GENERAL INFORMATION ABOUT THE OVERSIGHT OF INVESTMENT ADVISERS AND INVESTMENT ADVISER REPRESENTATIVES OPERATING IN OHIO

(Fifth Edition)

Prepared By

The Ohio Division of Securities
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"Disclaimer"

This compilation of material and information was prepared by the Ohio Division of Securities to provide general information and assistance about the Division's oversight of investment advisers and investment adviser representatives in Ohio. This information should not be construed as legal advice and is not a substitute for a thorough review of the relevant statutory provisions set out in Chapter 1707 of the Ohio Revised Code and related administrative rules set out in Chapter 1301:6-3 of the Ohio Administrative Code.

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Introduction.

The Ohio Securities Act (Act) provides for oversight of investment advisers and investment adviser representatives operating in Ohio. This oversight is administered and enforced by the Division of Securities (Division). Subject to certain limited exceptions, all investment advisers operating in Ohio must be either licensed by the Division or in compliance with certain notice filing requirements. Further, subject to certain limited exceptions, all investment adviser representatives with a place of business in Ohio must be licensed by the Division. Filings and fees for investment adviser notice filings or licensure must be submitted electronically through the Investment Adviser Registration Depository, or IARD, a nationwide database and filing system maintained by the National Association of Securities Dealers Inc. (NASD) that is available on the Internet at www.iard.com. Filings and fees for investment adviser representative licensure must be submitted electronically through the Central Registration Depository (CRD), the companion NASD database to IARD.

Pursuant to the federal National Securities Markets Improvement Act of 1996, only certain investment advisers are eligible to be registered with the federal Securities and Exchange Commission (Commission). Generally, there are eleven categories of investment advisers that are permitted to register with the Commission. The most commonly relied upon category is for investment advisers that have assets under management of $25,000,000 or more. Subject to certain limited exceptions, investment advisers registered with the Commission that are operating in Ohio must comply with the Act's notice filing requirements.

Investment advisers operating in Ohio that are not registered with the Commission must be licensed by the Division, subject to four limited exceptions.

Similarly, all investment adviser representatives with a place of business in Ohio must be licensed by the Division, subject to five limited exceptions. The general rule requiring licensure for investment adviser representatives holds true regardless of whether the investment adviser representative is affiliated with a Commission-registered investment adviser or a state-licensed investment adviser.

The starting points for a consideration of the Ohio investment adviser and investment adviser representative requirements are the definitional sections. "Investment adviser" is defined in Revised Code 1707.01(X). "Investment adviser representative" is defined in Revised Code 1707.01(CC). These definitions track the definitions of these terms contained in federal law.

If a person meets the definition of investment adviser or investment adviser representative under Ohio law, the person then must look to the Act's licensing and notice filing requirements. Revised Code 1707.141 and Revised Code 1707.151 set out the licensing and notice filing requirements for investment advisers, and Revised Code 1707.161 sets out the licensing requirements for investment adviser representatives.

Finally, investment advisers and investment adviser representatives are subject to certain anti-fraud and conduct standards. These standards are contained primarily in

Revised Code 1707.44(M) and Ohio Administrative Code 1301:6-3-15.1 and 1301:6-3-44.

Violations of the Act can result in criminal penalties. Revised Code 1707.99 provides that the penalties for certain violations range from fifth degree to first degree felonies. Violations can also give rise to civil liability. Consequently, the Division urges investment advisers and investment adviser representatives to take their compliance responsibilities seriously.

All forms relating to Investment Advisers and Investment Adviser Representatives are available on the Division of Securities' web site at http://www.securities.state.oh.us.

"Investment Adviser" Defined.

The Ohio definition of "investment adviser" is contained in Revised Code 1707.01(X), and parallels the federal definition (*see* § 202(a)(11) of the Investment Advisers Act of 1940). The flow chart entitled *"Are You An Investment Adviser Under Ohio Law?"* and accompanying notes included in this booklet provide a step-by-step guide through the elements of, and exclusions from, this definition.

In general, an investment adviser is a person who:

1. For compensation;

- Is engaged in the business of;

- Providing advice, making recommendations, issuing reports or furnishing analyses regarding the value of or the advisability of investing in securities, either directly or through publications.

A person must satisfy all three of these elements in order to be an "investment adviser." Either a natural person or a business entity can be an investment adviser.

These three elements are construed broadly. The "compensation" element is satisfied by the receipt of any economic benefit by the person providing advice, and the benefit need not be provided by the recipient of the advice. The "engaged in the business" element is satisfied if any one of the following occurs: the person holds himself or herself out as an investment adviser or as one who provides investment advice; the person receives compensation that represents a clearly definable charge for providing advice about securities; or, the person, on anything other than rare, isolated and non-periodic instances, provides specific investment advice. Finally, the advice must pertain to "securities" (in contrast to other investment alternatives like real estate or coins). However, in order to satisfy the "securities" element, the advice need not be about specific securities, but rather only about securities as an investment alternative.

A term often used interchangeably with investment adviser is "financial planner." Financial planners provide investment advice about investments in general--not just

securities. All investment advisers are financial planners, but not every financial planner may be an investment adviser.

Keep in mind that it is not necessary that a person's activities consist solely of investment advisory services in order to qualify as an investment adviser. Rather the test is whether any part of the person's activities meet the three elements of "for compensation," "engaged in the business" and "regarding securities."

Exclusions from the Definition of “Investment Adviser”.

Revised Code 1707.01(X)(2) excludes several classes of persons from the Ohio definition of investment adviser. These exclusions track the exclusions from the federal definition of investment adviser (*See* § 202(a)(11)(A)-(F) of the Investment Advisers Act of 1940). Whether an exclusion is available depends on all of the relevant facts and circumstances.

The first exclusion is for attorneys, accountants, engineers and teachers whose performance of advisory services is solely incidental to the practice of their profession. In general, three factors are relevant to whether the "solely incidental" exclusion is available: whether the person holds himself or herself out to the public as an investment adviser, financial planner, or other provider of advisory services; whether the advisory services are rendered in connection with and reasonably related to the professional services; whether the fee charged for advisory services is based on the same factors as those used to determine the fee for professional services.

Publishers of bona fide newspapers, news magazines and business and financial publications of general and regular circulation are excluded from the definition of “investment adviser”. In order to meet this exclusion, the publication must offer only impersonal advice, contain disinterested commentary and analysis, and be of a general and regular circulation (*See* Lowe v. Securities and Exchange Commission, 472 U.S. 181 (1985)). This exclusion, if available, extends to authors.

The third exclusion is for a person who acts solely as an investment adviser representative. This exclusion exists to prevent unintentional dual licensure requirements.

