

DEPARTMENT OF CORPORATIONS*Business Services and Consumer and Investor Protection*

Preston DuFauchard
California Corporations Commissioner
Sacramento, California

December 3, 2010

INVITATION FOR COMMENTS**PROPOSED CALIFORNIA INVESTMENT ADVISER REGULATIONS
PRO 27/03****BACKGROUND**

The Department of Corporations ("Department") licenses and regulates investment advisers under the Corporate Securities Law of 1968 (Corporations Code Section 25000 et seq., the "Corporate Securities Law"). Under the Corporate Securities Law, it is unlawful for an investment adviser to conduct business without first applying for and securing a certificate, as specified.

The Department is considering changes to certain regulations that impact California investment advisers, and in accordance with Government Code Section 11346.45, the Department is seeking comments from interested parties and those who would be subject to the proposed regulations, prior to the Department providing notice of a proposed rulemaking action.

More specifically, the Department is seeking comments on amendments to the following sections of Title 10 of the California Code of Regulations:

- Section 260.230.1 (*Notice Filing Requirements for Investment Advisers Registered Under Section 203 of the Investment Advisers Act of 1940*),
- Section 260.231 (*Application for Investment Adviser Certificate*),
- Section 260.235 (*Advertisements by Investment Advisers*),
- Section 260.237 (*Custody or Possession of Funds or Securities of Clients*),
- Section 260.237.2 (*Minimum Financial Requirements*),
- Section 260.238 (*Investment Advisers: Fair, Equitable and Ethical Principles*), and
- Section 260.241.3 (*Books and Records to be Maintained By Investment Advisers*).

The Department is further seeking comments on the adoption of the following sections in Title 10 of the California Code of Regulations:

- Section 260.235.5 (*Delivery of Brochures and Brochure Supplements*),

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Comments Requested by January 7, 2011

- Section 260.238.1 (*Investment Adviser Code of Ethics*),
- Section 260.238.2 (*Payment for Client Solicitations*) and
- Section 260.238.3 (*Investment Advisers Business Continuity Plan*).

Generally, the Department is considering changes to the rules to increase investor safeguards, to clarify legal standards for persons providing investment advisory services, and to increase consistency with model rules enacted by the North American Securities Administrators Association. Additionally, and to a lesser extent, these proposed changes will increase consistency with recently modified or adopted Securities and Exchange Commission rules and interpretations, where applicable.

Particularly noteworthy is the proposed amendment of the rule on custody procedure requirements for investment advisers that have custody of client funds or assets (Section 260.237). On December 30, 2009, The Securities and Exchange Commission adopted amendments to its custody rule. (See *SEC Release No. IA-2968; 17 CFR Parts 275 and 279*). The proposed amendments to Section 260.237 incorporate certain of the provisions contained in the amended SEC rule.

INVITATION

In accordance with Government Code Section 11346(b), the Department seeks to involve parties who would be subject to the regulations and other interested parties in discussions regarding the proposed regulations. Accordingly, the Department is providing text draft regulations to interested parties, and invites interested parties to submit comments on these documents by **JANUARY 7, 2011**. Within the following text, additions to existing regulations are shown by underline, and deletions are shown by strikethrough. Comments from interested persons will assist the Department in determining whether amendments to regulations under the Corporate Securities Law are necessary and appropriate.

This solicitation for comments from interested parties is not a proposed rulemaking action under Government Code Section 11346, and the public will have an additional opportunity to comment on proposed changes if, after consideration of the comments from interested parties, the Department proceeds with a notice of a proposed rulemaking action.

You may submit comments by any of the following means:

Electronic

Comments may be submitted electronically to regulations@corp.ca.gov. Please identify the comments as PRO 27/03.

INVITATION FOR COMMENTS
California Investment Adviser Regulations
Comments Requested by January 7, 2011

Mail

California Department of Corporations
Office of Legislation and Policy
Attn: Karen Fong (PRO 27/03)
1515 K St., Suite 200
Sacramento, CA 95814

Fax

(916) 322-5875

CONTACT PERSON

Questions regarding this invitation for comments may be directed to Ivan V. Griswold, Corporations Counsel, at (415) 972-8937 or igriswol@corp.ca.gov.

INVITATION FOR COMMENTS
PROPOSED INVESTMENT ADVISER REGULATIONS
(Additions shown by underline and deletions shown by strikethrough.)

1. Amend Section 260.230.1 to read:

§ 260.230.1. Notice Filing Requirements for Investment Advisers Registered
Under Section 203 of the Investment Advisers Act of 1940.

(a) Initial notice: A person subject to subsection (a) of Corporations Code Section 25230.1 shall file an initial notice consisting of Form ADV (Uniform Application for Investment Adviser Registration (17 CFR 279.1)) in accordance with the instructions in Form ADV within thirty (30) days of conducting business in the state. The notice shall be deemed filed when the fee required by Section 25608.1(d) and Form ADV are filed with and accepted by IARD on behalf of this state.

~~(b) Portions of Form ADV not yet accepted by IARD: If an investment adviser agrees to provide, within five (5) days of a request, Part 2 of Form ADV to the Commissioner, an investment adviser is not required to file Part 2 of Form ADV with the Commissioner until IARD provides for the filing of Part 2 of Form ADV.~~

~~(c)~~ (b) Annual renewal: The notice expires December 31st unless renewed. The annual renewal shall be filed with IARD in accordance with its procedures. The renewal of the notice filing shall be deemed filed when the fee required by Section 25608.1(d) is filed with and accepted by IARD on behalf of the state.

~~(d)~~ (c) Amendments to Form ADV: Any changes to the information contained in Form ADV shall be filed with IARD in accordance with the instructions in Form ADV.

~~(e)~~ (d) Investment Adviser Representatives: Each investment adviser representative, as defined in Section 25009.5(b) of the Code, with a place of business in

the state shall be reported in the manner prescribed in Section 260.236.1(b) of these rules.

(f) (e) Switching to state registration: Upon the filing of Form ADV-W (Notice of Withdrawal from Registration as an Investment Adviser) withdrawing registration with the Securities and Exchange Commission under the Investment Advisers Act of 1940, an investment adviser may not conduct business in this state as an investment adviser until the investment adviser has secured a certificate from the Commissioner or unless the investment adviser is otherwise exempt. An investment adviser may file an application for an investment adviser certificate in accordance with the instructions in Section 260.231 prior to the date the investment adviser's registration with the Securities and Exchange Commission is subject to termination.

Note: Authority cited: Sections 25230.1, 25610 and 25612.5, Corporations Code.
Reference: Sections 25230.1, 25231, 25608.1(d), 25612.3 and 25612.5, Corporations Code.

2. Amend Section 260.231 to read:

§ 260.231. Application for Investment Adviser Certificate.

The application for a certificate as an investment adviser and all amendments thereto shall be filed as follows:

(a) Initial Application: The application for a certificate as an investment adviser pursuant to Section 25231 of the Code shall be made by completing Form ADV in accordance with the form instructions and by filing the form with IARD for transmission to the Commissioner. The Commissioner may require additional documentation as deemed appropriate as prescribed in subsection ~~(a)(4)~~ (a)(3) of this rule.

~~(1) Part 2 of Form ADV shall be filed directly with the Commissioner until the form can be filed with IARD.~~

~~(1)(2)~~ An applicant shall complete a Customer Authorization of Disclosure of Financial Records, as set forth in subsection (i), and maintain a copy of the form in the applicant's books and records as provided in Section 25241 of the Code and Section 260.241.3 of these rules. The applicant shall provide the original form to the Commissioner ~~upon request.~~

~~(2)(3)~~ The applicant shall file directly with the Commissioner, a Statement of Financial Condition with worksheet that demonstrates compliance with the minimum financial requirements as prescribed in Section 260.237.2, investment advisory contract(s), and proof of compliance with the qualification requirements prescribed in Section 260.236.

~~(3)(4)~~ The Commissioner may request additional information, documentation or detail pertaining to Form ADV to be filed directly with the Commissioner.

(b) Filing fee: The fee for filing an initial application is \$125 as prescribed in Section 25608(q). The payment of this fee shall keep the certificate, if granted, in effect during the calendar year during which it is granted. The applicant shall remit the fee directly with IARD in accordance with its procedures for transmission to the Commissioner. Fees are not refundable except pursuant to Government Code Sections 13140- through 13144.

(c) Completion of Filing: ~~For the purposes of Section 250.51, an application for a certificate as an investment adviser is not considered filed until the required fee and all required submissions are received by the Commissioner.~~ The filing of Form ADV with IARD does not constitute automatic approval. The applicant shall not consider the

application approved until approved by the Commissioner and the approval has been received through IARD.

(d) Amendments to Form ADV: Any amendment to Form ADV shall be filed with IARD in accordance with the requirements of Section 260.241.4.

(e) Annual Renewal: The annual renewal shall consist of the fee as prescribed in Section 25608(q). The renewal fee shall be filed through IARD in accordance with its procedures for transmission to the Commissioner. This fee shall keep the certificate in effect for the next calendar year.

(f) Successions: An application for a certificate as an investment adviser pursuant to Section 25231 shall be filed in accordance with the instructions in this section if a person is succeeding to the business of an investment adviser licensed pursuant to Section 25230, and is not eligible for registration with the Securities and Exchange Commission. Notwithstanding the foregoing, if an investment adviser succeeds to and continues the business of a predecessor investment adviser, and the succession is based solely on a change on the predecessor's date or state of incorporation, form of organization, or composition of a partnership, and there has been no practical change in control or management, the successor may, within 30 days after the succession, amend the Form ADV of the predecessor investment adviser to reflect these changes.

(g) Switching to Securities and Exchange Commission registration: Upon registration with the Securities and Exchange Commission, the investment adviser shall file Form ADV-W with IARD in accordance with instructions in Form ADV-W.

(h) Dually certificated broker-dealers: Subsections (b) and (e) of this rule shall not apply to a broker-dealer licensed under Section 25210 of the Code.

