

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

Sec.

- 404.010. Advertisements by investment advisers and investment adviser representatives.
- 404.011. Investment adviser brochure disclosure.
- 404.012. Cash payment for client solicitation.
- 404.013. [Reserved].
- 404.014. Custody requirements for investment advisers.
- 404.020. [Reserved].

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

(a) The Department will consider the direct or indirect publication, circulation or distribution of an advertisement by an investment adviser or investment adviser representative to be 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) if the advertisement:

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

(2) 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 except that an advertisement setting forth or offering 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 is not prohibited if the advertisement:

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

(ii) Contains the following cautionary legend prominently displayed on the first page 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) Represents, directly or indirectly, that any graph, chart, formula or other device being offered:

(i) Can in and of itself be used to determine which securities to buy or sell, or when to buy or sell them.

- (ii) 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 and the difficulties with respect to its use.
- (4) Contains any statement 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) 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) Recommends the purchase or sale of any security unless the investment adviser or investment adviser representative simultaneously offers to furnish to any person on 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) This section does not apply to Federally covered advisers unless the conduct otherwise is actionable under section 401(a) or (c) of the act (70 P.S. § 1-401(a) and (c)) or section 404 of the act.

Authority

The provisions of this § 404.010 amended under sections 404(a) and 609(a) of the Pennsylvania Securities Act of 1972 (70 P.S. §§ 1-404(a) and 1-609(a)); section 202.C of the Department of Banking and Securities Code (71 P.S. § 733-202.C); and section 9(b) of the Takeover Disclosure Law (70 P.S. § 79(b)).

Source

The provisions of this § 404.010 adopted March 29, 1974, effective March 30, 1974, 4 Pa.B. 582; amended September 1, 2000, effective September 2, 2000, 30 Pa.B. 4551; transferred and renumbered from 64 Pa. Code § 404.010, December 14, 2012, effective December 15, 2012, 42 Pa.B. 7533; amended January 12, 2018, effective January 13, 2018, 48 Pa.B. 389. Immediately preceding text appears at serial pages (364785) to (364787).

Cross References

This section cited in 10 Pa. Code § 102.021 (relating to definitions).

§ 404.011. Investment adviser brochure disclosure.

(a) An investment adviser's failure to provide an advisory client or prospective advisory client with the disclosure required under 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 under this section which must contain the information required under Part 2 of Form ADV (17 CFR 279.1) (relating to Form ADV, for application for registration of investment adviser and for amendments to such registration statement).

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

(1) A current firm brochure.

(2) The 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 under this section shall be delivered in compliance with one of the following:

(1) Not less than 48 hours before 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 end the contract without penalty within 5 business days after entering into the contract.

(e) An investment adviser shall:

(1) Deliver or offer in writing to deliver to each of its clients the current brochure and any current brochure supplements required under subsection (b) without charge at least once a year.

(2) Send to a client that accepts a written offer 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 gives substantially different types of investment advisory services to different clients, the investment adviser may do the following:

(1) Provide the clients with different brochures, so long as each client receives all applicable information about services and fees.

- (2) Omit from the brochure delivered to a client any information required under Part 2A of Form ADV if the information applies only to a type of investment advisory service or fee which is not given or charged, or proposed to be given or charged, to that client or prospective client.
- (h) Except as provided in 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 must be a wrap fee brochure containing all the information required under Form ADV.
- (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.
- (3) Additional information in a wrap fee brochure must be limited to information applicable to wrap fee programs that the investment adviser sponsors.
- (i) In accordance with Part 2 of Form ADV, if information contained in the brochure or brochure supplement becomes materially inaccurate, the investment adviser shall:
- (1) Amend its brochure and any brochure supplement.
 - (2) Deliver the amendments to clients promptly.
 - (3) Promptly file the amendments with the Department or with IARD.
- (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) The delivery requirement set forth in subsection (d) does not apply to the extension or renewal of an investment advisory contract without material changes of the contract which is in effect immediately prior to the extension or renewal.