The fourth and fifth exclusions are for banks and bank holding companies. Note that "bank" is defined in Revised Code 1707.01(O) to include virtually all types of financial institutions. This exclusion extends to an employee of a bank to the extent that the employee is acting in his or her capacity as an employee.

Any securities dealer or salesperson licensed by the Division whose performance of advisory services is solely incidental to their business as a dealer or salesperson, and who receives no special compensation for advisory services is excluded from the definition of “investment adviser”.

The seventh exclusion is for persons who give advice only as to certain government and government-sponsored securities.

The eighth exclusion is for persons excluded from the federal definition of investment adviser.

The ninth and final exclusion is for persons excluded pursuant to the rules adopted by the Division. Ohio Administrative Code 1301:6-3-01(K)(1) excludes from the definition of investment adviser certain persons who privately advise a small number of the sophisticated, trust or family entities specified in the rule. Ohio Administrative Code 1301:6-3-01(K)(2) sets out a “safe harbor” for solicitors, providing that a person who acts solely as a solicitor and is in compliance with the rule regarding cash payments for client solicitations (Ohio Administrative Code 1301:6-3-44(C)(1)) is not deemed to be an investment adviser.

In addition to this statutory listing, other persons may be excluded because they do not meet the threshold elements of “for compensation,” “engaged in the business” and “regarding securities.”

Commission Release No. IA-1092 provides further guidance as to those persons that fit within the definition of "investment adviser." Go to www.securities.state.oh.us, “Resources”, then “Selected SEC Releases” to view this release.

Once a person meets the definition of “investment adviser” under Ohio law, the person must determine whether a license or notice filing with the Division is required.

Investment Adviser Notice Filings & Exceptions From Filing.

Revised Code 1707.141(A)(2) and 1707.141(B)(1) combine to require that investment advisers registered with the Commission and operating in Ohio make an annual electronic "notice filing" with the Division through the IARD. The only Commission-registered investment advisers operating in Ohio that are excepted from this filing requirement are ones that:

- Have no place of business in Ohio and have as clients only those certain "institutional clients" enumerated in Revised Code 1707.141(A)(3);

- Have no place of business in Ohio and during the preceding twelve month period have not more than five clients other than those described in Revised Code 1707.141(A)(3) *(See Revised Code 1707.141(A)(4));*

- Constitute certain charitable organizations as described in section 3(c)(10)(B) of the Investment Company Act of 1940 *(See Revised Code 1707.141(A)(5));*

- Constitute certain church employee benefit plans as described in section 414(e) of title 26 of the United States Code *(See Revised Code 1707.141(A)(6)).*

"Place of business" is defined in Ohio Administrative Code 1301:6-3-01(F) and generally means an office where services are regularly provided or any other location held out as a place where services are rendered.

Pursuant to Ohio Administrative Code 1301:6-3-14.1(A)(2), a notice filing shall be submitted electronically to the Division through the IARD/CRD system. Revised Code 1707.141(B)(1) and Ohio Administrative Code 1301:6-3-14.1(A) and (B) combine to provide that a notice filing shall consist of:

- A fully completed part 1 of the electronic Form ADV, *Uniform Application For Investment Adviser Registration*, fully completed schedules and disciplinary reporting pages pertaining to part 1 of the Form ADV, and a fully completed execution page of the Form ADV *(See Revised Code 1707.141(B)(1)(a) and Ohio Administrative Code 1301:6-3-14.1(A)(1));* and

- A notice filing fee of $50.

NOTE: An investment adviser is not required to submit Part II of the Form ADV as part of a notice filing. However, an investment adviser must prepare and maintain Part II, and distribute it as required by law.

Expiration and Renewal.

A notice filing expires on December 31st of the year for which it was filed. Pursuant to Revised Code 1707.17(A)(3) and Ohio Administrative Code 1301:6-3-14.1, a notice filing may be renewed prior to December 31st of each year by submitting the $50 notice filing fee through the IARD/CRD system in accordance with IARD Renewal Program and filing provisions.

Duty to Update and Termination.

Ohio Administrative Code 1301:6-3-14.1(C) requires that a notice filing be kept current by simultaneously filing with the Division any updates or amendments to the Form ADV filed with the Commission. Such filings must be made through the IARD/CRD system. Notice filings may be terminated by notifying the Division, by failing to timely renew, or by submitting a Form ADV-W to the IARD.

Investment Adviser License Applications & Exceptions from Licensing.

Revised Code 1707.141(A) provides that all investment advisers operating in Ohio not registered with the Commission must be licensed by the Division, subject to four limited exceptions.

The first exception from licensing is for investment advisers operating in Ohio that are not registered with the Commission, who have no place of business in Ohio, and have as clients only certain enumerated "institutional clients" including other investment

advisers, securities dealers, banks, insurance companies, employee benefit plans larger than $1,000,000 and government agencies. *See Revised Code 1707.141(A)(3).* "Place of business" is defined in Ohio Administrative Code 1301:6-3-01(F) and generally means an office where services are regularly provided or any other location held out as a place where services are rendered.

The second exception from licensing is for investment advisers operating in Ohio that are not registered with the Commission, who have no place of business in Ohio, and have, during the preceding twelve month period, not more than five clients in Ohio other than the "institutional clients" mentioned above. *See* Revised Code 1707.141(A)(4).

The third exception from licensing is for certain charitable organizations as defined in section 3(c)(10)(B) of the Investment Company Act of 1940. *(See Revised Code 1707.141(A)(5)).*

The fourth exception from licensing may be available for certain church employee benefit plans as described in section 414(e) of title 26 of the United States Code. *(See Revised Code 1707.141(A)(6)).*

These licensing exceptions are "self-executing," meaning that no filing with the Division is required to perfect reliance on any of the four exceptions.

Revised Code 1707.151(A) states that an investment adviser license application shall consist of the information, materials and forms specified in rules adopted by the Division. Both the Form ADV and filing fee listed below must be submitted through the IARD/CRD system. Ohio Administrative Code 1301:6-3-15.1(B) specifies that an application shall consist of:

- A fully completed Part 1 of the electronic Form ADV, uniform application for investment adviser registration, fully completed schedules and disciplinary reporting pages pertaining to Part 1 of the Form ADV, and a fully completed state registered investment adviser execution page of the Form ADV; and

- The licensing fee of $50.

NOTE: An investment adviser is not required to submit Part II of the Form ADV as part of an application. However, an investment adviser must prepare and maintain Part II and distribute it as required by law. In addition, please note that prior to field examinations of investment advisers, the Division may request a copy of Part II for review.