(i) An authorization for the disclosure of financial records shall be made on the following form:

STATE OF CALIFORNIA
DEPARTMENT OF CORPORATIONS
CUSTOMER AUTHORIZATION OF DISCLOSURE OF FINANCIAL RECORDS

Pursuant to Corporations Code Section 25241 and Government Code Sections 7470 and 7473, any financial institution, wherever situated, possessing financial records of:

Name of (check appropriate designation(s) below)

_____ Broker-Dealer

_____ Investment Adviser

is hereby authorized to disclose to the California Department of Corporations records of the above named broker-dealer or investment adviser business whether such records relate to accounts which have been closed, accounts which are currently maintained, or accounts which are hereafter established.

This authorization is effective as of the date of execution and shall remain effective until five years after the expiration or revocation of the above-named broker-dealer or investment adviser license, including renewals of such license.

This authorization may not be revoked.

The terms used in this authorization shall have the definitions contained in the California Right to Financial Privacy Act (Government Code Section 7460 et seq.) and the Corporate Securities Law (Corporations Code Section 25000 et seq.).

The above-named licensee has duly caused this authorization to be signed on its behalf by the undersigned, thereunto duly authorized.

Executed on _____, 20 ____ at _____

Name of Licensee

Licensee's Department of
Corporations File Number

By _____

(Title)

STATE OF CALIFORNIA
DEPARTMENT OF CORPORATIONS

INSTRUCTIONS FOR CUSTOMER AUTHORIZATION
OF DISCLOSURE OF FINANCIAL RECORDS

On the reverse is a Customer Authorization of Disclosure of Financial Records form. The Commissioner of Corporations is authorized to require such authorization from certain licensees and other persons pursuant to the authority cited in the first paragraph of the form.

The form must be properly executed and submitted with the attached application for license, qualification, registration or other authority.

All information required on the form, except the signature of the person executing the form, is to be typewritten.

If the form requests a Department of Corporations file number, the applicant need only provide such number if it is known to the applicant and is the type of file number appropriate for the license, qualification, registration or other authority applied for in the attached application.

If additional authorization forms are needed, they may be obtained from any office of the Department of Corporations, or accurate copies of the form may be utilized by applicants.

(j) The following notices required by state and federal law are hereby incorporated as part of any uniform form:

NOTICES REQUIRED UNDER STATE AND FEDERAL LAW
INFORMATION PRACTICES ACT OF 1977
(California Civil Code Section 1798.17)

(a) The Department of Corporations of the State of California, Securities Regulation Division, is requesting the information specified in the application for registration, qualification, a certificate or a license.

(b) The Chief Administrative Officer, 1515 K Street, Suite 200 Sacramento, CA 95814, telephone (916) 445-5541, is responsible for the system of records and shall, upon request, inform individuals regarding the location of the Department of Corporations' records and the categories of persons who use the information in the records.

(c) The records are maintained pursuant to the Corporate Securities Law of 1968 (Corporations Code Section 25000, et seq.).

(d) The submission of all items of information is mandatory unless otherwise noted. Section 17520 of the Family Code requires the Department of Corporations to collect social security numbers from all applicants. The Privacy Act of 1974 prohibits a

state agency from denying an individual any right, benefit or privilege provided by law because of the individual's refusal to disclose the individual's social security account number.

(e) Failure to provide all or any part of the information requested may preclude the Department of Corporations from approving the application.

(f) The principal purposes within the Department of Corporations for which the information is to be used are to determine whether (1) a license, qualification, registration, certificate or other authority should be accepted, granted, approved, denied, revoked or limited in any way; (2) business entities or individuals licensed or otherwise regulated by the Department of Corporations are conducting themselves in accordance with applicable laws; and/or (3) laws administered by the Department of Corporations are being or have been violated and whether administrative action, civil action, or referral to appropriate federal, state or local law enforcement or regulatory agencies, or to a self-regulatory organization, as authorized by law, is appropriate.

(g) Any known or foreseeable disclosures of the information pursuant to subdivision (e) or (f) of Civil Code Section 1798.24 may include transfers to other federal, state, or local law enforcement or regulatory agencies, or to a self-regulatory organization, as authorized by law.

(h) Subject to certain exceptions or exemptions, the Information Practices Act grants an individual a right of access to personal information concerning the requesting individual that is maintained by the Department of Corporations.

FEDERAL PRIVACY ACT OF 1974 (Public Law 93-579)

In accordance with Section 7 of the Privacy Act of 1974 (found at 5 U.S.C. § 552a note (Disclosure of Social Security Number)), the following is information on whether the disclosure of a social security account number is voluntary or mandatory, by what statutory or other authority such number is solicited, and what uses will be made of it.

(1) Section 17520 of the Family Code requires the Department of Corporations to collect social security numbers from all applicants. The Privacy Act of 1974 prohibits a state agency from denying an individual any right, benefit or privilege provided by law because of the individual's refusal to disclose the individual's social security account number.

(2) A social security account number is solicited pursuant to one or more of the following authorities: Sections 25210, 25211, 25230, 25230.1, 25231, and 25241 of the Corporations Code; Sections 260.210, 260.211, 260.211.1, 260.231, 260.231.2, 260.236.1, and 260.236.2 of Title 10, California Code of Regulations; and Section 17520 of the Family Code.

(3) For all persons disclosing a social security account number, the number may be used, in addition to other information provided, to conduct a background investigation of the individual by the Department of Justice's Identification and Information Branch or by other federal, state or local law enforcement agencies, or a self-regulatory organization, as authorized by law. The social security number may also be used to respond to requests for this number made by child support agencies.

NOTE: Authority cited: Sections 25231, 25610, 25612.3 and 25612.5, Corporations Code. Reference: Section 1798.17, Civil Code; Sections 25230, 25231, 25234, 25236, 25237, 25241, 25242, 25608, 25612.3, 25612.5 and 25613,

Corporations Code; Section 17520, Family Code; Sections 7470, 7473, 7490 and 13140-13144, Government Code; and Section 7 of Public Law 93-579 (5 U.S.C. Section 552a note).

3. Amend Section 260.235 to read:

§ 260.235. Advertisements by Investment Advisers.

(a) It shall constitute a fraudulent, deceptive, or manipulative act, practice or course of business, within the meaning of Section 25235 of the Code, for an investment adviser, directly or indirectly, to publish, circulate or distribute any advertisement:

(1) which refers, directly or indirectly, to any testimonial of any kind concerning the investment adviser or concerning any advice, analysis, report or other service rendered by such investment adviser; or

(2) which refers, directly or indirectly, to past specific recommendations of such investment adviser which were or would have been profitable to any person; provided, however, that this ~~Clause~~ paragraph (2) does not prohibit an advertisement that, as applicable, complies with subsection (b) and which sets out or offers to furnish a list of all recommendations made by such investment adviser within the immediately preceding period of not less than one year if such advertisement, and such list if it is furnished separately:

(i) states the name of each such security recommended, the date and nature of each such recommendation (e.g., whether to buy, sell or hold), the market price at that time, the price at which the recommendation was to be acted upon, and the market price of each such security as of the most recent practicable date, and

(ii) contains the following cautionary legend on the first page thereof in print or type as large as the largest print or type used in the body or text thereof: "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."; or

(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 his/her own decisions as to which securities to buy or sell, or when to buy or sell them, without prominently disclosing in such advertisement the limitations thereof and the difficulties with respect to its use; or

(4) which contains any statement to the effect that any report, analysis, or other service will be furnished free or without charge, unless such report, analysis or other service actually is or will be furnished entirely free and without any condition or obligation, directly or indirectly; or

(5) which contains any untrue statement of a material fact, or which is otherwise false or misleading.

(b) A licensed investment adviser may advertise its past performance (both actual performance or model results) only if the advertisement discloses all material facts necessary to avoid any unwarranted inference.

(1) Model and actual results. An investment adviser that advertises its performance data in connection with model and actual results shall not be in violation of subsection (a) if the advertisement:

(A) discloses the effect of material market or economic conditions on the results advertised (e.g., an advertisement stating that the accounts of the adviser's clients appreciated in value 25% should also disclose that the market generally appreciated 40% during that same period);

(B) includes model or actual results that reflect the deduction of advisory fees, brokerage, or other commissions, and any other expenses that a client would have paid or actually paid;

(C) discloses whether and to what extent the advertised results reflect the reinvestment of dividends or other earnings;

(D) if suggesting or making claims about the potential for profit, discloses the potential for loss;

(E) if comparing model or actual results to an index, discloses all material factors relevant to the comparison (e.g., an advertisement that compares model results to an index should disclose that the volatility of the index is materially different from that of the model portfolio); and

(F) discloses any material conditions, objectives, or investment strategies used to obtain the results advertised.

(2) Model results. An investment adviser that advertises its performance data in connection with model results shall not be in violation of subsection (a) if the advertisement:

(A) discloses prominently the limitations inherent in model results, particularly the fact that such results do not represent actual trading and that they may not reflect the impact that material economic and market factors might have had on the adviser's decision-making if the adviser were actually managing client's money;

(B) discloses that the conditions, objectives or investment strategies of the model portfolio changed materially during the time period portrayed in the advertisement and, if so, the effect of any such change on the results portrayed;

(C) discloses that the adviser's clients had investment results materially different from the results portrayed in the model; and

(D) discloses that the advertised results involve model performance, rather than actual performance.

(3) Actual results. An investment adviser that advertises its performance data in connection with actual results shall not be in violation of subsection (a) if the advertisement discloses prominently that the results portrayed relate only to a select group of the adviser's clients, the basis on which the selection was made, and the effect of this practice on the results portrayed, if material.

~~(b)~~(c) For the purposes of this section, the term "advertisement" includes any notice, circular, Internet website, letter or other communication addressed to more than one person, or any notice or other announcement in any publication or by radio or television, 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, or (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, or (3) any other investment advisory service with regard to securities.

NOTE: Authority cited: Sections ~~25235(d)~~ and 25610, Corporations Code.
Reference: Section 25235, Corporations Code.

