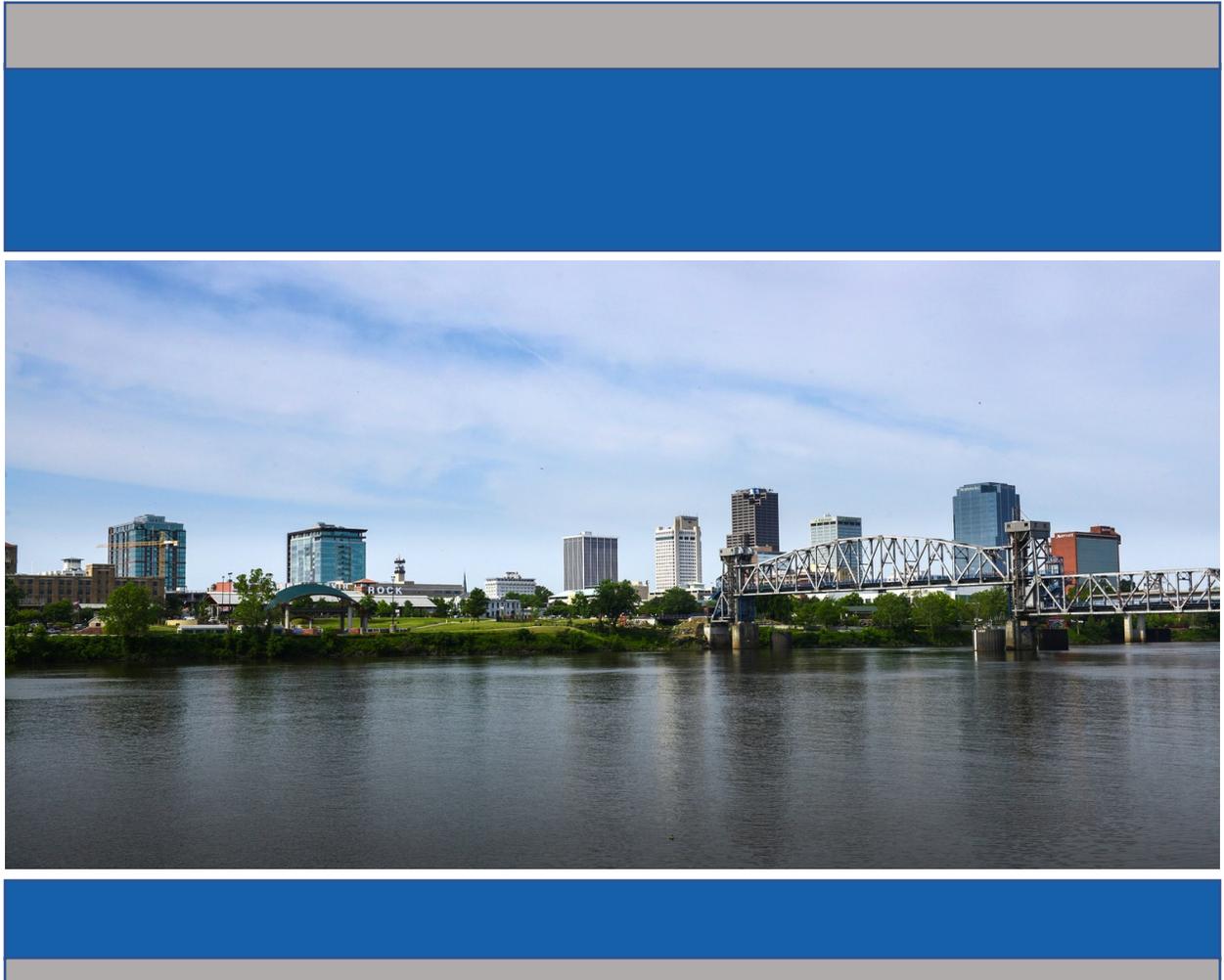


Arkansas Securities Department *Investment Adviser Guide*



Volume I (2022)





Introduction

The Arkansas Securities Department (the “Department”) produced this practical guide to help state registered investment advisers manage their compliance programs. The guide provides a brief overview of some of Arkansas’ investment adviser compliance requirements and highlights some of the more common deficiencies that have been identified on Department’s examinations of investment adviser firms.