Failure to answer all questions on the appropriate forms, and failure to provide all required information will delay the Division's review of an application. Applications for licensure must be submitted electronically using the IARD/CRD system, although a fingerprint card, if required, must be submitted directly to the Division.

Pursuant to Revised Code 1707.151(D), the Division may investigate any license applicant and may require any additional information as it deems necessary to a consideration of the application. After the Division has reviewed the application and completed its investigation, the applicant will be issued a license or notified that the Division intends to deny the application for licensure. If the applicant receives a notice of the Division's intent to deny the application, the applicant must, within 30 days, either withdraw the application or, pursuant to Revised Code Chapter 119, request an administrative hearing. Failure to withdraw or request a hearing within 30 days will result in the issuance by the Division of a final order to deny the application.

Natural Person, or Sole Proprietor, Investment Advisers.

Revised Code 1707.151(B) provides that each natural person applicant for an investment adviser license must demonstrate their competence to engage in the advisory business. A sole proprietor investment adviser is a natural person who has not created a legal entity to engage in that business. Sole proprietor investment advisers should keep in mind that, as with firms, they are subject to anti-fraud and business conduct standards. In addition, because sole proprietor investment advisers are distinguished from sole shareholders of corporate investment advisers, sole proprietor investment advisers need not file a Form U-4 with the Division and need not be licensed as an investment adviser representative (unless the person also acts as an investment adviser representative for another investment adviser). However, in addition to submitting the Form ADV and filing fee through the IARD/CRD system, a sole proprietor must also submit a standard impression sheet for fingerprints provided by the Division if one is not already on file with the National Association of Securities Dealers, Inc. (NASD) or Central Registration Depository (CRD). A sole proprietor investment adviser must also demonstrate minimum competency and good business repute, as discussed below.

In the case of a single natural person who chooses to use a legal entity such as a corporation to operate an investment adviser business, the legal entity is the investment adviser and, absent an exemption, must comply with the investment adviser licensing requirements. Upon becoming licensed, the legal entity is subject to the investment adviser anti-fraud and business conduct standards.

Unlike the sole proprietor investment adviser, the single natural person as, for example, a sole shareholder, operates as an investment adviser representative of the investment adviser, and must submit a Form U-4 through the IARD/CRD system and obtain an investment adviser representative license.

The Minimum Competency Standard for Sole Proprietors.

Under Ohio Administrative Code 1301:6-3-15.1(C), the minimum competency standard for sole proprietors may be satisfied in one of three ways:

- By achieving a passing score *on or after* January 1, 2000, on the Uniform Investment Adviser Law Examination, Series 65; or

- By achieving a passing score *on or after* January 1, 2000, on the Uniform Combined State Law Examination; series 66 and also, at any time, the General Securities Representative Examination, series 7; or

- By earning and being in good standing with the organization that issued any of the following credentials:

    - Certified Financial Planner awarded by the Certified Financial Planner Board of Standards, Inc.;

    - Chartered Financial Analyst;

    - Chartered Financial Consultant;

    - Chartered Investment Counselor; or

    - Certified Public Accountant with a Personal Financial Specialist designation.

An applicant who is not affiliated with an NASD-registered securities dealer may register for one of the NASD Series examinations listed above by submitting to the NASD a completed Form U-10, Uniform Examination Request for Non-NASD Candidates. A Form U-10 may be obtained from the Division or the NASD.

The Good Business Repute Standard.

In addition to the application and minimum competency requirements described above, Revised Code 1707.151(E) requires the Division to make an affirmative finding that an applicant is of "good business repute" before granting a license.

In determining the existence of good business repute, the Division is guided by the factors set forth in Ohio Administrative Code 1301:6-3-19(D), which generally include whether the applicant has:

- Engaged in fraudulent conduct or been found liable for conduct constituting incompetence in financial activities;

- Been subject to administrative, civil or other disciplinary action by a regulatory agency, or failed to fully satisfy any judgment or award;

- Been found guilty of a felony, or of any misdemeanor involving theft, deception or moral turpitude; or

- Engaged in any conduct that would reflect on the applicant's reputation for honesty, integrity and competence in business and personal dealings.

The primary source of the Division's information in making this determination is the Form ADV. If the Division determines that an applicant lacks good business repute, the Division will issue to the applicant a notice of intent to deny the application. The applicant must, within 30 days, either withdraw the application or, pursuant to Revised Code Chapter 119, request an administrative hearing. Failure to withdraw or request a hearing within 30 days will result in the issuance by the Division of a final order to deny the application.

Expiration and Renewal.

Revised Code 1707.17(A)(2) states that the license of every investment adviser shall expire on December 31st of each year. Renewals for the following year must be submitted through the Renewals Program of the IARD/CRD system in order to avoid cancellation of the license. *See Ohio Administrative Code 1301:6-3-15.1(B)(4).* The Division may deny a renewal application by issuing to the applicant a notice of intent to deny. The recipient of such a notice must, within 30 days either withdraw the renewal application or, pursuant to Revised Code Chapter 119, request an administrative hearing. Failure to withdraw or request a hearing within 30 days will result in the issuance by the Division of a final order to deny the renewal application.

License Transfer.

If a licensed investment adviser changes its business form, reincorporates, or by merger or reorganization becomes a different "person," upon application by the licensee the Division may transfer the investment adviser's license and the licenses of its investment adviser representatives to the successor entity, if the Division finds that the successor entity is substantially similar to the predecessor entity. The fee for the license transfer is $50, plus $10 for each investment adviser representative license transferred. A request for a license transfer and the filing fee should be submitted directly to the Division.

Duty to Update.

Ohio Administrative Code 1301:6-3-15.1(B)(3) requires every investment adviser licensed by the Division to file promptly with the Division, through the IARD/CRD system, amendments to the Form ADV.

Commission Release No. IA-1000 provides certain information about the Form ADV and other disclosure requirements. Although the release pertains to the former paper version of the Form ADV, it contains a great deal of information on substantive matters that continue to be relevant to filers. Go to www.securities.state.oh.us, "Resources", then "Selected SEC Releases" to view this release.

"Investment Adviser Representative" Defined.

The Ohio definition of "investment adviser representative" is contained in Revised Code 1707.01(CC), and parallels the federal definition (*See* Commission rule 203A-3(a)). The flow chart entitled *"Are You An Investment Adviser Representative Under Ohio Law?"* and accompanying notes, included in this package, provide a step-by-step guide through the elements of this definition.

In general, an investment adviser representative is a natural person who gives advice on behalf of an investment adviser to a certain minimum number of natural person clients through regular meetings or communications.