4. Adopt Section 260.235.5 to read:

§ 260.235.5. Delivery of Brochures and Brochure Supplements.

(a) General requirements. Unless otherwise provided in this section, an investment adviser licensed or required to be licensed pursuant to Section 25231 of the Corporations Code shall, in accordance with the provisions of this section, deliver a brochure and one or more brochure supplements to each client or prospective client that contains all information required by Part 2 of Form ADV (17 CFR 279.1), or such other information as the Commissioner may require.

(b) Delivery requirements. An investment adviser shall:

(1) Deliver to a client or prospective client the investment adviser's current brochure before or at the time the investment adviser enters into an investment advisory contract with that client.

(2) Deliver to each client, annually within 120 days after the end of the investment adviser's fiscal year and without charge, if there are material changes in the brochure since the last annual updating amendment:

(A) A current brochure; or

(B) The summary of material changes to the brochure as required by Item 2 of Form ADV, Part 2A that offers to provide the investment adviser's current brochure without charge, accompanied by the website address (if available) and an e-mail address (if available) and telephone number by which a client may obtain the current brochure from the investment adviser, and the website address for obtaining information about the investment adviser through the Investment Adviser Public Disclosure (IAPD) system.

(3) Deliver to each client or prospective client a current brochure supplement for a supervised person before or at the time that supervised person begins to provide advisory services to the client; provided, however that if the investment advice for a client is provided by a team comprised of more than five supervised persons, a current brochure supplement need only be delivered to that client for the five supervised persons with the most significant responsibility for the day-to-day advice provided to that client. For purposes of this section, a supervised person will provide advisory services to a client if that supervised persons will:

(A) Formulate investment advice for the client and have direct client contact; or

(B) Make discretionary investment decisions for the client, even if the supervised person will have no direct client contact.

(4) Deliver the following to each client promptly after the adviser creates an amended brochure or brochure supplement, as applicable, if the amendment adds disclosure of an event, or materially revises information already disclosed about an event, in response to Item 9 of Part 2A of Form ADV or Item 3 of Part 2B of Form ADV (Disciplinary Information), respectively, (A) the amended brochure or brochure supplement, as applicable, along with a statement describing the material facts relating to the change in disciplinary information or (B) a statement describing the material facts relating to the change in disciplinary information.

(c) Exceptions to delivery requirements.

(1) An investment adviser is not required to deliver a brochure to a client:

(A) That is an investment company registered under the Investment Company Act of 1940 [15 U.S.C. 80a-1 to 80a-64] or a business development company as

defined in that act, provided that the advisory contract with that client meets the requirements of section 15(c) of that act [15 U.S.C. 80a-15(c)]; or

(B) Who receives only impersonal investment advice for which the investment adviser charges less than \$500 per year.

(2) An investment adviser is not required to deliver a brochure supplement to a client:

(A) To whom the investment adviser is not required to deliver a brochure under paragraph (c)(1) of this rule.

(B) Who receives only impersonal investment advice: or

(C) Who is an officer, employee, or other person related to the adviser that would be a “qualified client,” as defined in paragraph (d)(1)(iii) of Rule 205-3 (17 CFR 275.205-3(d) under the Investment Advisers Act of 1940), of the investment adviser’s firm.

(d) Wrap fee program brochures.

(1) If the investment adviser is a sponsor of a wrap fee program, then the brochure that paragraph (b) of this section requires the investment adviser to deliver to a client or prospective client of the wrap fee program must be a wrap fee brochure containing all the information required by Part 2A, Appendix 1 of Form ADV. Any additional information in a wrap fee program brochure must be limited to information applicable to wrap fee programs that the investment adviser sponsors.

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

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

(e) Multiple Brochures. If the investment adviser provides substantially different advisory services to different clients, the investment adviser may provide each client with a different brochure, provided that each client receives all information about the services and fees applicable to that client. The brochure the investment adviser delivers to a client may omit any information required by Part 2A of Form ADV if the information does not apply to the advisory services or fees that the investment adviser will provide or charge, or that the investment adviser proposes to provide or charge, to that client.

(f) Other disclosure obligations. Nothing in this section shall relieve any investment adviser from any obligation under any provision of these rules and regulations or other federal or state law to disclose any information to its advisory clients or prospective advisory clients not specifically required by this section.

(g) Electronic delivery. Any delivery required by this rule may be electronic upon prior written consent of the client.

(h) DEFINITIONS. For the purpose of this rule:

(1) “brochure” and “brochure supplement” means those terms as defined in Part 2 of Form ADV

(2) “contract for impersonal advisory services” means any contract relating solely to the provision of investment advisory services:

(A) by means of written material or oral statements which do not purport to meet the objectives or needs of specific individuals or accounts;

(B) through the issuance of statistical information containing no expression of opinion as to the investment merits of a particular security; or

(C) any combination of the foregoing services.

(3) “Current brochure” and “current brochure supplement” mean the most recent revision of the brochure of brochure supplement, including all amendments to date.

(4) “Delivery” does not include the placement of a brochure or brochure supplement on an Internet website.

(5) “entering into,” in reference to an investment advisory contract, does not include an extension or renewal without material change of any such contract that is in effect immediately prior to such extension or renewal.

(6) “Sponsor of a wrap fee program” means an investment adviser that is compensated under a wrap fee program for sponsoring, organizing, or administering the program, or for selecting, or providing advice to clients regarding the selection of other investment advisers in the program.

(7) “Supervised person” means any partner, officer, director (or other person occupying a similar status or performing similar functions), or employee of an investment adviser, or other person who provides investment advice on behalf of the investment adviser and is subject to the supervision and control of the investment adviser, or any person defined in Section 25009.5 of the Code.

(8) “Wrap fee program” mean an advisory program under which a specified fee or fees not based directly upon transactions in a client’s account is charged for investment advisory services (which may include portfolio management or advice concerning the selection of other investment advisers) and the execution of client transactions.

NOTE: Authority cited: Section 25610, Corporations Code. Reference: Section 25235(d), Corporations Code.

5. Amend Section 260.237 to read:

§ 260.237. Custody or Possession of Funds or Securities of Clients.

~~It shall constitute a fraudulent, deceptive or manipulative act, practice or course of business, within the meaning of Section 25235 of the Code, for any investment adviser who has custody or possession of any funds or securities, except prepaid fees for periodic publications or other advisory services, in which any client has any beneficial interest to do any act or take any action, directly or indirectly, with respect to any such funds or securities, unless:~~

~~(a) all securities of each client are segregated, marked to identify the particular client who has the beneficial interest therein, and held in safekeeping in some place reasonably free from risk of destruction or other loss; and~~

~~(b)~~

~~(1) all funds of clients are deposited in one or more bank accounts which contain only clients' funds,~~

~~(2) the account or accounts are maintained in the name of the investment adviser as agent or trustee for the clients, and~~

~~(3) the investment adviser maintains a separate record for each account which shows 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; and~~

~~(c) the investment adviser, immediately after accepting custody or possession of funds or securities from any client, notifies the client in writing of the place and manner in which the funds and securities will be maintained, and thereafter, if and when there is any change in the place or manner in which the funds or securities are being maintained, gives each client written notice thereof; and~~

~~(d) the investment adviser sends to each client, not less frequently than once every three months, an itemized statement showing the funds and securities in the custody or possession of the investment adviser at the end of the period, and all debits, credits and transactions in the client's account during the period; and~~

~~(e) all funds and securities of clients are verified by actual examination at least once during each calendar year by an independent certified public accountant or public accountant at a time which shall be chosen by the accountant without prior notice to the investment adviser. A certificate of the accountant stating that such person has made an examination of the funds and securities, and describing the nature and extent of the examination, shall be filed with the Commissioner promptly after each examination.~~

(a) Safekeeping required. It is unlawful and deemed to be a fraudulent, deceptive, or manipulative act, practice or course of business within the meaning of Section 25235 of the Code for an investment adviser licensed or required to be licensed, to have custody of client funds or securities unless:

(1) Notice to the Commissioner. The investment adviser notifies the Commissioner that the investment adviser has or may have custody. Such notification is required to be given on Form ADV.

(2) Qualified custodian. A qualified custodian maintains those funds and securities:

(A) In a separate account for each client under that client's name; or

(B) In 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.

(3) Notice to clients. If the investment adviser opens an account with a qualified custodian on the investment adviser's client's behalf, either under the client's name or under the investment adviser's name as agent or trustee, the investment adviser shall notify the client in writing of the qualified custodian's name, address, and the manner in which the funds or securities are maintained, promptly upon the opening of the account and following any changes to this information. If the investment adviser sends an account statement to a client to which the investment adviser is required to provide this notice, the investment adviser shall include in the notice provided to that client and in any subsequent account statement sent to that client, a statement urging the client to compare the account statements from the custodian with those from the investment adviser.

(4) Account statements must be sent to clients, either:

(A) By a qualified custodian. 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, identifying the amount of funds and of each security in the account at the end of the period and setting forth all transactions in the account during that period including investment advisory fees; or

(B) By the investment adviser.

(i) The investment adviser sends an account statement, at least quarterly, to each client for whom the investment adviser has custody of funds or securities,

identifying the amount of funds and of each security of which the investment adviser has custody at the end of the period and setting forth all transactions during that period; and

(ii) An independent certified public accountant verifies all client funds and securities by actual examination at least once during each calendar year at a time chosen by the accountant without prior notice or announcement to the adviser and that is irregular from year to year, and files a copy of the auditor's report with the Commissioner within 120 days after the start of the examination, stating that it has examined the funds and securities and describing the nature, extent and findings of the examination; and

(iii) The independent certified public accountant, upon finding any material discrepancies during the course of the examination, notifies the Commissioner within one business day of the finding, by means of a facsimile transmission or electronic mail, followed by first class mail, directed to the attention of the Commissioner; and

(iv) The investment adviser and the independent certified public accountant enter into a written agreement, to be signed by both parties, setting forth the requirements of clauses 260.237(a)(4)(B)(ii) and (iii).