The Department recommends all individuals responsible for investment adviser regulatory compliance and all investment adviser representatives read and maintain familiarity with the Arkansas Securities Act and Rules. Topics in this guide include the requirements relating to regulatory filings, record keeping, net capital, custody of client funds or securities, supervision, and state examinations. The guide also includes a series of “common deficiencies” that highlight areas where firms are often found to be deficient on examinations, and “best practice tips” that include recommendations by the Department that may assist firms with organizing its books and records and improve compliance. Having a strong and detailed compliance program can help reduce risk to your firm, ensure that clients are receiving clear and personalized advisory services to fit their needs, and facilitate an efficient regulatory examination process.

This guide is intended to be informational and is not all inclusive of your firm’s responsibilities. Your firm is responsible for, and must comply with, all required rules and regulations. If there are any conflicts, perceived or otherwise, between this document and the Arkansas Securities Act or Rules, your firm is required to follow the Arkansas Securities Act and Rules. The contents of this guide do not constitute legal advice. Please call the Department with any questions at (501) 324-9260.

Table of Contents

Regulatory Filings.....Pg. 4

Books, Records, and Retention Requirements.....Pg. 5

Financial RequirementsPg. 7

Custody.....Pg. 8

Client Contract.....Pg. 9

State Examinations.....Pg. 10

Other Reminders and Best Practices..... Pg. 11



All of the requirements found in this document can be referenced by viewing the Arkansas Securities Act and Rules at www.securities.arkansas.gov

Annual Renewal Filing

Rule 302.02 (b)(2) states that the application for annual renewal registration as an investment adviser shall be accomplished by filing for renewal with the IARD in accordance with the form instructions, along with the fee as set forth in Section 23-42-304(a) of the Act.

Rule 302.02 (c)(2) The application for annual renewal of registration for an investment adviser representative shall be made by filing necessary amendments to Form U4, in accordance with the form instructions, with the IARD. The application for annual renewal of registration shall include the fee required by Section 23-42-304 of the Act.

ADV Updates and Amendments

Rule 302.02 (b)(3)(A) requires updates and amendments to an Investment Adviser's form ADV to be filed with IARD in accordance with the instructions in Form ADV within ninety (90) days after the registrant's fiscal year. In addition to the annual updating amendment, any **material** information that becomes inaccurate must be filed promptly, (within thirty (30) days of the event that requires the filing of the amendment), according to the Form ADV general instruction.

The instructions for Part 1 provide specific items that must be updated promptly if changes occur. If any information in the ADV Part 2A ("Firm Brochure") or Part 2B ("Brochure Supplement") becomes materially inaccurate, appropriate updates must be made on the brochures then submitted on IARD. Changes made to Parts 2A or 2B require that the date on the cover page be changed.

Form U4 Filings

Rule 302.02(C)(3) states that the investment adviser representative is under a continuing obligation to update information required by Form U4 as changes occur. Any amendments to the representative's U4 must be filed promptly with the IARD. An amendment will be considered to be filed promptly if the amendment is filed within thirty (30) days of the event that requires the filing of the amendment.

If an investment adviser representative is employed with multiple investment advisers, a Form U-4 is required to be filed under each investment adviser firm.

Additional Filings

Form U5 - an application for withdrawal from licensing as an investment adviser representative for an investment adviser or federal covered adviser in Arkansas and any amendment to such application to be completed by following the instructions on Form U5 (Uniform Termination Notice for Securities Industry Registration) and filing Form U5 with IARD.

If the investment adviser representative associates with another investment adviser, that investment adviser shall file a form U-4 as an initial application for licensing for the investment adviser representative.