Specifically, in order to be an investment adviser representative, the natural person first must be a "supervised person." "Supervised person" is defined in Revised Code 1707.01(DD) and generally means officers, directors and employees of an investment adviser as well as others who provide advice on behalf of the investment adviser firm.

Second, the supervised person must have more than five clients who are natural persons other than "excepted persons," and more than 10% of the clients must be natural persons other than "excepted persons." "Excepted person" is defined in Revised Code 1707.01(EE) and generally means certain wealthy and high net worth individuals.

Third, the supervised person must on a regular basis solicit, meet with, or otherwise communicate with clients of the investment adviser.

All three of these elements must be met in order for a person to qualify as an investment adviser representative. However, even if a natural person meets all three of these elements, Revised Code 1707.01(CC)(1)(b) provides that the natural person is excluded from the definition of investment adviser representative if the natural person provides advisory services only by means of written materials or oral statements that do not purport to meet the objectives or needs of specific individuals or accounts.

Investment Adviser Representative License Applications & Exceptions From Filing.

Revised Code 1707.161(A) requires that all investment adviser representatives operating in Ohio be licensed by the Division, subject to certain exceptions.

The first exception from licensing is for a natural person licensed by the Division as an investment adviser who does not act as an investment adviser representative for other investment advisers. *See* Revised Code 1707.161(A)(2). This will avoid a dual licensure requirement for a natural person who acts solely as an investment adviser. This exception is self-executing.

The second exception from licensing is where an investment adviser representative is employed by or associated with an investment adviser registered with the Commission

and the investment adviser representative does not have a place of business in Ohio. *See* Revised Code 1707.161(A)(3). Note that where an investment adviser representative is employed by or associated with an investment adviser registered with the Commission and the investment adviser representative does have a place of business in Ohio, the investment adviser representative must be licensed by the Division. "Place of business" is defined in Ohio Administrative Code 1301:6-3-01(F) and generally means an office where services are regularly provided or any other location held out as a place where services are rendered.

The third exception from licensing is for investment adviser representatives who are employed by or associated with an investment adviser that is excepted from investment adviser licensure pursuant to Revised Code 1707.141(A)(3) or (4). This exception also applies to investment adviser representatives employed by or associated with an investment adviser that is registered with the Commission and excepted from the Division's notice filing requirement pursuant to Revised Code 1707.141(B)(3). See Revised Code 1707.161(A)(4).

The fourth exception is for persons who serve as investment adviser representatives for certain charitable organizations that are excepted from the Division's licensing and notice filing requirements by virtue of the Federal Philanthropy Protection Act of 1995 *(See Revised Code 1707.161(A)(4)).*

The fifth exception is for persons who serve as investment adviser representatives for certain church employee benefit plans that are excepted from the Division's licensing and notice filing requirements by virtue of NSMIA *(See Revised Code 1707.161(A)(4)).*

Affiliations.

Revised Code 1707.161(E) provides that an investment adviser representative license authorizes a person to act as an investment adviser representative for the investment adviser, or investment advisers that are under common ownership and control, named in the application. Thus, an investment adviser representative may be employed by or associated with multiple investment advisers that are under common ownership or control, provided that the license application lists the multiple advisers.

In addition, Revised Code 1707.161(B) permits an investment adviser representative to act as an investment adviser representative for up to two unaffiliated investment advisers, provided that the:

- Investment adviser representative is properly licensed, or properly excepted from licensure, as an investment adviser representative for each of the two investment advisers; *and*

- Investment adviser representative notifies both investment advisers of the dual affiliation via filing of the Form U-4 on the IARD/CRD system and retains evidence of that notification in his or her records.

Contents of the Investment Adviser Representative License Application.

Revised Code 1707.161(D)(1) states that an application for an investment adviser representative license shall consist of the information, materials and forms specified in rules adopted by the Division. Ohio Administrative Code 1301:6-3-16.1(A) specifies that an application shall consist of:

- A completed Form U-4 for each investment adviser for whom the applicant seeks to act as an investment adviser representative;
- The license fee of $35; and
- A standard impression sheet provided by the Division (*i.e.* a fingerprint card), if not already on file with the NASD or CRD.

Failure to answer all questions on the appropriate forms, and failure to provide all required information will delay the Division's review of an application. The Division requires use of the IARD/CRD system for submission of all initial investment adviser representative applications and the IARD system for renewal of investment adviser representative licenses.

After the Division has reviewed the application and completed its investigation, the applicant will be issued a license or notified that the Division intends to deny the application for licensure. If the applicant receives a notice of the Division's intent to deny the application, the applicant may either withdraw the application or, pursuant to Revised Code Chapter 119, request an administrative hearing.

The Minimum Competency Standard.

Revised Code 1707.161(D)(2) provides that applicants must demonstrate their competence to engage in the advisory business. Under Ohio Administrative Code 1301:6-3-16.1(B), this minimum competency standard may be satisfied in one of two ways:

- By achieving a passing score on one of the NASD Series 6, 7, 22, 24, 26, 39, 62, 63, 65 or 66 examinations; or
- By earning and being in good standing with the organization that issued any one of the following credentials:
  - Certified Financial Planner awarded by the Certified Financial Planner Board of Standards, Inc.;
  - Chartered Financial Analyst;
  - Chartered Financial Consultant; or
  - Chartered Investment Counselor; or

- Certified Public Accountant with a Personal Financial Specialist designation.

An applicant who is not affiliated with a NASD-registered securities dealer may register for one of the NASD Series examinations listed above by submitting to the NASD a completed Form U-10, Uniform Examination Request for non-NASD Candidates. A Form U-10 may be obtained from the Division or the NASD.

The Good Business Repute Standard.

In addition to the application and minimum competency requirements described above, Revised Code 1707.161(E) requires the Division to make an affirmative finding that an applicant is of "good business repute" before granting a license. In determining the existence of good business repute, the Division is guided by the factors set forth in Ohio Administrative Code 1301:6-3-19(D), which generally include whether the applicant has:

- Engaged in fraudulent conduct or been found liable for conduct constituting incompetence in financial activities;

- Been subject to administrative, civil or other disciplinary action by a regulatory agency, or failed to fully satisfy any judgment or award;

- Been found guilty of a felony, or of any misdemeanor involving theft, deception or moral turpitude; or

- Engaged in any conduct that would reflect on the applicant's reputation for honesty, integrity and competence in business and personal dealings.

The primary source for the Division's information in making this determination is the Form U-4. If the Division determines that an applicant lacks good business repute, the Division will issue to the applicant a notice of intent to deny the application. The applicant then may either withdraw the application or, pursuant to Revised Code Chapter 119, request an administrative hearing.