Authority

The provisions of this § 404.011 issued under sections 404(a) and 609(a) of the Pennsylvania Securities Act of 1972 (70 P.S. §§ 1-404(a) and 1-609(a)); amended under section 202.C of the Department of Banking and Securities Code (71 P.S. § 733-202.C); section 609(a) of the Pennsylvania Securities Act of 1972 (70 P.S. § 1-609(a)); and section 9(b) of the Takeover Disclosure Law (70 P.S. § 79(b)).

Source

The provisions of this § 404.011 adopted September 1, 2000, effective September 2, 2000, 30 Pa.B. 4551; transferred and renumbered from 64 Pa. Code § 404.011, December 14, 2012, effective December 15, 2012, 42 Pa.B. 7533; amended January 12, 2018, effective January 13, 2018, 48 Pa.B. 389. Immediately preceding text appears at serial pages (364787) to (364789).

Cross References

This section cited in 10 Pa. Code § 102.021 (relating to definitions); 10 Pa. Code § 304.012 (relating to investment adviser required records); and 10 Pa. Code § 404.012 (relating to cash payment for client solicitation).

§ 404.012. Cash payment for client solicitation.

(a) An investment adviser's failure 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 or other economic benefit, directly or indirectly, to a solicitor with respect to solicitation activities unless:

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

(2) The solicitor is registered as an investment adviser representative or is exempt from registration under § 302.071 (relating to registration exemption for solicitors) or qualifies for another exemption under the act.

(3) The cash fee or other economic benefit is paid under a written agreement to which the investment adviser is a party.

(4) The written agreement required under paragraph (3):

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

(ii) Contains 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) Requires 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 prospective client with a current copy of the following:

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

(B) A separate written disclosure document which contains all of 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 the 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 prospective 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 under which the investment adviser has agreed to compensate the solicitor for soliciting prospective clients for, or referring prospective clients to, the investment adviser.

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

(c) For purposes of subsection (b)(5), this section does not apply to an investment adviser as follows:

(1) If the cash fee is paid to a solicitor with respect to solicitation activities for the provision of impersonal investment advisory services only.

(2) If the cash fee is paid to a solicitor who is either of the following:

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

(ii) A partner, officer, director or employee 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 employee of the investment adviser or other person, is disclosed to the client at the time of the solicitation or referral.

(d) This section does not relieve a person of a fiduciary or other obligation to which the person may be subject under the law.

Authority

The provisions of this § 404.012 issued under sections 404(a) and 609(a) of the Pennsylvania Securities Act of 1972 (70 P.S. §§ 1-404(a) and 1-609(a)); amended under section 202.C of the Department of Banking and Securities Code (71 P.S. § 733-202.C); section 609(a) of the Pennsylvania Securities Act of 1972 (70 P.S. § 1-609(a)); and section 9(b) of the Takeover Disclosure Law (70 P.S. § 79(b)).

Source

The provisions of this § 404.012 adopted September 1, 2000, effective September 2, 2000, 30 Pa.B. 4551; transferred and renumbered from 64 Pa. Code § 404.012, December 14, 2012, effective December 15, 2012, 42 Pa.B. 7533; amended January 12, 2018, effective January 13, 2018, 48 Pa.B. 389. Immediately preceding text appears at serial pages (364789) to (364791).

Cross References

This section cited in 10 Pa. Code § 102.021 (relating to definitions); 10 Pa. Code § 302.071 (relating to registration exemption for solicitors); and 10 Pa. Code § 304.012 (relating to investment adviser required records).

§ 404.013. [Reserved].**Authority**

The provisions of this § 404.013 issued under sections 404(a) and 609(a) of the Pennsylvania Securities Act of 1972 (70 P.S. §§ 1-404(a) and 1-609(a)); reserved under section 202.C of the Department of Banking and Securities Code (71 P.S. § 733-202.C); section 609(a) of the Pennsylvania Securities Act of 1972 (70 P.S. § 1-609(a)); and section 9(b) of the Takeover Disclosure Law (70 P.S. § 79(b)).

Source

The provisions of this § 404.013 adopted September 1, 2000, effective September 2, 2000, 30 Pa.B. 4551; amended April 15, 2005, effective April 16, 2005, 35 Pa.B. 2307; transferred and renumbered from 64 Pa. Code § 404.013, December 14, 2012, effective December 15, 2012, 42 Pa.B. 7533; reserved January 12, 2018, effective January 13, 2018, 48 Pa.B. 389. Immediately preceding text appears at serial pages (364791) to (364793).

