

Kansas Administrative Regulations

Department of Insurance Assistant Commissioner, Securities Division

Article 14.—Investment Advisers and Investment Adviser Representatives

81-14-4. Recordkeeping requirements for investment advisers.

(a) Definitions. For purposes of this regulation, the following definitions shall apply:

(1) "Control" means 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. Each person who owns beneficially, either directly or through one or more controlled companies, more than 25 percent of the voting securities of a company shall be presumed to control the company.

(2) "Discretionary power" shall not include discretion regarding the price or the time at which a transaction is to be effected if the client has directed or approved the purchase or sale of a definite amount of a particular security before the order is given by the investment adviser.

(3) "Investment supervisory services" means the giving of continual advice about the investment of funds on the basis of each client's individual needs.

(4) "Solicitor" means any person or entity who, for compensation, acts as an agent of an investment adviser in referring potential clients.

(b) Except as otherwise provided in subsection (j) of this regulation, each investment adviser registered or required to be registered under the act shall make and keep true, accurate, and current all of the following books, ledgers, and records:

(1) Each investment adviser shall maintain 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) Each investment adviser shall maintain general and auxiliary ledgers or other comparable records reflecting asset, liability, equity, capital, income, and expense accounts.

(3)(A) Each investment adviser shall maintain memoranda concerning orders, instructions, modifications, or cancellations, including memoranda of the following:

- (i) Each order given by the investment adviser for the purchase or sale of any security;
- (ii) any instruction received by the investment adviser from the client concerning the purchase, sale, receipt, or delivery of a particular security; and
- (iii) any modification or cancellation of an order or instruction.

(B) Each memorandum shall show the following information:

- (i) The terms and conditions of the order, instruction, modification, or cancellation;
- (ii) the name of the person connected with the investment adviser who recommended the transaction to the client and the name of the person who placed the order;
- (iii) the account for which the order, instruction, modification, or cancellation was entered;
- (iv) the date of entry; and
- (v) the bank, broker, or dealer by or through whom the transaction was executed, if appropriate.

(C) Each order entered pursuant to the exercise of discretionary power shall be so designated.

(4) Each investment adviser shall maintain all checkbooks, bank statements, canceled checks, and cash reconciliations.

(5) Each investment adviser shall maintain all bills or statements, paid or unpaid, relating to the adviser's business as an investment adviser.

(6) Each investment adviser shall maintain all trial balances, financial statements, and internal audit working papers relating to the adviser's business as an investment adviser. For purposes of this paragraph, "financial statements" shall mean a balance sheet prepared in accordance with generally accepted accounting principles, an income statement, a cash flow statement, and a net worth computation if a net worth computation is required by K.A.R. 81-14-9.

(7)(A) Each investment adviser shall maintain originals of all written communications received and copies of all written communications sent by the investment adviser relating to 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; and

(iii) the placing or execution of any order to purchase or sell any security.

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

(C) If the investment adviser sends any notice, circular, or other advertisement offering any report, analysis, publication, or other investment advisory service to more than 10 persons, the investment adviser shall not be required to keep a record of the names and addresses of the persons to whom the notice, circular, or advertisement was sent. However, 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) Each investment adviser shall maintain a list or other record of all accounts that identifies the accounts in which the adviser is vested with any discretionary power with respect to the funds, securities, or transactions of any client.

(9) Each investment adviser shall maintain a copy of all powers of attorney and other evidence of the granting of any discretionary authority by any client to the investment adviser.

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

(11) Each investment adviser shall maintain a file containing a copy of each notice, circular, advertisement, newspaper article, investment letter, bulletin, or other communication that the adviser circulates or distributes, directly or indirectly, including by electronic media, to two or more persons who are not connected with the investment adviser. If the notice, circular, advertisement, newspaper article, investment letter,

bulletin, or other communication recommends the purchase or sale of a specific security and does not state the reasons for the recommendation, the file shall contain a memorandum of the investment adviser indicating the reasons for the recommendation.

(12) (A) For purposes of paragraph (b)(12), the term "advisory representative" shall mean any of the following;

(i) Any partner, officer, or director of the investment adviser;

(ii) any employee who participates in any way in the determination of which recommendations shall be made;

(iii) any employee who, in connection with the employee's duties, obtains any information concerning which securities are being recommended before the effective dissemination of the recommendations; or

(iv) any person in a control relationship to the investment adviser, any affiliated person of a controlling person, or any affiliated person of an affiliated person who obtains information concerning securities recommendations being made by the investment adviser before the effective dissemination of the recommendations.