(C) Special rule for limited partnerships and limited liability companies. If the investment adviser 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 (a)(4) of this section must be sent to each limited partner (or member or other beneficial owner or their independent representative).

(5) Independent designee. A client may designate an independent designee to receive, on his or her behalf, notices and account statements as required under paragraphs (a)(3) and (a)(4) of this section.

(6) Direct Fee Deduction. An adviser who has custody as defined in subparagraph (c)(2)(B) of this section by having fees directly deducted from client accounts must also provide the following safeguards:

(A) Written Authorization. The investment adviser shall have written authorization from the client to deduct advisory fees from the account held with the qualified custodian;

(B) Notice of fee deduction. Each time a fee is directly deducted from a client account, the investment adviser must concurrently:

(i) Send the qualified custodian notice of the amount of the fee to be deducted from the client's account; and

(ii) Send the client an invoice itemizing the fee. Itemization includes the formula used to calculate the fee, the value of the assets under management on which the fee is based, and the time period covered by the fee.

(C) Notice of Safeguards. The investment adviser notifies the Commissioner in writing that the investment adviser intends to use the safeguards provided in paragraph (a)(6). Such notification is required to be given on Form ADV.

(D) Waiver of Net Worth and Audited Financial Statements. An investment adviser having custody solely because it meets the definition of custody as defined in subparagraph (c)(2)(B) of this section and who complies with the safekeeping requirements in paragraphs (a)(1) through (6) of this section will not be required to meet

the custodial requirements as set forth in Section 260.237.2 and Section 260.241.2 of these rules.

(7) Pooled Investments. An investment adviser who has custody as defined in subparagraph (c)(2)(C) of this section and who does not meet the exception provided under paragraph (b)(2) of this section must comply with the following safeguards:

(A) Engage an Independent Party. The investment adviser must hire an independent party to approve all fees, expenses and capital withdrawals from the pooled accounts:

(B) Review of Fees. The investment adviser must send all invoices or requests for reimbursement to the independent party, detailing the amount of the fee, expenses or capital withdrawal and the method of calculation such that the independent party can:

(i) Determine that the payment is in accordance with the pooled investment vehicle standards (generally the partnership agreement or membership agreement) and

(ii) Forward to the qualified custodian approval for payment of the invoice with a copy to the investment adviser.

(C) For purposes of this section, an independent party means a person that:

(i) Is engaged by the investment adviser to act as a gatekeeper for the payment of fees, expenses and capital withdrawals from the pooled investment;

(ii) Does not control and is not controlled by and is not under common control with the investment adviser;

(iii) Does not have, and has not had within the past two years, a material business relationship with the investment adviser; and

(iv) Is a licensed certified public accountant or an attorney in good standing with the California State Bar.

(D) Notice of Safeguards. The investment adviser must notify the Commissioner in writing that the investment adviser intends to use the safeguards provided in paragraph (a)(7). Such notification is required to be given on Form ADV.

(E) Waiver of Net Worth and Audited Financial Statements. An investment adviser having custody solely because it meets the definition of custody as defined in subparagraph (c)(2)(C) of this section and who complies with the safekeeping requirement in paragraphs (a)(1) through (5) and (a)(7) of this section will not be required to meet the custodial requirements as set forth in Section 260.237.2 and Section 260.241.2 of these rules.

(8) Investment Adviser or Investment Adviser Representative as Trustee. When a trust retains an investment adviser, investment adviser representative, or employee, director or owner of an investment adviser as trustee and the investment adviser acts as the investment adviser to that trust, the investment adviser will:

(A) Notice of Safeguards. Notify the Commissioner in writing that the investment adviser intends to use the safeguards provided in paragraph (a)(8). Such notification is required to be given on Form ADV.

(B) Invoice Requirement. Send to the settlor of the trust, the attorney for the trust if it is a testamentary trust, the co-trustee (other than the investment adviser, investment adviser representative, or employee, director or owner of the investment adviser); or a defined beneficiary of the trust, at the same time that it sends any invoice to the qualified custodian, an invoice showing the amount of the trustee's fee or investment management or advisory fee, the value of the assets on which the fees were based, and the specific manner in which the fees were calculated.

(C) Agreement Requirement. Enter into a written agreement with a qualified custodian which specifies:

(i) Payment of fees. That the qualified custodian will not deliver trust securities or any funds to the investment adviser, any investment adviser representative or employee, director or owner of the investment adviser, any investment adviser representative or employee, director or owner of the investment adviser, except that the qualified custodian may pay the trustee's fees to the trustee and investment management or advisory fees to the investment adviser, provided that:

(1) the settlor of the trust or attorneys for the trust, if it is a testamentary trust, the co-trustee (other than the investment adviser, investment adviser representative, or employee, director or owner of the investment adviser), or a defined beneficiary of the trust has authorized the qualified custodian in writing to pay those fees:

(2) the statements for those fees show the amount of the fees for the trustee and, in the case of statements for investment management or advisory fees, show the value of the trust assets on which the fee is based and the manner in which the fee was calculated; and

(3) the qualified custodian agrees to send to the settlor of the trust, the attorneys for a testamentary trust, the co-trustee (other than the investment adviser, investment adviser representative, or employee, director or owner of the investment adviser), or a defined beneficiary of the trust, at least quarterly, a statement of all disbursements from the account of the trust, including the amount of investment management fees paid to the investment adviser and the amount of trustees' fees paid to the trustee.

(ii) Distribution of Assets. Except as otherwise set forth in subclause (a)(8)(C)(ii)(1), that the qualified custodian may transfer funds or securities, or both, of the trust only upon the direction of the trustee (who may be the investment adviser, investment adviser representative, or employee, director or owner of the investment adviser), who the investment adviser has duly accepted as an authorized signatory. The settlor of the trust or attorneys for the trust, if it is a testamentary trust, the co-trustee (other than the investment adviser, investment adviser representative, or employee, director or owner of the investment adviser), or a defined beneficiary of the trust, must designate the authorized signatory for management of the trust. The direction to transfer funds or securities, or both, can only be made to the following:

(1) to a trust company, bank trust department or brokerage firm independent of the investment adviser for the account of the trust to which the assets relate;

(2) to the named settlors or to the named beneficiaries of the trust;

(3) to a third person independent of the investment adviser in payment of the fees or charges of the third person including, but not limited to:

(a) attorney's, accountant's, or qualified custodian's fees for the trust; and

(b) taxes, interest, maintenance or other expenses, if there is property other than securities or cash owned by the trust;

(4) to third persons independent of the investment adviser for any other purpose legitimately associated with the management of the trust; or

(5) to a broker-dealer in the normal course of portfolio purchases and sales, provided that the transfer is made on payment against delivery basis or payment against trust receipt.

(D) Waiver of Net Worth and Audited Financial Statements. An Investment adviser having custody solely because it meets the definition of custody as defined in clause (c)(2)(C) of this section and who complies with the safekeeping requirements in paragraphs (a)(1) through (5) and (a)(8) of this section will not be required to meet the custodial requirements as set forth in Section 260.237.2 and Section 260.241.2 of these rules.

(b) Exceptions.

(1) Certain privately offered securities.

(A) The investment adviser is not required to comply with subsection (a) of this section with respect to securities that are:

(i) acquired from the issuer in a transaction or chain of transactions not involving any public offering;

(ii) uncertificated, and ownership thereof is recorded only on books of the issuer or its transfer agent in the name of the client; and

(iii) transferable only with prior consent of the issuer or holders of the outstanding securities of the issuer.

(B) Notwithstanding subparagraph (b)(1)(A), the provisions of subsection (b)(1) are available with respect to securities held for the account of a limited partnership (or limited liability company, or other type of pooled investment vehicle) only if the limited partnership is audited, the audited financial statements are distributed to the limited partners, as described in subsection (b)(2) of this section and the investment adviser notifies the Commissioner in writing that the investment adviser intends to provide audited financial to the limited partners as described in this subparagraph. Such notification is required to be given on Form ADV.

(2) Limited partnerships subject to annual audit. The investment adviser is not required to comply with paragraph (a)(3) of this rule with respect to the account of a limited partnership (or limited liability company, or another type of pooled investment vehicle) that is audited at least annually and that distributes its audited financial statements prepared in accordance with generally accepted accounting principles to all limited partners (or members or other beneficial owners) within 120 days of the end of its fiscal year. The investment adviser must also notify the Commissioner in writing that the investment adviser intends to employ the use of the audit safeguards described in this paragraph. Such notification is required to be given on Form ADV.

(3) Registered investment companies. The investment adviser is not required to comply with this rule with respect to the account of an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a et seq.).

(4) Beneficial Trusts. An investment adviser is not required to comply with safekeeping requirements of subsection (a) or the custody requirements set forth in Section 260.237.2 if the investment adviser has custody solely because the investment adviser, investment adviser representative or employee, director or owner of the investment adviser is a trustee for a beneficial trust, if all of the following conditions are met for each trust:

(A) The beneficial owner of the trust is a parent, a grandparent, a spouse, a sibling, a child or a grandchild of the trustee. These relationships shall include "step" relationships.

(B) For each account under subsection (A) the investment adviser complies with the following:

(i) The investment adviser provides a written statement to each beneficial owner (or the conservator or guardian thereof) of the account setting forth a description of the requirements of subsection (a) of this section and the reasons why the investment adviser will not be complying with those requirements.

(ii) the investment adviser obtains from each beneficial owner (or the conservator or legal guardian thereof) a signed and dated statement acknowledging the receipt of the written statement required under clause (i) above.

(iii) the investment adviser maintains a copy of both documents described in clauses (i) and (ii) above until the account is closed or the investment adviser is no longer trustee.

(5) Any investment adviser who intends to have custody of client funds or securities but is not able to utilize a qualified custodian as that term is defined in this section must first obtain approval from the Commissioner and must comply with all of the applicable safekeeping provisions in this division including taking responsibility for those provisions that are designated to be performed by a qualified custodian.