§ 404.014. Custody requirements for investment advisers.

(a) *Safekeeping required.* It is unlawful and considered to be 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), for an investment adviser, registered or required to be registered under section 301 of the act (70 P.S. § 1-301), to have custody of client funds or securities unless:

(1) The investment adviser notifies the Department promptly in writing on Form ADV that the investment adviser has or may have custody.

(2) A qualified custodian maintains those funds and securities in one of the following:

(i) A separate account for each client under that client's name.

(ii) Accounts that contain only the investment adviser's clients' funds and securities under the investment adviser's name as agent or trustee for the clients or, in the case of a pooled investment vehicle that the investment adviser manages, in the name of the pooled investment vehicle.

(3) The investment adviser meets the following conditions:

(i) If the investment adviser opens an account with a qualified custodian on its client's behalf, under the client's name, under the name of the investment adviser as agent or under the name of a pooled investment vehicle, the investment adviser shall notify the client in writing of the qualified custodian's name, address and how the funds or securities are maintained, promptly when the account is opened and following any changes to this information.

(ii) If the investment adviser sends account statements to a client to which the investment adviser is required to provide the notice in subparagraph (i), the investment adviser shall include in the notification provided to that client and in any subsequent account statement the investment adviser

sends that client a statement urging the client to compare the account statements from the custodian with those from the investment adviser.

(4) The investment adviser meets the following conditions:

(i) The investment adviser has a reasonable basis, after due inquiry, for believing that the qualified custodian sends an account statement, at least quarterly, to each client for which it maintains funds or securities and the account statement:

(A) Identifies the amount of funds in the account.

(B) Identifies the amount of each security in the account at the end of the period.

(C) Sets forth all transactions in the account during that period.

(ii) If the investment adviser or a related person is a general partner of a limited partnership (or managing member of a limited liability company, or holds a comparable position for another type of pooled investment vehicle), the account statements required under paragraph (3) shall be sent to each limited partner (or member or other beneficial owner).

(5) The investment adviser meets the following conditions:

(i) The client funds and securities of which the investment adviser has custody are verified by actual examination at least once during each calendar year, by an independent certified public accountant, under a written agreement between the investment adviser and the independent certified public accountant, at a time that is chosen by the independent certified public accountant without previous notice or announcement to the investment adviser and that is irregular from year to year.

(ii) The written agreement provides for the first examination to occur within 6 months of becoming subject to this paragraph, except that, if the investment adviser maintains client funds or securities under this section as a qualified custodian, the agreement must provide for the first examination to occur no later than 6 months after obtaining the internal control report.

(iii) The written agreement must require the independent certified public accountant to:

(A) File a certificate on Form ADV-E with the Department within 120 days of the time chosen by the independent certified public accountant in this paragraph, stating that it has examined the funds and securities and describing the nature and extent of the examination.

(B) Notify the Department within 1 business day of the finding, by means of a facsimile transmission or e-mail, followed by first class mail, directed to the attention of the Department on finding any material discrepancies during the course of the examination.

(C) File Form ADV-E within 4 business days of the resignation or dismissal from, or other termination of, the engagement or removing itself or being removed from consideration for being reappointed, accompanied by a statement that includes:

(I) The date of resignation, dismissal, removal or other termination, and the name, address and contact information of the independent certified public accountant.

(II) An explanation of any problems relating to examination scope or procedure that contributed to resignation, dismissal, removal or other termination.

(6) If the investment adviser has custody because a related person maintains client funds or securities under this section as a qualified custodian in connection with advisory services the investment adviser provides to clients, the investment adviser shall obtain, or receive from its related person, within 6 months of becoming subject to this paragraph and thereafter no less frequently than once each calendar year a written internal control report prepared by an independent certified public accountant that performs the independent verification required under paragraph (5) that complies with the following:

(i) The internal control report must include an opinion of an independent certified public accountant as to whether controls have been placed in operation as of a specific date, and are suitably designed and are operating effectively to meet control objectives relating to custodial services, including the safeguarding of funds and securities held by either the investment adviser or a related person on behalf of the investment adviser's clients, during the year.