(B) Each investment adviser shall maintain a record of every transaction in a security, except as provided in paragraph (b)(12)(E), in which the adviser or any advisory representative of the adviser has, or by reason of any transaction acquires, any direct or indirect beneficial ownership. Each record shall state the following:

(i) The title and amount of the security involved;

(ii) the date and nature of the transaction, including whether it is a purchase, sale, or other acquisition or disposition;

(iii) the price at which the transaction was effected; and

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

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

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

(E) A record shall not be required for either of the following:

(i) Any transaction effected in an account over which neither the investment adviser nor any advisory representative of the investment adviser has any direct or indirect influence or control; or

(ii) any transaction in a security that is a direct obligation of the United States.

(F) An investment adviser shall not be deemed to have violated the provisions of paragraph (b)(12) because of the failure to record securities transactions of any advisory representative if the adviser establishes that it instituted adequate procedures and used reasonable diligence to promptly obtain reports of all transactions required to be recorded.

(13) (A) For purposes of this paragraph (b)(13), the term "advisory representative," when used in connection with a company primarily engaged in a business or businesses other than advising investment advisory clients, shall mean either of the following:

(i) Any partner, officer, director, or employee of the investment adviser who participates in any way in the determination of which recommendations shall be made, or whose functions or duties relate to the determination of which securities are being recommended before the effective dissemination of the recommendations; or

(ii) any person in a control relationship to the investment adviser, any affiliated person of a controlling person, or any affiliated person of an affiliated person who obtains information concerning securities recommendations being made by the investment adviser before the effective dissemination of the recommendations or of the information concerning the recommendations.

For purposes of this paragraph (b)(13), an investment adviser shall be deemed to be "primarily engaged in a business or businesses other than advising investment advisory clients" if, for each of its most recent three fiscal years or for the period of time since organization, whichever is less, the investment adviser derived, on an unconsolidated basis, more than 50 percent of total sales and revenues, and more than 50 percent of income or loss before income taxes and extraordinary items, from other business or businesses that did not primarily involve the giving of investment advice.

(B) Notwithstanding the provisions of paragraph (b)(12), if the investment adviser is primarily engaged in a business or businesses other than advising investment advisory

clients, the adviser shall maintain a record of every transaction in a security, except as provided in paragraph (b)(13)(E), in which the adviser or any advisory representative of the adviser has, or by reason of any transaction acquires, any direct or indirect beneficial ownership. The record shall state the following:

- (i) The title and amount of the security involved;
- (ii) the date and nature of the transaction, including whether it is a purchase, sale, or other acquisition or disposition;
- (iii) the price at which the transaction was effected; and
- (iv) the name of the broker-dealer or bank with or through whom the transaction was effected.

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

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

(E) A record shall not be required for either of the following:

- (i) Any transaction effected in an account over which neither the investment adviser nor any advisory representative of the investment adviser has any direct or indirect influence or control; or
- (ii) any transaction in a security that is a direct obligation of the United States.

(F) An investment adviser shall not be deemed to have violated the provisions of paragraph (b)(13) because of the failure to record securities transactions of any advisory representative if the investment adviser establishes that the adviser instituted adequate procedures and used reasonable diligence to promptly obtain reports of all transactions required to be recorded.

(14) Each investment adviser shall maintain the following records:

(A) A copy of each written statement and each amendment or revision given or sent to any client or prospective client of the adviser in accordance with the provisions of K.A.R. 81-14-10(b);

(B) any summary of material changes that is required by part 2 of form ADV but is not contained in the written statement; and

(C) a record of the date that each written statement, each amendment or revision to the written statement, and each summary of material changes was given or offered to any client or prospective client who subsequently became a client.

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

(i) Evidence of any written agreement in which the investment adviser agrees to pay a fee to the solicitor;

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

(iii) a copy of the solicitor's written disclosure statement.

(B) The written agreement, acknowledgment, and solicitor disclosure statement shall satisfy the requirements of paragraph (b)(15)(A) if the documents are in compliance with K.A.R. 81-14-5(f).

(16) Each investment adviser shall maintain 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 that the investment adviser circulates or distributes, directly or indirectly, including electronic media, to two or more persons other than persons connected with the investment adviser. 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 the retention of all worksheets necessary to demonstrate the calculation of the performance or rate of return of all managed accounts, shall satisfy the requirements of this paragraph.