(c) Definitions. For purposes of this section:

(1) "Control" means the power, directly or indirectly, to direct the management or policies of a person, whether through ownership of securities, by contract, or otherwise.

For purposes of this definition:

(A) Each of the investment adviser's officers, partners, or directors exercising executive responsibility (or persons having similar status or functions) is presumed to control the investment adviser;

(B) A person is presumed to control a corporation if the person:

(i) Directly or indirectly has the right to vote 25 percent or more of a class of the corporations' voting securities; or

(ii) Has the power to sell or direct the sale of 25 percent or more of a class of the corporation's voting securities;

(C) A person is presumed to control a partnership if the person has the right to receive upon dissolution, or has contributed, 25 percent or more of the capital of the partnership;

(D) A person is presumed to control a limited liability company if the person:

(i) Directly or indirectly has the right to vote 25 percent or more of a class of the interests of the limited liability company;

(ii) Has the right to receive upon dissolution, or has contributed, 25 percent or more of the capital of the limited liability company; or

(iii) Is an elected manager of the limited liability company; and

(E) A person is presumed to control a trust if the person is a trustee or managing agent of the trust.

(2) "Custody" means holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them, or having the ability to appropriate them. An investment adviser has custody if a related person holds, directly or indirectly, client funds or securities, or has any authority to obtain possession of them, or has the ability to appropriate them, in connection with advisory services the investment adviser provides to clients. Custody includes:

(A) Possession of client funds or securities unless received inadvertently and returned to the sender promptly, but in any case within 3 (three) business days of receiving them.

(B) Any arrangement (including a general power of attorney) under which the investment adviser is authorized or permitted to withdraw client funds or securities maintained with a custodian upon the investment adviser's instruction to the custodian.

(C) Any capacity (such as general partner of a limited partnership, managing member of a limited liability company or a comparable position for another type of pooled investment vehicle, or trustee of a trust) that gives the investment adviser or the investment adviser's representative legal ownership of or access to client funds or securities.

(3) Receipt of checks drawn by clients and made payable to unrelated third parties will not meet the definition of custody if forwarded to the third party within 24 hours of receipt and the adviser maintains the records required under Section 260.241.3 of these rules.

(4) "Independent designee" means a person who:

(A) Acts as agent for an advisory client, including in the case of a pooled investment vehicle, for limited partners of a limited partnership, members of a limited liability company, or other beneficial owners of another type of pooled investment vehicle, and by law or contract is obliged to act in the best interest of the advisory client or the limited partners, members, or other beneficial owners;

(B) Does not control, is not controlled by, and is not under common control with the investment adviser; and

(C) Does not have, and has not had within the past two years, a material business relationship with the investment adviser.

(5) “Qualified custodian” means the following independent institutions or entities that are not affiliated with the adviser by any direct or indirect common control and have not had a material business relationship with the adviser in the previous two years:

(A) A bank or savings association that has deposits insured by the Federal Deposit Insurance Corporation under the Federal Deposit Insurance Act;

(B) A registered broker-dealer holding the client assets in customer accounts insured by the Securities Investor Protection Corporation (SIPC);

(C) A registered futures commission merchant registered under Section 4f(a) of the Commodity Exchange Act (7 U.S.C. 6f(a)), holding the client assets in customer accounts, but only with respect to clients’ funds and security futures, or other securities incidental to transactions in contracts for the purchase or sale of a commodity for future delivery and options thereon; and

(D) A transfer agent of an open-end company as defined in Section 5(a)(1) of the Investment Company Act of 1940 (15 U.S.C. 80a-5(a)(1)).

(6) “Related person” means any person, directly or indirectly, controlling or controlled by the investment adviser, and any person that is under common control with the investment adviser.

NOTE: Authority cited: Sections 25237 and 25610, Corporations Code.

Reference: Sections 25235 and 25237, Corporations Code.

6. Amend Section 260.237.2 to read:

§ 260.237.2. Minimum Financial Requirements.

(a) Every investment adviser who has custody of client funds or securities shall maintain at all times a minimum net worth of \$35,000, and every investment adviser

who 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.

(b) Every investment adviser who accepts prepayment of more than \$500 per client and six or more months in advance shall maintain at all times a positive net worth.

(c) If an investment adviser is subject to subsection (a) or (b) of this section, that investment adviser shall at all times ensure that current liabilities do not exceed current net capital.

(d) Every investment adviser who has custody or discretion shall compute and prepare a trial balance and compute the minimum financial requirements of this rule on a monthly basis.

~~(e)~~(e) Unless otherwise exempted, as a condition of the right to continue to transact business in this state, every investment adviser shall, by the close of business on the next business day following the discovery that the investment adviser's net worth or current net capital is less than the minimum required by this rule, is less than the minimum required, notify the Commissioner that the investment adviser's net worth or current net capital is less than the minimum required ~~is less than the minimum required.~~ Such notice shall not be deemed to be an authorization to continue to transact business in this state while failing to meet the minimum standards set forth in this rule. After transmitting such notice, by the close of business on the next business day, each investment adviser shall file a report with the Commissioner of its financial condition, including the following:

(1) A balance sheet and income statement ~~trial balance of all ledger accounts;~~

(2) An itemized statement of each client's funds and securities ~~which are not segregated;~~

(3) A computation of the aggregate amount of client ledger debit balances; ~~and~~

(4) A statement as to the number of client accounts; ~~and~~

(5) The location where the securities and funds are held.

~~(d)~~(f) For purposes of this rule, the term "net worth" shall mean an excess of assets over liabilities, as determined by generally accepted accounting principles, but shall not include as assets: prepaid expenses (except as to items properly classified as current assets under generally accepted accounting principles), deferred charges, goodwill, franchise rights, organizational expenses, patents, copyrights, marketing rights, unamortized debt discount and expense, and all other assets of intangible nature; home, home furnishings, automobile(s), and any other personal or tangible items not readily marketable in the case of an individual; retirement accounts; advances or loans to or from stockholders ~~and~~, officers, and directors in the case of a corporation; and advances or loans to or from partners in the case of a partnership; and all advance, loans, or other receivables to or from any subsidiary, holding company parent, or other affiliate of the officers, partners, managing members, directors or controlling persons of such entities or the investment adviser.

(g) The term "current net capital" shall mean the current assets of the investment adviser and (A) includes all unpledged, readily marketable securities and (B) excludes all advances or loans to or from stockholders, officers, directors in the case of a corporation; advances or loans to or from partners in the case of a partnership; advances or loans to or from managing members in the case of a limited liability company; advances or loans to or from an owner in the case of a sole proprietorship, and all advances, loans or other receivables from any subsidiary, holding company,

parent, or other affiliate or the officers, directors or controlling persons of such entities or the investment adviser.

~~(e)~~ For purposes of this rule, the term “custody” shall have the same meaning as in Section 260.237(c)(2) of these rules. ~~a person will be deemed to have custody if said person directly or indirectly holds client funds or securities, has any authority to obtain possession of them, or has the ability to appropriate them.~~

~~(f)~~(h) For purposes of this rule, an investment adviser shall not be deemed to be exercising discretion when it places trade orders with a qualified custodian, as that term is defined in Section 260.237(c)(5), ~~broker-dealer~~ pursuant to a third party trading agreement if:

(1) the investment adviser has executed a separate investment adviser contract exclusively with its client which acknowledges that the investment adviser must secure client permission prior to effecting each securities transactions for the client in the client's ~~brokerage~~ investment account(s), and

(2) the investment adviser in fact does not exercise discretion with respect to the account, and

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

~~(g)~~(i) The Commissioner may require that a current appraisal be submitted in order to establish the worth of any asset.

~~(h)~~(j) Every investment adviser that has its principal place of business in a state other than this state shall maintain only such minimum capital as required by the state in

which the investment adviser maintains its principal place of business, provided the investment adviser is licensed in such state and is in compliance with such state's minimum capital requirements.

~~(j)~~(k) This section shall not apply to an investment adviser that has secured a certificate as a broker-dealer from the Commissioner under Section 25210 of the Code or an investment adviser registered under Section 203 of the Investment Advisers Act of 1940.

~~(j)~~(l) For purposes of subsection (c) this rule, if the An investment adviser that is unable to establish compliance with the minimum financial requirements of this section because of the failure to maintain discover that an investment adviser's net worth is less than the minimum required is the result of the investment adviser's failure to keep true, accurate and current the books and records as required under Section 260.241.3 of these rules, the investment adviser will be deemed to have not met discovered that the investment adviser's net worth is less than the minimum financial requirements required by this section.

(m) An investment adviser with a net worth or current net capital less than the minimum required by this section shall file any reports required under Section 260.241.2(d) of these rules.

(n) An investment adviser with a net worth or current net capital less than the minimum required by this section shall disclose this deficiency in its financial condition to each client in accordance with Section 260.235.4 of these rules.

NOTE: Authority cited: Sections 25237 and 25610, Corporations Code.
Reference: Sections 25237 and 25613, Corporations Code.

7. Amend Section 260.238 to read:

§ 260.238. Investment Advisers: Fair, Equitable and Ethical Principles.

(a) A person who is an investment adviser or an investment adviser representative is a fiduciary and in the context of providing investment advisory services has a duty to act primarily for the benefit of his or her clients.

(b) The following activities do not promote "fair, equitable or ethical principles," as that phrase is used in Section 25238 of the Code:

~~(a)~~ (1) Recommending to a client to whom investment supervisory, management or consulting services are provided the purchase, sale or exchange of any 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 or acquired by the adviser after reasonable examination of such of the client's records as may be provided to the adviser.

~~(b)~~ (2) Placing an order to purchase or sell a security for the account of a client without authority to do so.

~~(c)~~ (3) Placing an order to purchase or sell a security for the account of a client upon instruction of a third party without first having obtained a written third-party trading authorization from the client.

