to the member broker or dealer, to obtain information relative to its financial condition.

(f) The Commission has determined to treat confidential the following information which will not be available for public inspection under any provision of the act and which the Commission deems excluded from the definition of public records in section 1(2) of the Right-to-Know Law:

(1) Social Security number, date of birth and home address of an individual registered or applying for registration as an agent or an investment adviser representative that appears on the uniform application for securities industry registration or transfer (Form U-4) or successor form thereto required to be filed with the Commission under § 303.013 or 303.014 (relating to agent registration procedures; and investment adviser representative registration procedures).

(2) The Social Security number, date of birth and home address of an individual registered or applying for registration as an investment adviser or filing a notice as a Federally covered adviser that appears on the uniform application for investment adviser registration (Form ADV) or successor form thereto required to be filed with the Commission or an investment adviser registration depository designated by order of the Commission under § 303.012 or 303.015 (relating to investment adviser registration procedure; and notice filing for Federally covered advisers).

(3) The Social Security number, date of birth and home address of an individual who is a principal of a person registered or applying for registration as a broker-dealer or investment adviser or filing a notice as a Federally covered adviser that appears on the uniform application for broker-dealer registration (Form BD) or Form ADV or successor forms thereto. For purposes of this section, the term "principal" has the meaning as set forth in § 303.012(e).

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