Form ADV-W - an application for withdrawal from licensing as an investment adviser in Arkansas and any amendment to such application shall be completed by following the instructions on Form ADV-W (Notice of Withdrawal from Registration as Investment Adviser) and filing Form ADV-W with IARD.

Proof of Corporate Surety Bond – If the Investment Adviser has custody of any customer funds or securities, unless the custody is solely as a consequence to the authority to make withdrawals from client accounts to pay advisory fees and the investment adviser complies with the terms described under Rule 307.02(b)(3)(A)(B) and (C).

Amendments to the Firm’s Investment Advisory Contracts – Any amendments to the Firm’s investment advisory contracts should be filed with the Commissioner within ninety (90) days after the close of the Firm’s fiscal year.

Best Practice Tips

- Set a calendar reminder to review the Department’s website at least quarterly for any potential changes to the Act or Rules.
- Retire all outdated versions of the Firm Brochure and Brochure Supplement via the IARD system. If Firms are licensed with multiple states, contact those State Securities Departments for their specific filings and termination requirements.

Books and Records & Retention Requirements

Books and Records

Rule 306.02 (a) All registered investment advisers shall make and keep true, accurate and current books and records relating to their investment advisory business.

Rule 306.02 (b) The business records required to be maintained shall include, but are not limited to:

Journals, including cash receipts and disbursements records;

- General ledgers reflecting asset, liability, equity, capital, income and expense accounts;
- A memorandum of each order for the purchase or sale of any security, showing the terms and conditions of the order, instruction, modification or cancellation;
- Bank statements, canceled checks, and cash reconciliations;
- Bills or statements, paid or unpaid, relating to the business;
- Trial balances, financial statements (prepared in accordance with generally accepted accounting principles (i.e. accrual basis)), and internal working papers;



- Written communications (i.e. emails, letters, etc.) received and sent by the adviser, including recommendations, orders, and receipt/disbursement of funds/securities;
- A list or other record of all clients and accounts, including a list of services provided to each client/account;
- Copy of all powers of attorney and other evidence granting discretionary authority;
- Client agreements and all other agreements relating to the business of the firm;
- Copies of notices, circulars, advertisements, articles or other communication the adviser circulates or distributes;
- Copies of the adviser's brochure, including amendments or revisions sent to clients or prospective clients;
- Accounts, books, internal working papers and other documents that form the basis for or calculations managed accounts;
- Communications regarding customer complaints and litigation;
- Written information about each client that is the basis for recommendations or investment advice given to the client;
- Written procedures to supervise the activities of employees and representatives;
- Copies of all documents filed with or received from any state or federal agency or self-regulatory organization that pertains to the firm or its representatives;
- Copies, with original signatures, of the initial form U-4 for investment adviser representatives and all amendments to the disclosure reporting pages filed; and
- A file memorializing the due diligence conducted for alternative and non-exchange traded investment products recommended to or purchased on behalf of clients.

Retention Requirements

Rule 306.02 (c) Unless specifically provided otherwise, all books and records shall be maintained and preserved in an easily accessible place for a period of not less than five (5) years from the end of the fiscal year during which the last entry was made on the record.

Rule 306 (d) (1) Records required to be maintained and preserved may be maintained and preserved for the required time, and immediately produced or reproduced by the investment adviser by:

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

(B) Electronic storage media, including any digital storage medium or system that meets and complies with the other requirements of this Rule; or



(C) Other similar medium that meets and complies with the other requirements of this Rule.

(2) Records must be easily accessible and retrievable in a form that is legible, true, and complete.

(3) Records created or maintained on electronic storage media:

(A) Must be maintained and preserved in a manner to reasonably safeguard them from loss, alteration, or destruction;

(B) Must be only accessible to properly authorized personnel and the Commissioner or representatives of the Commissioner.

Refer to the Arkansas Securities Act and Rules for additional retention requirements for specific documents.