~~(d)~~ (4) Exercising any discretionary power, including any power of attorney, in placing an order for the purchase or sale of securities without first obtaining written 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.

~~(e)~~ (5) Inducing trading in a client's account that is excessive in size and frequency in view of the financial resources, investment objectives and character of the account.

~~(f)~~ (6) Borrowing money or securities from a client unless the client is a broker-dealer, an affiliate of the adviser, or a financial institution engaged in the business of loaning funds or securities.

~~(g)~~ (7) Loaning money to a client unless the adviser is a financial institution engaged in the business of loaning funds or the client is an affiliate of the adviser.

~~(h)~~ (8) Misrepresenting to any advisory client, or any prospective advisory client, the qualifications of the adviser, its representatives or any employees, or misrepresenting the nature of the advisory services being offered or fees to be charged for such service, or omitting to state a material fact necessary to make the statements made regarding the qualifications, services or fees, in light of the circumstances under which they are made, not misleading.

~~(i)~~ (9) Providing a report or recommendation to any advisory client prepared by someone other than the adviser without disclosing the fact. This prohibition does not apply, however, to a situation where the adviser uses published research reports or statistical analyses to render advice or where an adviser orders such a report in the normal course of providing service.

~~(j)~~ (10) Charging a client an advisory fee that is unreasonable in light of the type of services to be provided, the experience and expertise of the adviser, the sophistication and bargaining power of the client, and whether the adviser has disclosed that lower fees for comparable services may be available from other sources.

~~(k)~~ (11) Failing to disclose to a client in writing before entering into or renewing an advisory agreement with that client any material conflict of interest relating to the adviser, its representatives or any of its employees, which could be reasonably expected to impair the rendering of unbiased and objective advice including:

~~(1)~~ (A) Compensation arrangements connected with advisory services to clients which are in addition to compensation from such clients for such services; and

~~(2)~~ (B) Charging a client an advisory fee for rendering advice without disclosing that a commission for executing securities transactions pursuant to such advice will be received by the adviser, its representatives or its employees, or that such advisory fee is being reduced by the amount of the commission earned by the adviser, its representatives or employees for the sale of securities to the client.

~~(l)~~ (12) Guaranteeing a client that a specific result will be achieved (e.g., a gain or no loss) as a result of the advice which will be rendered.

~~(m)~~ (13) Disclosing the identity, affairs, ~~or~~ investments, or other confidential information of any client to any third party unless required by law to do so, or unless consented to by the client.

~~(n)~~ (14) Entering into, extending or renewing any investment advisory contract, other than a contract for impersonal advisory services, unless such contract is in writing and discloses, in substance, the services to be provided, the term of the contract, the advisory fee or the formula for computing the fee the amount or the manner of calculation of the amount of the prepaid fee to be returned in the event of contract termination or nonperformance, whether the contract grants discretionary power to the adviser or its representatives.

~~(e)~~ (15) Making any untrue statement of a material fact or omitting a statement of material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading in the solicitation of advisory clients.

(16) Failing to comply with Section 260.238.1 of these rules.

(17) Including in an advisory contract, any condition, stipulation, or provision binding any person to waive compliance with any provision of these rules.

(18) Engaging in conduct or any act, indirectly or through any other person, which would be unlawful for such person to do directly under the provisions of these rules.

(c) The conduct set forth above is not inclusive. Engaging in other conduct such as non-disclosure, incomplete disclosure, or deceptive practices shall be deemed an unethical business practice.

NOTE: Authority cited: Sections 25238 and 25610, Corporations Code.

Reference: Section 25238, Corporations Code.

8. Adopt Section 260.238.1 to read:

§ 260.238.1. Investment Adviser Code of Ethics.

Every investment adviser licensed or required to be licensed shall establish, maintain, and enforce policies and procedures reasonably designed to prevent the misuse of material, nonpublic information by such investment adviser or any of the investment adviser's supervised persons.

(a) These policies shall be written and at a minimum shall include:

(1) A standard of business conduct that the investment adviser requires of any investment adviser representative that reflects the fiduciary obligations of the investment adviser and those of the investment adviser representatives.

(2) Provisions requiring supervised persons to comply with applicable federal and state securities laws;

(3) Provisions requiring the investment adviser to provide each of the supervised persons with a copy of the code of ethics and any amendments, and requiring the supervised persons to provide the investment adviser with a written acknowledgment of their receipt of the code and any amendments;

(4) Provisions requiring supervised persons to report any violations of the code of ethics promptly to the investment adviser or other person designated in the code of ethics;

(5) Provisions reasonably designed to prevent access to material nonpublic information about the securities recommendations and clients' securities holdings and transactions, by persons who do not need such information to perform their duties; and

(6) Provisions requiring the investment adviser and investment adviser representatives to maintain records of all securities holdings and transactions required by paragraphs 260.241.3(a)(12) and (13) of these rules.

(b) Small Advisers. If the investment adviser has only one investment adviser representative (i.e., himself or herself), the investment adviser is not required to create written procedures as set forth in subsection (a) of this section, if the investment adviser maintains records of all holdings and transactions required by paragraphs 260.241.3(a)(12) and (13) of these rules.

(c) Definitions. For the purpose of this section:

(1) “Federal securities laws” means the Securities Act of 1933 (15 U.S.C. 77a-aa), the Securities Exchange Act of 1934 (15 U.S.C. 78a — mm), the Sarbanes-Oxley Act of 2002 (Pub. L. 107-204, 116 Stat. 745 (2002)), the Investment Company Act of 1940 (15 U.S.C. 80a), the Investment Advisers Act of 1940 (15 U.S.C. 80b), Title V of the Gramm-Leach-Bliley Act (Pub. L. No. 106-102, 113 Stat. 1338 (1999)), any rules adopted by the Securities and Exchange Commission under any of these statutes, the Bank Secrecy Act (31 U.S.C. 5311 — 5314; 5316 — 5332) as it applies to funds and investment advisers, and any rules adopted thereunder by the Securities and Exchange Commission or the Department of the Treasury.

(2) “State securities laws” means the Corporate Securities Law of 1968 (Corporations Code 25000 et seq.) and any rules promulgated thereunder by the Commissioner of Corporations.

(3) “Supervised person” means any partner, officer, director (or other person occupying a similar status or performing similar functions), or employee of an investment adviser, or other person who provides investment advice on behalf of the investment adviser and is subject to the supervision and control of the investment adviser, or any person defined in Section 25009.5 of the Code.

NOTE: Authority cited: Sections 25238 and 25610, Corporations Code.

Reference: Section 25238, Corporations Code.

9. Adopt Section 260.238.2 to read:

§ 260.238.2. Payments for Client Solicitations.

(a) It shall be unlawful for any investment adviser licensed or required to be licensed pursuant to Section 25230 to pay compensation, directly or indirectly, to a solicitor with respect to solicitation activities unless:

(1) The investment adviser is licensed under Section 25230 of the Code;

(2) The solicitor is in compliance with reporting requirements set forth in Section 260.236.1 of these rules.

(3)The solicitor is not a person who is:

(A) Subject to the Commissioner's order under Section 25232.1 of the Code, or

(B) (i) subject to a Securities and Exchange Commission order issued under section 203(f) of the Investment Advisers Act of 1940, or (ii) convicted within the previous ten years of any felony or misdemeanor involving conduct described in section 203(e)(2)(A) through (D) of the Investment Advisers Act of 1940, or (iii) who has been found by the Securities and Exchange Commission to have engaged, or has been convicted of engaging, in any of the conduct specified in paragraphs (1), (5) or (6) of section 203(e) of the Investment Advisers Act of 1940, or (iv) is subject to an order, judgment or decree described in section 203(e)(4) of the Investment Advisers Act of 1940;

(4) The compensation is paid pursuant to a written agreement to which the adviser is a party, which agreement the investment adviser shall retain a copy of as part of the records required to be kept under Section 260.241.3 of these rules; and

(5) The compensation is paid to a solicitor:

(A) With respect to solicitation activities for the provision of impersonal advisory services only; or

(B) Who is (i) a partner, officer, director or employee of such investment adviser or (ii) a partner, officer, director or employee of a person which controls, is controlled by, or is under common control with such investment adviser; provided that the status of such solicitor as a partner, officer, director or employee of such investment adviser or other person, and any affiliation between the investment adviser and such other person, is disclosed to the client at the time of the solicitation or referral; or

(C) Other than a solicitor specified in subparagraph (a)(5)(A) or (B) of this section if all of the following conditions are met:

(i) The written agreement required by paragraph (a)(4) of this section: (1) describes the solicitation activities to be engaged in by the solicitor on behalf of the investment adviser and the compensation to be received therefor; (2) contains an undertaking by the solicitor to perform his or her duties under the agreement in a manner consistent with the instructions of the investment adviser and the provisions of the Code and the rules thereunder; (3) 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 client with a current copy of the investment adviser's brochure required by Section 260.235.5 of these rules and a separate written disclosure document described in subsection (b) of this rule.

(ii) The investment adviser receives from the client, prior to or at the time of entering into any written or oral investment advisory contract with such client, a signed and dated acknowledgment of receipt of the investment adviser's brochure and the solicitor's written disclosure document. The investment adviser shall retain a copy of each acknowledgment and solicitor disclosure document as part of the records required to be kept under Section 260.241.3 of these rules.

(iii) The investment adviser ascertains that the solicitor has complied with the agreement.

(b) The separate written disclosure document required to be furnished by the solicitor to the client pursuant to this section shall contain the following information:

(1) The name of the solicitor;

(2) The name of the investment adviser;

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

(4) A statement that the solicitor will be compensated for his or her solicitation services by the investment adviser;

(5) The terms of such compensation arrangement, including a description of the compensation paid or to be paid to the solicitor; and

(6) The amount, if any, for the cost of obtaining his or her 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 advisory fees charged by the investment adviser if such 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.

(c) Nothing in this section shall be deemed to relieve any person of any fiduciary or other obligation to which such person may be subject under any law.