(17) Each investment adviser shall maintain a file containing a copy of all communications received or sent regarding any litigation involving the investment

adviser or any investment adviser representative or employee, and regarding any customer or client complaint.

(18) Each investment adviser shall maintain written information about each investment advisory client that is the basis for making any recommendation or providing any investment advice to the client.

(19) Each investment adviser shall maintain written procedures to supervise the activities of employees and investment adviser representatives that are reasonably designed to achieve compliance with the act and these regulations.

(20) Each investment adviser shall maintain a file containing a copy of each document, other than any notice 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. The file shall contain all applications, amendments, renewal filings, and correspondence.

(21) Each investment adviser shall retain copies, with the original signatures of the investment adviser's appropriate signatory and the investment adviser representative, of each initial form U-4 and each amendment to the disclosure reporting pages filed on behalf of an investment advisor representative. The copies shall be made available for inspection upon request by the administrator or the administrator's staff.

(22) If the adviser inadvertently held or obtained a client's securities or funds and returned them to the client within three business days or has forwarded third-party checks within 24 hours, the adviser shall keep the following records relating to the inadvertent custody:

(A) The issuer, type of security and series, and date of issue;

(B) for debt instruments, the denomination, interest rate, and maturity date;

(C) the certificate number, including alphabetical prefix or suffix;

(D) the name in which the securities are registered, the date given to the adviser, the date sent to the client or sender, the form of delivery to the client or sender, and a copy of proof of delivery to the client or sender; and

(E) the mail confirmation number, if applicable, or confirmation by the client or sender of the return of the funds or securities.

(23) If an investment adviser obtains possession of securities that are acquired from the issuer in a transaction or series of transactions that meets the requirements of the exception from custody under K.A.R. 81-14-9(b)(2)(B), the adviser shall keep the following records:

(A) A record showing the issuer's or current transfer agent's name, address, phone number, and other applicable contact information pertaining to the party responsible for recording client interests in the securities; and

(B) a copy of any legend, shareholder agreement, or other agreement showing that those securities are transferable only with the prior consent of the issuer or holders of the outstanding securities of the issuer.

(c) (1) If an investment adviser has custody, as that term is defined in K.A.R. 81-14-9, the records required to be made and kept by the investment adviser shall include the following:

(A) A copy of any and all documents executed by the client, including a limited power of attorney, under which the adviser is authorized or permitted to withdraw a client's funds or securities maintained with a custodian upon the adviser's instruction to the custodian;

(B) 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;

(C) 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;

(D) copies of confirmations of all transactions effected by or for the account of any client;

(E) a record for each security in which any client has a position that shows the name of each client having any interest in each security, the amount or interest of each client, and the location of each security;

(F) a copy of each of the client's quarterly account statements, as generated and delivered by the qualified custodian. If the adviser also generates a statement that is

delivered to the client, the adviser shall also maintain a copy of each statement along with the date the statement was sent to the client;

(G) if applicable to the adviser's situation, a copy of the auditor's report and financial statements and letter verifying the completion of the examination by an independent certified public accountant and describing the nature and extent of the examination;

(H) a record of any finding by the independent certified public accountant of any material discrepancies found during the examination; and

(I) if applicable, evidence of the client's designation of an independent representative.

(2) If an investment adviser has custody because it advises a pooled investment vehicle, the adviser shall also keep the following records:

(A) True, accurate, and current account statements;

(B) if the adviser qualifies for the exception in K.A.R. 81-14-9(b)(2)(C), the date of each audit, a copy of the financial statements, and evidence of the mailing of the audited financial statements to all limited partners, members, or other beneficial owners within 120 days of the end of the adviser's fiscal year; and

(C) if the adviser complies with K.A.R. 81-14-9(b)(1)(G), a copy of the written agreement with the independent party reviewing all fees and expenses, indicating the responsibilities of the independent third party, and copies of all invoices and receipts showing approval by the independent party for payment through the qualified custodian.

(3) If an investment adviser has custody because it is acting as the trustee for a beneficial trust but qualifies for the exception in K.A.R. 81-14-9(b)(2)(E), the adviser shall also keep the following records until the account is closed or the adviser is no longer acting as the trustee:

(A) A copy of the written statement given to each beneficial owner setting forth a description of the requirements of K.A.R. 81-14-9(b)(1) and the reason why the adviser will not be complying with those requirements; and

(B) a written acknowledgement signed and dated by each beneficial owner, evidencing receipt of the statement required under paragraph (c)(3)(A).