(ii) The independent certified public accountant shall verify that the funds and securities are reconciled to a custodian other than the investment adviser or the investment adviser's related person.

(7) A client may designate an independent representative to receive, on his behalf, notices and account statements as required under paragraphs (3) and (4).

(b) *Exceptions.*

(1) *Shares of mutual funds.* With respect to shares of an open-end company as defined in section 5(a)(1) of the Investment Company Act of 1940 (15 U.S.C.A. § 80a-5(a)(1)) (mutual fund), the investment adviser may use the mutual fund's transfer agent instead of a qualified custodian to comply with subsection (a).

(2) *Certain privately offered securities.*

(i) The investment adviser does not need to comply with subsection (a)(2) with respect to securities that are:

(A) Acquired from the issuer in a transaction or chain of transactions not involving any public offering.

(B) Uncertificated and ownership is recorded only on the books of the issuer or its transfer agent in the name of the client.

(C) Transferable only with previous consent of the issuer or holders of the outstanding securities of the issuer.

(ii) Notwithstanding subparagraph (i), the provisions of this paragraph are available with respect to securities held for the account of a pooled investment vehicle only if the pooled investment vehicle is audited, and the audited financial statements are distributed, in accordance with § 303.042(a)(3)(ii) (relating to investment adviser capital requirements) and the investment adviser notifies the Department in writing on Form ADV that the investment adviser intends to provide audited financial statements, as described in this subparagraph.

(3) *Fee deduction.* Notwithstanding subsection (a)(5), an investment adviser does not need to obtain an independent verification of client funds and securities maintained by a qualified custodian if the investment adviser is in compliance with § 303.042(a)(3)(i).

(4) *Limited partnerships subject to annual audit.* An investment adviser does not need to comply with subsection (a)(3) and (4) and will be considered to have complied with subsection (a)(5) with respect to the account of a pooled investment vehicle that is subject to audit and is in compliance with § 303.042(a)(3)(ii).

(5) *Registered investment companies.* The investment adviser does not need to comply with this section with respect to the account of an investment company registered under the Investment Company Act of 1940 (15 U.S.C.A. §§ 80a-1—80a-64).

(c) *Delivery to related persons.* Sending an account statement under subsection (a)(4) or distributing audited financial statements under subsection (b)(4) does not satisfy the requirements of this section if the account statements or financial statements are sent solely to limited partners (or members or other beneficial owners) that themselves are limited partnerships (or limited liability companies, or another type of pooled investment vehicle) and are related persons of the investment adviser.

(d) *Department authority.* An investment adviser who cannot comply with one or more of the specific provisions in this section may request that the Department waive the specific provisions if the investment adviser can establish that undue hardship would be placed on the investment adviser and that investment adviser can establish sufficient alternative safeguards.

Authority

The provisions of this § 404.014 issued under section 202.C of the Department of Banking and Securities Code (71 P.S. § 733-202.C); section 609(a) of the Pennsylvania Securities Act of 1972 (70 P.S. § 1-609(a)); and section 9(b) of the Takeover Disclosure Law (70 P.S. § 79(b)).

Source

The provisions of this § 404.014 adopted January 12, 2018, effective January 13, 2018, 48 Pa.B. 389.

404-10

Cross References

This section cited in 10 Pa. Code § 102.021 (relating to definitions); and 10 Pa. Code § 305.019 (relating to dishonest and unethical practices).

§ 404.020. [Reserved].**Source**

The provisions of this § 404.020 adopted March 29, 1974, effective March 30, 1974, 4 Pa.B. 582; amended January 17, 1992, effective January 18, 1992, 22 Pa.B. 294; reserved September 1, 2000, effective September 2, 2000, 30 Pa.B. 4551; transferred and renumbered from 64 Pa. Code § 404.020, December 14, 2012, effective December 15, 2012, 42 Pa.B. 7533. Immediately preceding text appears at serial page (310509).

[Next page is 501-1.]

404-12

(389786) No. 521 Apr. 18

Copyright © 2018 Commonwealth of Pennsylvania