Best Practice Tips

- Be prepared to provide your firm's books and records to the Department, preferably in an electronic format. If providing through email, ensure that the data is encrypted, or password protected.
- Make copies of any checks received and keep them in an easily accessible file.
- Update written suitability at least every 2 years or when there is a material change in a client's situation.

Financial Requirements

Net Worth Requirement

Rule 303.02 (a) Except as otherwise provided in the Act or in the Rules, each registered investment adviser shall at all times have and maintain not less than the minimum net capital (\$12,500) required by Section 23-42-303(a) of the Act.

(b) Net capital for purposes of Rule 303.02 shall mean the net worth of an applicant or registrant calculated in accordance with generally accepted accounting principles.

(c) The provisions of this Rule shall not apply to an investment adviser whose principal place of business is located in a state other than Arkansas, provided that the investment adviser is registered or licensed as an investment adviser in that state and is in compliance with the net capital requirements of that state.

Annual Delivery of Financial Statements

Each year, an investment adviser must file directly with the Commissioner, within ninety (90) days after the close of the fiscal year, annual financial statements in accordance with Rule 302.02 (b)(3)(B)(iii).



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If an Investment Adviser maintains custody of client funds or securities or requires prepayment of client fees of more than five hundred dollars (\$500) per client and more than six (6) months in advance, the Investment Adviser must submit **audited** financial statements prepared in accordance with generally accepted accounting principles by an independent certified public accountant.

An Investment Adviser that does not maintain custody of client funds or securities and complies with Rule 307.02(b)(3)(A)(B) and (C) (Fee Deduction), shall submit an **unaudited** balance sheet prepared in accordance with generally accepted accounting principles. The balance sheet must be signed by an officer of the Investment Adviser.

Out of state investment advisers submit financial reports required by and filed with the securities commissioner in the Investment Adviser's home state.

Best Practice Tips

- Set a calendar reminder so that the annual financial statements are submitted within the ninety (90) day filing period.
- If you are an out-of-state investment adviser, make sure to review and maintain the minimum capital required by your home state.

Custody

An investment adviser who has custody, which generally means directly or indirectly holding a client's securities or funds or having any authority to obtain possession of them (such as through direct deduction of fees), can be subject to the "dishonest and unethical conduct" rule unless the adviser complies with certain requirements or an exception applies.

Invoicing

If your firm directly deducts fees or directly invoices, you are required to send the client an invoice specifying and itemizing the fee. Itemization includes the formula used to calculate the fee, the amount of assets under management or investment advisory services the fee is based on, the amount of time charged and the services provided for hourly billing and the time period covered by the fee. See Rule 307.02 (b)(3)

Pooled Investments

Pooled investments have very specific requirements outlined in Rule 307.02 (b)(4).



Login Credentials

A firm is prohibited from accessing a client's account by using the client's own unique identifying information (such as username and password) as outlined in Rule 308.02 (y).

Common Deficiencies

- Failure to itemize the fee on client invoices, which includes: the formula to calculate the fee, the amount of assets under management or a description of the investment advisory services the fee is based on, and the time period covered by the fee.
- Failure to avoid custody by accessing client accounts with the client's log-in credentials and the adviser not obtaining their own login credentials with the custodian.

Best Practice Tips

The Department continues to consistently see errors and a lack of clarity in fee calculations and descriptions of the calculation method. Consider these best practice tips to ensure your firm is properly billing clients:

- If a third party generates your clients' invoices or deducts fees on your behalf, carefully review the invoices and deductions every billing period.
- Your firm remains responsible for ensuring clients are billed the correct amount. Clients should be able to verify the accuracy of their fee and understand what services have been provided for the fee by only referencing their invoice and using a calculator.

Client Contract

Rule 308.02 (p) states it is dishonest and unethical conduct for an investment adviser to enter into a contract that is not in writing and does not disclose, in substance, the following information:

The services to be provided;
The term of the contract;
The investment objectives, risk tolerance levels, annual income, net worth, and liquid net worth for the client;
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 the contract termination or non-performance;
Whether the contract grants discretionary power to the adviser;
That no assignment of the contract shall be made by the investment adviser without the consent of the other party to the contract.