(d) For purposes of this section:

(1) Solicitor means any person who, directly or indirectly, solicits any client for, or refers any client to, an investment adviser.

(2) Client includes any prospective client.

(3) Impersonal advisory services means investment advisory services provided solely by means of (A) written materials or oral statements which do not purport to meet the objectives or needs of the specific client, (B) statistical information containing no expressions of opinions as to the investment merits of particular securities, or (C) any combination of the foregoing services.

NOTE: Authority cited: Sections 25238 and 25610, Corporations Code.

Reference: Section 25238, Corporations Code.

10. Adopt Section 260.238.3 to read:

§ 260.238.3 Investment Adviser Business Continuity Plan

(a) Each investment adviser licensed or required to be licensed pursuant to Section 25230 of the Code shall create and maintain a written business continuity plan identifying procedures relating to an emergency or significant business disruption, including death or incapacitation of the investment adviser or of any of its representatives. Such procedures must be reasonably designed to enable the investment adviser or any of his or her representatives to meet existing obligations to customers.

(b) Each investment adviser must update its plan in the event of any material change to the investment adviser's operations, structure, business or location. Each investment adviser must also conduct an annual review of its business continuity plan to determine whether any modifications are necessary in light of changes to the investment adviser's operations, structure, business, or location.

(c) The elements that comprise a business continuity plan are flexible and may be tailored to the size and needs of an investment adviser. Each plan should, as applicable, address:

(1) Data back-up and recovery (hard copy and electronic);

(2) Retention of client records;

(3) Continuity or termination of operations;

(4) Alternate communications between the investment adviser and:

(A) Its customers;

(B) Its employees;

(C) Its investment adviser representatives;

(D) The Commissioner; and

(E) The custodian.

(5) Alternate physical location of employees and investment adviser representatives.

(6) Regulatory reporting.

(7) How the investment adviser will assure customers' prompt access to their funds and securities, including prepaid fees, in the event that the investment adviser determines that it is unable to continue its business.

(8) How the investment adviser will assure customers' prompt access to their funds and securities, including prepaid fees, in the event of the investment adviser's or of any of the investment adviser representative's death or incapacitation, including alternative contact information.

(9) How the investment adviser will ensure that no client is charged for advisory services during a period where a client is not receiving advisory services.

(10) How the investment adviser will ensure that clients and custodians are immediately notified in the event of death or incapacitation of the investment adviser or of any of the investment adviser representatives, or the inability to continue business.

(11) A succession plan designed to ensure administration of client accounts after the death or incapacitation of the investment adviser or of any of the investment adviser representatives.

(e) Each investment adviser must disclose to its customers how its business continuity plan addresses the possibility of a future significant business disruption and how the investment adviser plans to respond to events of varying scope. At a minimum, such disclosure shall be made in writing to customers at account opening and upon request by the client. The investment adviser shall, without charge, annually deliver or offer to deliver upon request to each of its advisory clients its business continuity plan. However, the business continuity plan provided to advisory clients need not include confidential identifying information or financial account identifying information.

(f) The business continuation plan and any supporting documents must be maintained as required by Section 260.241.3(a)(26) of these rules.

(g) For purposes of this section incapacitation shall mean the temporary or permanent inability to provide advisory services.

NOTE: Authority cited: Sections 25238 and 25610, Corporations Code.

Reference: Section 25238, Corporations Code.

11. Amend Section 260.241.3 to read:

§ 260.241.3. Books and Records to Be Maintained by Investment Advisers.

(a) Every licensed investment adviser shall make and keep true, accurate and current the following books and records relating to such person's investment advisory business:

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

(3) A ~~memorandum~~ memoranda 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 a client concerning the purchase, sale, receipt or delivery of a particular security, and of any modification or cancellation of any such order or instruction. Such 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 such order; and shall show the account for which entered, the date of entry, and the bank or broker-dealer by or through whom executed where appropriate. Orders entered pursuant to the exercise of a power of attorney shall be so designated.

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

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

(6) All trial balances, financial statements, prepared in accordance with generally accepted accounting principles, worksheets that contain computations of minimum financial requirements required under Section 260.237.2, of these rules, and internal

audit working papers relating to the business of such investment adviser. The investment adviser shall maintain a balance of all ledger accounts and a record of the computations of minimum financial requirements pursuant to Section 260.237.2 of these rules. For purposes of this section, "financial statements" shall mean a balance sheet, an income statement, and a statement of cash flow.

(7) Originals of all written communications received and copies of all written communications sent by such investment adviser relating to (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, or (iii) the placing or execution of any order to purchase or sell any security; provided, however, that 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; and provided that 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 it was sent, except that if such notice, circular or advertisement is distributed to persons named on any list, the investment adviser shall retain with the copy of such notice, circular or advertisement a memorandum describing the list and the source thereof.

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

(9) A copy of All all powers of attorney and other evidences of the granting of any discretionary authority by any client to the investment adviser, ~~or copies thereof.~~

(10) A copy of all All written agreements ~~(or copies thereof)~~ entered into by the investment adviser with any client or otherwise relating to the business of such investment adviser as such.

(11) A copy of each notice, circular, advertisement, newspaper article, investment letter, bulletin or other communication, including those transmitted by electronic media, recommending the purchase or sale of a specific security, which the investment adviser circulates or distributes, directly or indirectly, to 10 or more persons (other than investment supervisory clients or persons connected with such investment adviser), and if such notice, circular, advertisement, newspaper article, investment letter, bulletin or other communication does not state the reasons for such recommendation, a memorandum of the investment adviser indicating the reasons therefor.

(12) A record of every transaction in a security in which the investment adviser or any advisory representative (as hereinafter defined) of such investment adviser has, or by reason of such transaction acquires, any direct or indirect beneficial ownership, except (i) transactions effected in any account over which neither the investment adviser nor any advisory representative of the investment adviser has any direct or indirect influence or control; and (ii) transactions in securities which are direct obligations of the United States. Such record shall state the title and amount of the security involved; the date and nature of the transaction (i.e., purchase, sale or other acquisition or disposition); the price at which it was effected; and the name of the broker-dealer or bank with or through whom the transaction was effected. Such record may also contain a statement declaring that the reporting or recording of any such 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. A transaction shall be recorded not later than 10 days after the end of the calendar quarter in which the transaction was effected.

For purposes of this subsection (12):

(A) The term "advisory representative" shall mean any partner, officer or director of the investment adviser; any employee who makes any recommendation, who participates in the determination of which recommendation shall be made, or whose functions or duties relate to the determination of which recommendation shall be made; any employee who, in connection with such person's duties, obtains any information concerning which securities are being recommended prior to the effective dissemination of such recommendations or of the information concerning such recommendations; and any of the following persons who obtain information concerning securities recommendations being made by such investment adviser prior to the effective dissemination of such recommendations or of the information concerning such recommendations: (i) any person in a control relationship to the investment adviser, (ii) any affiliated person of such controlling person and (iii) any affiliated person of such affiliated person.

(B) The term "control" shall mean the power to exercise a controlling influence over the management and policies of a person, unless such power is solely the result of an official position with such person.

An investment adviser shall not be deemed to have violated the provisions of this subsection (12) because of its failure to record securities transactions of any advisory representative if it establishes that it instituted adequate procedures and used

reasonable diligence to obtain promptly reports of all transactions required to be recorded.

(13) Notwithstanding the provisions of subsection (12) above, where the investment adviser is primarily engaged in a business or businesses other than advising registered investment companies or other advisory clients, a record must be maintained of every transaction in a security in which the investment adviser or any advisory representative (as hereinafter defined) of such investment adviser has, or by reason of such transaction acquires, any direct or indirect beneficial ownership, except (i) transactions effected in any account over which neither the investment adviser nor any advisory representative of the investment adviser has any direct or indirect influence or control; and (ii) transactions in securities which are direct obligations of the United States. Such record shall state the title and amount of the security involved; the date and nature of the transaction (i.e., purchase, sale or other acquisition or disposition); the price at which it was effected; and the name of the broker-dealer or bank with or through whom the transaction was effected. Such record may also contain a statement declaring that the reporting or recording of any such 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. A transaction shall be recorded not later than 10 days after the end of the calendar quarter in which the transaction was effected.

For the purposes of this subsection (13):

(A) The term "advisory representative," when used in connection with a company primarily engaged in a business or businesses other than advising registered investment companies or other advisory clients, shall mean any partner, officer, director or employee of the investment adviser who makes any recommendation, who

participates in the determination of which recommendation shall be made, or whose functions or duties relate to the determination of which recommendation shall be made, or who, in connection with its duties, obtains any information concerning which securities are being recommended prior to the effective dissemination of such recommendations or of the information concerning such recommendations; and any of the following persons who obtain information concerning securities recommendations being made by such investment adviser prior to the effective dissemination of such recommendations of the information concerning such recommendations: (i) any person in a control relationship to the investment adviser, (ii) any affiliated person of such controlling person and (iii) any affiliated person of such affiliated person.

(B) The term "control" shall mean the power to exercise a controlling influence over the management and policies of a person, unless such power is solely the result of an official position with such person.

(C) An investment adviser is "primarily engage in a business or businesses other than advising registered investment companies or other advisory clients" when, for each of its most recent three 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 (i) its total sales and revenues, and (ii) its income (or loss) before income taxes and extraordinary items, from other business or businesses.

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

(14) A copy of each brochure and brochure supplement, and each amendment or revision to the brochure and brochure supplement given or sent to any client or prospective client of the investment adviser in accordance with the provisions of Section 260.235.5 of these rules; any summary of material changes that satisfies the requirements of Section 260.235.5 of these rules but that is not contained in the brochure; any written approval by a client to receive a brochure, brochure supplement, or summary of material changes electronically; and a record of the dates that each brochure and brochure supplement, and each amendment or revision to the brochure or brochure supplement, was 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 compensation was paid:

(A) evidence of a written agreement to which the adviser is a party related to the payment of such fee;

(B) 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; and,

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

(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, securities recommendations and model results in any notice, circular, advertisement, newspaper article, website, 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); provided, however, 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 complaint, arbitration, litigation, or regulatory action involving the investment adviser or any investment adviser representative or employee, 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 such client, including the client's investment objectives.