(d) Each investment adviser subject to subsection (b) who 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, perform the following:

(1) Make and keep true, accurate, and current records showing separately for each client the securities purchased and sold, and the date, amount, and price of each purchase and sale; and

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

(e) Any books or records required by this regulation 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 a similar designation.

(f) Each investment adviser subject to subsection (b) of this regulation shall preserve the following records in the manner prescribed:

(1) All books and records required to be made under the provisions of subsection (b) through paragraph (d)(1), except for books and records required to be made under the provisions of paragraphs (b)(11) and (b)(16) through (b)(20), shall be maintained and preserved in an easily accessible place for at least five years from the end of the fiscal year during which the last entry was made on the record. The records shall be maintained during the first two years 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 any predecessor shall be maintained in the principal office of the investment adviser until termination of the enterprise, and then preserved in an easily accessible place until at least three years after termination of the enterprise.

(3) The books and records required to be made under the provisions of paragraphs (b)(11) and (b)(16) shall be maintained and preserved in an easily accessible place for at least five years 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. The records shall be maintained during the first two years in the principal office of the investment adviser.

(4) The books and records required to be made under the provisions of paragraphs (b)(17) through (b)(20) shall be maintained and preserved in an easily accessible place for at least five years from the end of the fiscal year during which the last entry was made on the record, with the first two years in the principal office of the investment adviser, or for the time period during which the investment adviser was registered or required to be registered in this state, whichever is less.

(5) Notwithstanding any other record preservation requirements of this regulation, the following records or copies shall be maintained, for the periods described in this subsection, 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:

(A) The records required to be preserved under paragraphs (b)(3), (b)(7) through (b)(10), (b)(14), (b)(15), (b)(17) through (b)(19), and subsections (c) and (d); and

(B) the records or copies required under paragraphs (b)(11) and (b)(16) that identify the name of the investment adviser representative providing investment advice from that business location, or that identify the business location's physical address, mailing address, electronic mailing address, or telephone number.

(g) Before ceasing to conduct or discontinuing business as an investment adviser, each investment adviser shall arrange for and be responsible for the preservation of the books and records required to be maintained and preserved under this regulation for the remainder of each period specified in this regulation, and shall notify the administrator in writing of the exact address where the books and records will be maintained.

(h) The records required by this regulation may be maintained and preserved by electronic imaging or by photograph on film. Any investment adviser may also maintain and preserve records on computer tape, disk, or other computer storage medium if, in the ordinary course of the adviser's business, the records are created by the adviser on electronic media or received by the adviser solely on electronic media or by electronic data transmission. In whatever form, the records shall be maintained and preserved for the time required by this regulation. If records are produced or reproduced by

photographic film, electronic imaging, or computer storage medium, the investment adviser shall meet the following criteria:

(1) Arrange the records and index the films, electronic images, or computer storage media to permit the immediate location of any particular record;

(2) be ready at all times to promptly provide a facsimile enlargement of film, a computer printout, or a copy of the electronic images or computer storage medium that the administrator by its examiners or other representatives may request;

(3) store, separately from the original, one other copy of each film, electronic image, or computer storage medium for the time required;

(4) with respect to electronic images and records stored on computer storage medium, maintain procedures for maintenance and preservation of, and access to, records in order to reasonably safeguard these records from loss, alteration, or destruction; and

(5) with respect to records stored on photographic film, at all times have facilities available for immediate, easily readable projection of the film and for producing easily readable facsimile enlargements.

(i) Any book or other record made, kept, maintained, and preserved in compliance with SEC rule 17a-3, 17 C.F.R. 240.17a-3, and SEC rule 17a-4, 17 C.F.R. 240.17a-4, both of which are adopted by reference in K.A.R. 81-2-1, that is substantially the same as the book or other record required to be made, kept, maintained, and preserved under this regulation, shall be deemed to comply with this regulation.

(j) Each investment adviser that is registered or required to be registered in this state and that has its principal place of business in a state other than this state shall be exempt from the requirements of this regulation, if the investment adviser is licensed in that state and is in compliance with that state's recordkeeping requirements.

(Authorized by K.S.A. 2005 Supp. 17-12a605(a); implementing K.S.A. 2005 Supp. 17-12a411; effective Oct. 26, 2001; amended Aug. 18, 2006.)

***** Authenticated Kansas Administrative Regulation *****