License Effective Period, Expiration and Renewal.

Revised Code 1707.161(C) states that an investment adviser representative's license shall not be effective during any period when the investment adviser representative is not employed by, or associated with, an investment adviser that is either licensed by the Division or in compliance with the notice filing requirement. Notice of the commencement and termination of the employment or association of the licensed investment adviser representative must be filed with the Division within 30 days after the commencement or termination by either:

- the investment adviser, if the investment adviser is licensed by the Division; or
- the investment adviser representative, if the investment adviser is registered with the Commission.

Revised Code 1707.17(A)(2) states that the license of every investment adviser representative shall expire on December 31st of each year. The Division may deny a renewal application by issuing to the applicant a notice of intent to deny. The recipient of such a notice must, within 30 days, either withdraw the renewal or, pursuant to Revised Code Chapter 119, request an administrative hearing. Failure to withdraw or request a hearing within 30 days will result in the issuance by the Division of a final order to deny the application.

Duty to Update.

Under Ohio Administrative Code 1301:6-3-16.1(C), all applicants and all licensed investment adviser representatives have a continuing obligation to promptly update the information submitted to the Division pursuant to Ohio Administrative Code 1301:6-3-16.1(A)(1).

"Solicitor."

A solicitor is any person who, directly or indirectly, solicits any client for, or refers any client to, an investment adviser or investment adviser representative. Solicitors *per se* are not required to be licensed by the Division—there is no "solicitor's license". Rather, solicitors need to be licensed by the Division only if their activities meet the definition of investment adviser or investment adviser representative. As under federal law, Ohio law requires a solicitor who receives cash payments to provide a written solicitation disclosure document to clients.

Ohio Administrative Code 1301:6-3-01(K)(2) establishes a "safe harbor" for solicitors, providing that a person who acts solely as a solicitor and is in compliance with the rule regarding cash payments for client solicitations is not deemed to be an investment adviser.

Overview of Anti-Fraud and Conduct Standards.

Investment advisers and investment adviser representatives (collectively and alternatively referred to in this section as "advisers") are fiduciaries who have an affirmative obligation of utmost good faith and full and fair disclosure, and who owe their clients undivided loyalty. Further, advisers have a duty to avoid misleading their clients, and may not engage in activity that conflicts with a client's interest without the client's consent. *See* S.E.C. v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963). Consequently, advisers are subject to a set of conduct and anti-fraud standards.

The conduct standards include a series of business responsibilities, set out in Ohio Administrative Code 1301:6-3-15.1, that are based on analogous federal responsibilities and are applicable to investment advisers licensed or required to be licensed by the Division. Statutory anti-fraud standards are set out in Revised Code 1707.44(M) and generally prohibit misstatements or misleading omissions of material facts and other fraudulent acts and practices in connection with the conduct of an advisory business. In general, Revised Code 1707.44(M) applies to all investment advisers and investment adviser representatives operating in Ohio.

The statutory anti-fraud standards are amplified by a series of administrative rules set out in Ohio Administrative Code 1301:6-3-44 and based on analogous federal regulations. The administrative rules are prophylactic in nature and are generally aimed at prohibiting activities that are fraudulent, deceptive or manipulative. Pursuant to federal law, the applicability of the Division's anti-fraud administrative rules set out in Ohio Administrative Code 1301:6-3-44 is limited to investment advisers licensed or required to be licensed under the Act and investment adviser representatives employed by or associated with investment advisers licensed or required to be licensed under the Act. *However, in general, all investment advisers and investment adviser representatives operating in Ohio are subject to the statutory anti-fraud provisions.*

The Brochure Rule.

Ohio Administrative Code 1301:6-3-15.1(G), the "brochure rule," generally requires every investment adviser, licensed or required to be licensed under the Act, to deliver to each client and prospective client a written disclosure statement, or "brochure," describing the investment adviser's business practices and educational and business background. An adviser must deliver this brochure either: (1) at least forty-eight hours before entering into any written or oral contract with a client or prospective client, or (2) at the time of entering into the contract with a client or prospective client if the contract permits the client to terminate the contract without penalty within five business days after entering into it. The rule also requires an investment adviser to offer to deliver a brochure to existing clients, on an annual basis, without charge.

The information required by the brochure rule is included as Part II of Form ADV. To comply with the brochure rule, an investment adviser either may deliver Part II of Form ADV, or another document containing at least the information disclosed in Part II of Form ADV. Investment advisers are not required to submit Part II of the Form ADV to the Division as part of a notice filing or application for licensure, although the Division may request a copy for purposes of review.

Advisers are not required to deliver a brochure to clients for whom they provide advisory services pursuant to a contract for impersonal investment advice for less than $200. An adviser entering into a contract for impersonal investment advice for $200 or more need only offer to deliver a brochure.

Other Disclosure Requirements.

Ohio Administrative Code 1301:6-3-44(D) requires investment advisers licensed or required to be licensed by the Division and investment adviser representatives employed by or associated with investment advisers licensed or required to be licensed by the Division that have custody or discretionary authority over client funds or securities (or that require prepayment six months or more in advance of more than $500 of advisory fees) to disclose promptly to clients (and within forty-eight hours of entering into written or oral contract with prospective clients) any financial conditions of the investment adviser and investment adviser representative that are reasonably likely to impair the ability of the investment adviser and investment adviser representative to meet contractual commitments to clients. This disclosure requirement can be satisfied by giving disclosure at the time of entering into a contract with a prospective client, if the contract permits the client to terminate the contract without penalty within five business days after entering into it.

Investment advisers and investment adviser representatives subject to this rule (regardless of whether or not they have custody or require prepayment of fees) are also required to disclose promptly to clients legal or disciplinary events that are material to an evaluation of the adviser’s integrity or ability to meet their commitments to clients. The rule lists a number of legal and disciplinary events for which there is a rebuttable presumption of materiality for these purposes. Keep in mind that although an event may not be on the list in the rule, it may still be material.

Consistent with the position taken by the Commission, the Division takes the position that investment advisers and investment adviser representatives subject to this rule must disclose to clients all material information regarding compensation, such as if the adviser's fee is higher than the fee typically charged by other advisers for similar services (in most cases, this disclosure is necessary if the annual fee is three percent of assets or higher). Investment advisers and investment adviser representatives subject to this rule must disclose all potential conflicts of interest between the adviser and its clients, even if the adviser believes that a conflict has not affected and will not affect the adviser's recommendations to its clients. This obligation to disclose conflicts of interest includes the obligation to disclose any benefits advisers may receive from third parties as a result of their recommendations to clients.