(19) A file containing a copy of any document or report required to be created under Section 260.238.1 of these rules.

(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 investment adviser or its investment adviser representatives which file shall contain, but not be limited to, all applications, amendments, renewal filings, and correspondence.

(21) Copies with original signatures of the investment adviser's appropriate signatory and the investment adviser representative, of each initial Form U-4 and each amendment to Disclosure Reporting Pages (DRPs U-4).

(22) Where the adviser inadvertently held or obtained a client's securities or funds and returned them to the client within two business days or has forwarded third party checks within two business days, the adviser will be considered as not having custody but shall keep the following records relating to the inadvertent custody:

A ledger or other listing of all securities or funds held or obtained, including the following information:

(A) Issuer;

(B) Type of security and series;

(C) Date of issue;

(D) For debt instruments, the denomination;

(E) Certificate number, including alphabetical prefix or suffix;

(F) Name in which registered;

(G) Date given to the adviser;

(H) Date sent to client or sender;

(I) Form of delivery to client or sender, or sender;

(J) Mail confirmation number, if applicable, or confirmation by client or sender of the fund's or security's return;

(K) Client name;

(L) Account number (if applicable); and

(M) Amount involved.

(23) If an investment adviser obtains possession of securities that are acquired from the issuer in a transaction or chain of transactions not involving any public offering

that complies with the exception from custody under Section 260.237(b)(1) of these rules, the adviser shall keep the following records:

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

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

(C) Client name; and

(D) Client account number.

~~(14)~~(24) A properly completed and executed Customer Authorization of Disclosure of Financial Records (Section 260.231(i) of these rules).

~~(15)~~(25) If the investment adviser is ~~an individual owner (e.g., a sole proprietorship)~~, a properly completed and executed Statement of Citizenship, Alienage, and Immigration Status form (Section 250.61 of these rules) and any documents establishing proof thereof.

~~(16)~~(26) Evidence of compliance with Section 260.236 of these rules and the investigation of each investment adviser representative.

~~(17)~~(27) ~~For investment advisers filing through IARD, copies, with original signatures of the investment adviser's appropriate signatory and the investment adviser representative, of each initial Form U4.~~Any document required to be created pursuant to Section 260.238.3 of these rules, including a business continuity plan.

(b) (1) ~~If a licensed~~ If an investment adviser has custody ~~or possession~~ of securities or funds of any client, as that term is defined in Section 260.237(c)(1) of these

rules, the records required to be made and kept under ~~Subsection~~ subsection (a) above shall include:

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

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

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

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

(F) A copy 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 copies of the statements along with the date the statements were sent to the clients.

(G) If applicable to the advisor's situation, a copy of the auditor's report pursuant to clause 260.237(a)(4)(B)(ii) of these rules 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.

(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, as specified in subparagraph 260.237(c)(2)(C) of these rules, the adviser shall also keep the following records:

(A) True, accurate and current account statements of the pooled investment vehicle and the client's investment in the pool;

(B) Where the adviser complies with paragraph 260.237(b)(2) of these rules, the records required to be made and kept shall include:

i. the date(s) of the audit;

ii. a copy of the audited financial statements; and

iii. 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 its fiscal year.

(C) Where the adviser complies with paragraph 260.237(a)(7) of these rules, the records required to be made and kept shall include:

i. A copy of the written agreement with the independent party reviewing all fees and expenses, indicating the responsibilities of the independent third party.

ii. Copies of all invoices and receipts showing approval by the independent party for payment through the qualified custodian.

iii. Written agreement with qualified custodian that custodian will abide by independent third party approval.

(3) If an investment adviser has custody because it is acting as the trustee for a beneficial trust as it is described in paragraph 260.237(b)(4) of these rules, the investment adviser shall also keep the following records:

(A) A copy of the written statement given to each beneficial owner (or the conservator or guardian thereof) setting forth a description of the requirements of subsection 260.237(a) 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 (or the conservator or guardian thereof), and evidencing receipt of the statement required under subparagraph (A) above.

(c) Every licensed investment adviser subject to subsection (a) 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, make and keep true, accurate and current:

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

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

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

(e) Every investment adviser shall preserve the following records in the manner prescribed:

~~(e)~~(1) All books and records required to be made under the provisions of subsections (a) to (c)(4), inclusive, of this section (except for books and records required to be made under the provisions of paragraph (a)(11) and (a)(16) of this section) shall be maintained and preserved in an easily accessible place for a period of not less than five years from the end of the fiscal year during which the last entry was made on such record, the first two years in ~~an appropriate~~ the principal office of the investment adviser.

(2) Partnership agreements and any amendments, articles of incorporation, or other charter~~Charter~~ documents, minute books, and stock certificate books of the investment adviser and of any predecessor, and books and records required to be made under the provisions of paragraphs (a)(24), (a)(25) and (a)(26) of this rule, shall be maintained in the principal office of the investment adviser and preserved until at least ~~three~~ five years after termination of the ~~enterprise~~ entity.

(3) Books and records required to be maintained under paragraphs (a)(11) and (a)(16) of this section shall be maintained and preserved in an easily accessible place for a period of not less than five years after the investment adviser ceases using the advertisement, the first two years 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 maintained under paragraphs (a)(17) through (a)(22) of this section shall be maintained and preserved in an easily accessible place for a period of not less than five years from the end of the fiscal year during which the last entry was made on such record, 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 the state, if less.

(5) Notwithstanding other record preservation requirements of this section, the following records or copies shall be maintained at the home office and a copy 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) records required to be preserved under paragraphs (a)(3), (a)(7) through (a)(10), (a)(14), (a)(15), (a)(17) through (a)(19), and subsections (b) and (c) inclusive of this section, and (B) the records or copies required under the provision of paragraphs (a)(11) and (a)(16) of this section 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 location's physical address, mailing address, electronic mailing address, or telephone number. The records will be maintained for the period described in subsection (e) of this section.

(f) ~~A licensed investment adviser, before~~ Before ceasing to conduct or discontinuing business as an investment adviser, an investment adviser subject to subsection (a) shall arrange for 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 Commissioner in writing on Form ADV-W of the exact address where such books and records will be maintained during such period.

~~(g)(1) The records required to be maintained and preserved pursuant to this rule may be produced or reproduced by photograph on film or, as provided in paragraph (g)(2) below, 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:~~

~~(A) arrange the records and index the films or computer storage medium so as to permit the immediate location of any particular record;~~

~~(B) be ready at all times to promptly provide any facsimile enlargement of film or computer printout or copy of the computer storage medium which the Commissioner, the Commissioner's examiners or other representatives of the Commissioner may request;~~

~~(C) store separately from the original one other copy of the file or computer storage medium for the time required;~~

~~(D) 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, and~~

~~(E) with respect to records stored on photographic film, at all times have available for examination by the Commissioner, the Commissioner's examiners or other representatives of the Commissioners its records pursuant to Section 25241 of the~~

~~Code facilities for immediate, easily readable projection of the film and for producing easily readable facsimile enlargements.~~

~~(2) Pursuant to subsection (g) (1) an 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.~~

(g)(1) The records required to be maintained and preserved by subsection (e) of this section may be immediately produced or reproduced, and maintained and preserved for the required time, by an investment adviser on:

(A) Paper or hard copy form, as those records are kept in their original form;

(B) Micrographic media, including microfilm, microfiche, or any similar medium;

or

(C) Electronic storage media, including any digital storage medium or system that meet the terms of this section.

(2) The investment adviser shall:

(A) Arrange and index the records in a way that permits easy location, access, and retrieval of any particular record;

(B) Provide immediately any of the following that the Commissioner (by its examiners or other representatives) may request:

(i) A legible, true, and complete copy of the record in the medium and format in which it is stored;

(ii) A legible, true, and complete printout of the record; and

(iii) Means to access, view, and print the records; and

(C) Separately store, for the time required for preservation of the original record, a duplicate copy of the record on any medium allowed by this section.

(3) In the case of records created or maintained on electronic storage media, the investment adviser must establish and maintain procedures:

(A) To maintain and preserve the records, so as to reasonably safeguard them from loss, alteration, or destruction;

(B) To limit access to the records to properly authorized personnel and the Commissioner (including its examiners and other representatives); and

(C) To reasonably ensure that any reproduction of a non-electronic original record on electronic storage media is complete, true, and legible when retrieved.

(h)(1) Any book or other record made, kept, maintained and preserved in compliance with ~~sections~~Sections 260.241 and 260.241.1 of these rules, which is substantially the same as the book or other record required to be made, kept, maintained and preserved under this section, shall satisfy the requirements of this section.

(2) A record made and kept pursuant to any provision of subsection (a) of this section, which contains all the information required under any other provision of subsection (a), need not be maintained in duplicate in order to meet the requirements of the other provision of subsection (a) of the section.

(i) ~~As used in this section, the terms~~ For purposes of this section, "investment supervisory services" means the giving of continuous advice as to the investment of funds on the basis of the individual needs of each client; and "power of attorney" and "discretionary authority" do 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.

~~(j) Any investment adviser who is subject to the minimum financial requirements of Section 260.237.1 or Section 260.237.2, as applicable, shall, in addition to the records otherwise required under this section, maintain a record of the proof of money balances of all ledger accounts in the form of trial balances and a record of the computations of net capitals and aggregate indebtedness pursuant to Section 260.237.1 of these rules or minimum net worth pursuant to Section 230.237.2 of these rules (as of the trial balance date). The trial balances and computations shall be prepared currently at least once a month.~~

(j) This section is subject to the limitations set forth in Section 222 of the Investment Advisers Act of 1940.

NOTE: Authority cited: Sections 25241 and 25610, Corporations Code.

Reference: Sections 25230, 25236, 25237, 25238, 25241 and 25613, Corporations Code.

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