Investment advisers are required to enter into an advisory agreement/contract with clients before any investment advice or advisory service is provided.



Common Deficiencies

- Firms fail to update contracts after material changes (i.e., change in fees, change in services, etc.), which requires a signed re-execution of the contract or a signed addendum to the contract.
- Firms fail to execute contracts with every client, regardless if the client receives services from and has a contract with a third-party adviser.
- Failing to abide by the contract with regards to services offered and fee billing practices.

Best Practice Tips

- Correct identification of investment adviser entity/purveyor, including legal name and “doing business as” name, if appropriate, per the firm’s ADV filing and Secretary of State filings, and clear identification of the client.
- Clear outline of what services are to be provided and when those services are to be provided.
- The fee to be charged for services including whether billing is in advance or arrears, the formula used to calculate fees, and the method of payment.
- Clear enumeration of discretionary or non-discretionary authority for asset management services.
- Clients either must receive the ADV Part 2 at least 48 hours prior to entering into any written advisory contract or the client has a right to terminate the contract without penalty within five business days after entering the contract.

Examinations

The Department conducts examinations and interviews to ensure compliance with laws and regulations. The Staff conducts periodic examinations of broker-dealers, agents, investment advisers, and investment adviser representatives located inside and outside Arkansas. An examination may be conducted at any time and without advance notice. The Staff may copy and remove copies of all records that are determined to be reasonably necessary or appropriate to conduct the examination. Examinations by the staff are authorized under the Arkansas Securities Act Section 23-42-306(d).

Additionally, the examinee should note that for each day or for each part of a day, during which the examiners are absent from the office of the commissioner, a fee of one hundred and fifty dollars (\$150) per examiner is to be paid to the Department. You will receive an invoice from the Department several days after the on-site examination.

Common Deficiencies Identified on Examinations

The following are common deficiencies noted during the examination process:

Failure to file timely updates to Forms ADV, U-4, and ADV Part 2;



Discrepancies between disclosures in Forms ADV Part 1, ADV Part 2, and advisory agreements (“contract”);

Failure to maintain updated and comprehensive suitability information for each client;

Missing signed client agreements and failure to re-execute contracts with addendums;

Misrepresentations on advertising or marketing materials (i.e. website, social media, pamphlets, etc.);

Failure to maintain and follow written supervisory procedures;

Billing errors and incorrect fee calculations;

Failure to license investment adviser representatives;

Failure to maintain Cybersecurity and Business Continuity & Succession Planning policies;

Failure to maintain Privacy Policy;

Failure to maintain an accurate client list and complete client files;

Other Reminders and Best Practices

The Fiduciary Duty

A person who is an investment adviser, an investment adviser representative or a federal covered adviser is a fiduciary and has a duty to act primarily for the benefit of its clients. The fiduciary duty is broad and extends to all activities or transactions that extend from or are connected to the advisory relationship. See SEC Release No. IA-5248, Commission Interpretation Regarding Standards of Conduct for Investment Advisers, July 12, 2019 for more information regarding the extent of your fiduciary duty.

Licensing

It is the firm’s responsibility to ensure that all individuals are properly licensed. Your firm may find more about licensing on the Department’s website at <http://www.securities.arkansas.gov/page/405/Broker%20Dealer/Investment%20Adviser>.

Common Deficiencies

- Failing to license all required firm personnel. Investment adviser representatives include individuals who are a partner, officer, or director of an investment adviser or who occupy a status similar to or perform functions similar to those of a partner, officer, or director for an investment adviser.

Best Practice Tips

- The fiduciary duty may extend to outside business activities (“OBA”) such as insurance sales, so it’s a good idea to document the appropriateness of any OBA recommendations to advisory clients and ensure they receive complete disclosure regarding all conflicts of interest.



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