Prohibited Contractual and Fee Provisions.

Advisory contracts are required to be in writing. (See OAC 1301:6-3-15.1(H)(2)). Following is a discussion of contract terms and fee provisions that are prohibited.

Ohio Administrative Code 1301:6-3-15.1(H)(1)(b) requires each investment advisory contract entered into by an investment adviser licensed or required to be licensed under the Act to provide that the contract may not be assigned without the client's consent. Ohio Administrative Code 1301:6-3-15.1(A)(2) defines "assignment" generally to include any direct or indirect transfer of an investment advisory contract by an investment adviser or any transfer of a controlling block of an investment adviser's outstanding voting securities. A transaction that does not result in a change of actual control or management of the investment adviser (*e.g.,* a reorganization for purposes of changing an adviser's state of incorporation), would not be deemed to be an assignment for these purposes. Ohio Administrative Code 1301:6-3-15.1(H)(1)(c) provides that if an investment adviser is organized as a partnership, each of its advisory contracts must provide that the adviser will notify the client of a change in its membership.

Performance Fees.

Ohio Administrative Code 1301:6-3-15.1(H) prohibits an investment adviser licensed or required to be licensed under the Act, from receiving any type of advisory fee calculated as a percentage of capital gains or appreciation in the client's account. This is known as a performance fee arrangement. This prohibition extends to contingent fee arrangements, including contracts that provide for the fee to be waived or reduced if certain performance levels are not met.

However, this prohibition does not apply to contracts with:

- Clients having more than $1 million in managed assets, if specific conditions are met;
- Private investment companies excepted from the Investment Company Act of 1940 under Section 3(c)(7); and
- Clients that are not United States residents.

Advisers are also permitted to charge performance fees to:

- Clients with at least $750,000 under management with the adviser or more than $1,500,000 of net worth;

- Clients who are *"qualified purchasers"* under section 2(a)(51)(A) of the Investment Company Act of 1940; and

- Certain knowledgeable employees of the investment adviser.

Further, compensation based on the total value of a fund averaged over a definite period or as of definite dates, or taken as of a definite date is permitted; this allows for advisory fees that consist of a percentage of assets under management.

Advertising Restrictions.

Ohio Administrative Code 1301:6-3-44(A) prohibits investment advisers licensed or required to be licensed under the Act and their investment adviser representatives from using any advertisement that contains any untrue statement of material fact or that is otherwise misleading. The rule broadly defines "advertisement" to include any notice, circular, letter or other written communication addressed to more than one person, or any notice or other announcement in any publication or by radio or television, that offers any investment advisory service.

In addition, an advertisement may not:

- Use or refer to testimonials (which include any statement of a client's experience or endorsement);

- Refer to past, specific recommendations made by the adviser that were profitable, unless the advertisement sets out a list of all recommendations made by the adviser within the preceding period of not less than one year, and complies with other, specified conditions;

- Represent that any graph, chart, formula, or other device can, in and of itself, be used to determine which securities to buy or sell, or when to buy or sell such securities, or can assist persons in making those decisions, unless the advertisement prominently discloses the limitations thereof and the difficulties regarding its use; and

- Represent that any report, analysis, or other service will be provided without charge unless the report, analysis or other service will be provided without any obligation whatsoever.

Consistent with the position taken by the Commission, the Division takes the position that an adviser subject to this rule may advertise its past performance (both actual

performance and hypothetical or model results), only if the advertisement meets certain conditions and restrictions. An advertisement using performance data must disclose all material facts necessary to avoid any unwarranted inference.

Among other things, an adviser may not advertise its performance data if the adviser:

- Fails to disclose the effect of material market or economic conditions on the results portrayed (e.g., an advertisement stating that the accounts of the adviser's clients appreciated in value 25% without disclosing that the market generally appreciated 40% during the same period);

- Includes model or actual results that do not reflect the deduction of advisory fees, brokerage or other commissions, and any other expenses that a client would have paid or actually paid;[i]

- Fails to disclose whether and to what extent the results portrayed reflect the reinvestment of dividends and other earnings;

- Suggests or makes claims about the potential for profit without also disclosing the possibility of loss;

- Compares model or actual results to an index without disclosing all material facts relevant to the comparison (e.g. an advertisement that compares model results to an index without disclosing that the volatility of the index is materially different from that of the model portfolio);

- Fails to disclose any material conditions, objectives, or investment strategies used to obtain the results portrayed (e.g. the model portfolio contains equity stocks that are managed with a view towards capital appreciation);

- Fails to disclose 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 clients' money;

- Fails to disclose if applicable, 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;

- Fails to disclose, if applicable, that any of the securities contained in, or the investment strategies followed with respect to, the model portfolio do not relate, or only partially relate, to the type of advisory services currently offered by the adviser (e.g., the model includes some types of securities that the adviser no longer recommends for its clients);

- Fails to disclose, if applicable, that the adviser's clients had investment results materially different from the results portrayed in the model;

- Fails to disclose prominently, if applicable, 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.

Since the Division does not have authority to issue opinions or take no-action positions, the Division will not pre-approve advertisements for compliance with the above requirements, although advertisements are subject to review during Division inspections.

In addition, Ohio Administrative Code 1301:6-3-15.1(E) requires an investment adviser licensed or required to be licensed by the Division to retain copies of all advertisements and other communications that the investment adviser has circulated, directly or indirectly, to ten or more persons. Further, an adviser must create and retain all documents necessary to substantiate any performance information contained in advertisements or communications.

Suitability Requirements.

As fiduciaries, advisers owe their clients a duty to provide only suitable investment advice. This duty generally requires an adviser to determine that the investment advice it gives to a client is suitable for the client, taking into consideration the client's financial situation, investment experience and investment objectives.

Custody Requirements.

Unless an investment adviser licensed or required to be licensed by the Division, and its investment adviser representatives, follow the Division's rule regarding custody of client funds and securities, such custody will be deemed a fraudulent, deceptive or manipulative practice in violation of the statutory anti-fraud provision. The Division rule, set out in Ohio Administrative Code 1301:6-3-44(B), mirrors the federal rule and has been newly updated to complement the new custody provisions adopted by the Commission.

An adviser has custody if it holds client funds or securities directly or indirectly, or has authority to obtain possession of such assets. For example, an adviser has custody any time it physically holds client stock certificates, bonds or cash—even if temporarily. It

should be noted that inadvertent receipt will not result in custody as long as the check or securities inadvertently received are returned to the client within three business days. In addition, checks written to third parties and forwarded on to that third party will not result in custody.

A second example of custody is when an adviser is authorized to sign checks on a client's behalf to withdraw funds or securities from a client's account or to dispose of client funds or securities for any purpose other than authorized trading. To illustrate this more clearly, custody occurs where advisers are authorized to deduct advisory fees or other expenses directly from a client's account, or, where the adviser has a general power of attorney.

Custody is triggered any time an adviser acts in a capacity that gives the adviser legal ownership of, or access to, client funds or securities. Illustrations of this include a general partner of a limited partnership; a managing member of a limited liability company; a comparable position for another type of pooled investment vehicle; or, a trustee of a trust.

The new custody rule requires that all advisers maintain client funds and securities with only four types of "qualified custodians, including United States banks; broker-dealers registered with, and regulated by, the SEC; futures commission merchants registered under the Commodity Exchange Act; or foreign financial institutions that customarily hold financial assets for their customers provide they hold them in segregated accounts. The client's funds and securities must be either placed in a separate account for each client under the client's name or placed in an account that contains only the adviser's clients' funds and securities under the adviser's name as agent or trustee for the clients.

The adviser is responsible for delivering notice to its clients. An adviser that opens an account with a qualified custodian on the client's behalf, whether in the name of the client or in the name of the adviser, as agent, must notify the client in writing and provide the name and address of the qualified custodian; the manner in which the client funds or securities are being held; and, prompt notification to the client upon the change of this information.

Clients must receive quarterly account statements directly from the qualified custodian that identify the amount of funds and each security held in the adviser's custody at the end of the period; and, all transactions in the account occurring during the period. The adviser must have a reasonable basis for believing that the qualified custodian is delivering proper quarterly accounts statements to its clients. To form this reasonable basis for believing, the adviser is required to receive duplicate copies of the account statements from the qualified custodian of what was delivered to the adviser's clients. The adviser cannot receive the quarterly account statements and then forward copies on to its clients. **Failure to comply with the quarterly account statement delivery requirements will result in the adviser being required to have annual surprise audits conducted by an independent public accountant.**

Limited partnerships, limited liability companies, other pooled investment vehicles, and trusts must have clients' funds and securities maintained with a qualified custodian.

The qualified custodian must deliver quarterly account statements regarding transactions and holdings in the limited partnerships, limited liability companies, other pooled investment vehicles, and trusts, not just transactions or holdings relating to the individual investors/limited partners. The qualified custodian must deliver the quarterly account statements directly to the limited partners, members, or beneficial owners. Account statement delivery is not required if the limited partnership, limited liability company, or pooled investment vehicle is audited annually by an independent public accountant the audited financials are prepared in accordance with GAAP accounting; and the audited financials are distributed to each limited partner or pooled investment vehicle member within 120 days of the limited partnership's or pooled investment vehicle's fiscal year end.

Restriction on Payment of Referral Fees.

Ohio Administrative Code 1301:6-3-44(C) generally prohibits an investment adviser licensed or required to be licensed by the Division, and investment adviser representatives employed by or associated with investment advisers licensed or required to be licensed by the Division, from paying a cash fee to a "solicitor" (a person who solicits clients for or refers clients to an investment adviser or investment adviser representative) unless the arrangement complies with a number of conditions.

Among other things, the rule requires that:

- There be a written agreement between any investment adviser or investment adviser representative and the solicitor (a copy of which the investment adviser must retain), detailing the referral arrangement;

- At the time of any solicitation activities, the solicitor provide the prospective client with a copy of the investment adviser's brochure pursuant to Ohio Administrative Code 1301:6-3-15.1(G) and a separate, written disclosure document that discloses, among other things, that the solicitor is being compensated for referring or recommending the investment adviser or investment adviser representative, and the terms of the compensation (including any additional amounts the client will be charged by the adviser as a result of the referral arrangement); and

- The investment adviser or investment adviser representative receives from the client, prior to, or at the time of, entering into any written or oral investment advisory agreement with the client, a signed and dated acknowledgment that the client received the investment adviser's brochure and the solicitor's written disclosure document.

Wrap Fee Programs.

Many advisers participate in “wrap fee programs”. A wrap fee program is an arrangement under which investment advice and brokerage execution services are provided for a single “wrapped” fee that is not based on transactions in a client’s account.

For investment advisers licensed or required to be licensed by the Division, Ohio Administrative Code 1301:6-3-15.1(G) requires the sponsor of a wrap fee program to prepare a "wrap fee brochure" that provides, in narrative form, a full explanation of the program and its sponsor, and to deliver the wrap fee brochure to wrap fee clients. An investment advisory program under which all clients pay traditional, transaction-based commissions is not a wrap fee program. Similarly, a program under which client assets are allocated among mutual funds is not a wrap fee program because normally there is no payment for brokerage execution.

The wrap fee brochure must be prepared by the "sponsor" of the wrap fee program, i.e., the person that, for a portion of the fee, sponsors, organizes, or administers the program or recommends portfolio managers under the program. Some wrap fee programs will have more than one sponsor, in which case only one of the sponsors, as selected by the sponsors, needs to prepare the wrap fee brochure. An investment adviser providing portfolio management services to wrap fee clients is not a sponsor unless it performs other duties that would cause it to fall within the definition.

Best Execution and "Soft Dollars".

As a fiduciary, an adviser has an obligation to obtain "best execution" of clients' transactions. In meeting this obligation, an adviser must execute securities transactions for clients in such a manner that the client's total cost or proceeds in each transaction is the most favorable under the circumstances.

In assessing whether this standard is met, an adviser should consider the full range and quality of a broker's services when placing brokerage orders, including, among other things, execution capability, commission rate, financial responsibility, responsiveness to the adviser, and the value of any research services provided. An investment adviser must keep in mind the fiduciary obligation of best price and best execution when considering these factors.

When an investment adviser causes an account to pay more than the lowest available commission to a broker-dealer in return for research products and services, these payments are commonly referred to as "soft dollars." Federal law contains a "safe harbor" for certain soft dollar payments in section 28(e) of the Securities Exchange Act of 1934 and is available for all investment advisers operating in Ohio. This safe harbor protects an adviser from claims for breach of fiduciary duty based solely on the fact that the adviser paid more than the lowest available commission rate if the adviser, in good faith, determined that the higher commission was reasonable in relation to the value of the brokerage and research services provided. Section 28(e)(3) provides that brokerage and research services within the safe harbor include:

- Furnishing advice, either directly or through publications or writings, as to the value of the securities, the advisability of investing in, purchasing, or selling securities and the availability of securities or purchasers or sellers of securities;

- Furnishing analyses and reports concerning issuers, industries, securities, economic factors and trends, portfolio strategy, and the performance of accounts; or

- Effecting securities transactions and performing functions incidental thereto (such as clearance, settlement, and custody) or required in connection therewith by rules of the Commission or a self-regulatory organization of which such person is a member or person associated with a member or in which such person is a participant.

The Commission has issued extensive guidance under section 28(e). The Division takes the position that this guidance, along with section 28(e), sets out the appropriate standards to follow regarding soft dollar arrangements for all investment advisers operating in Ohio. In particular, the Division is guided by **Securities Exchange Act Release No. 34-23170** (April 23, 1986) which may be viewed by going to www.securities.state.oh.us, “Resources”, then “Selected SEC Releases.”

The Division especially emphasizes the following in regard to soft dollar arrangements:

- Investment advisers engaging in soft dollar arrangements must comply with all applicable disclosure requirements, and disclosure is required even if an arrangement is within the safe harbor provided by section 28(e);

2. Although an investment adviser need not solicit competitive bids on each transaction, an investment adviser should periodically and systematically evaluate the execution performance of broker-dealers executing their transactions; and

- Where an investment adviser is affiliated with or has a relationship with the brokerage firm executing the transaction, and a commission higher than the lowest available rate is paid, the adviser's burden of showing that it acted solely in the interest of the client is particularly heavy.

Aggregation of Client Orders.

In directing orders for the purchase or sale of securities to a broker-dealer for execution, an adviser may aggregate or "bunch" those orders on behalf of two or more of its accounts, so long as the bunching is done for purposes of achieving best execution, and no client is systematically advantaged or disadvantaged by the bunching. An investment adviser may include accounts in which it or its officers or employees have an interest in a bunched order. Investment advisers must have procedures in place that are designed to ensure that the trades are allocated in such a manner that all clients are treated fairly and equitably.

Principal Transactions; Agency Cross Transactions; Cross Trades.

R.C. 1707.44(M)(1)(c) prohibits an investment adviser or an investment adviser representative, acting as principal for their own account, from knowingly selling any security to or purchasing any security from a client ("principal transaction"), without notifying the client in writing, and obtaining the client's consent before the completion of the transaction. The Division shares the view of the Commission that a transaction is “completed” upon its settlement. Thus, consent may be obtained prior to execution or prior to settlement (*See* **Commission Release IA-1732** which may be viewed at www.securities.state.oh.us, “Resources”, then “Selected SEC Releases”)**.** Notification and consent for principal transactions must be obtained separately for each transaction. However, this prohibition does not apply to any investment adviser registered with the Commission, or to any transaction with a customer of a licensed dealer or salesperson who is not acting as an investment adviser or investment adviser representative in relation to the transaction.

For investment advisers licensed or required to be licensed by the Division and their investment adviser representatives, Ohio Administrative Code 1301:6-3-44(G) permits an adviser to act as broker for both its advisory client and the party on the other side of the brokerage transaction ("agency cross transaction"), without obtaining the client's

prior consent to each transaction, provided that the adviser obtains a prior consent for these types of transactions from the client, and complies with other, enumerated conditions. The rule does not relieve advisers of their duties to obtain best execution and best price for any transaction. A principal or agency cross transaction executed by an affiliate of an adviser is deemed to have been executed by the adviser for purposes of R.C. 1707.44(M)(1) and Ohio Administrative Code 1301:6-3-44(G).

While an agency cross transaction involves an advisory client and a non-advisory client, a “cross trade” describes the circumstance where an adviser executes a transaction between advisory clients. The Division shares the view of the Commission that, in executing a cross trade, if an adviser receives no compensation (other than its advisory fee), directly or indirectly, for effecting a particular cross trade between advisory clients, the adviser will not be “acting as a salesperson” within the meaning of R.C. 1707.44(M)(1)(c). However, full disclosure of such cross trade is required, and the adviser must ensure that the cross trade achieves best execution and does not disfavor any client.

Trading Procedures and Duty of Supervision.

Ohio Administrative Code 1301:6-3-15.1(F) requires investment advisers licensed by the Division to establish, maintain and enforce written policies and procedures reasonably designed to prevent the misuse of material, nonpublic information by the investment adviser or any of its investment adviser representatives. In addition, Ohio Administrative Code 1301:6-3-15.1(D) imposes a general duty of supervision on an investment adviser licensed by the Division.

Books and Records Maintenance & Retention Requirements.

Ohio Administrative Code 1301:6-3-15.1(E) requires investment advisers licensed by the Division to make and keep certain books and records. With some exceptions, pursuant to section 222(b) of the Investment Advisers Act of 1940, these books and records requirements apply only to those investment advisers that are licensed by the Division and have their principal place of business in Ohio. Under OAC 1301:6-3-15.1(E), these books and records are subject to examination by the Division.

In general, there are three categories of books and records that must be maintained. Category One applies to all investment advisers. Category Two applies to investment advisers that have custody of client monies or securities. Category Three applies only to investment advisers that manage client assets.

Category One (Ohio Administrative Code 1301:6-3-15.1(E)(1)) consists of the following eighteen items: (1) general journals (including at least a cash receipt journal and a cash disbursements journal); (2) general ledger; (3) order memoranda (for brokerage orders); (4) bank records; (5) bills and statements; (6) trial balances and financial records; (7) written communications (business correspondence sent and received); (8) list of discretionary accounts; (9) powers (*e.g.* powers of attorney); (10) written agreements pertaining to the business of the adviser; (11) advertising; (12) representatives transaction record (a record of the personal securities transactions by advisory representatives); (13) principals transaction record (a record of the personal securities

transactions by principals of the firm who do not provide advisory services); (14) record of disclosure statements (including the dates they were provided); (15) solicitor documents (disclosure statements and client acknowledgments); (16) backup for performance claims; (17) list of all claims; and (18) advisory contracts.

Category Two (Ohio Administrative Code 1301:6-3-15.1(E)(2)), which must be maintained in addition to Category One if an investment adviser has custody or possession of client's securities or funds, consists of the following five items: (1) journal of all securities transactions, movements, debits and credits (a chronological blotter); (2) separate ledgers for each client; (3) copies of confirmations; (4) a record, by security, showing each client's interest and location; and (5) the accountant's certificate referenced in OAC 1301:6-3-44(B)(1)(c)(ii).

Category Three (Ohio Administrative Code 1301:6-3-15.1(E)(3)), which must be maintained in addition to Categories One and Two if an investment adviser renders supervisory or management services to any client, consists of the following two records: (1) a record, by client, showing purchases and sales; and (2) a record, by security, showing each client's position.

Pursuant to Ohio Administrative Code 1301:6-3-15.1(E)(5), the required books and records must be maintained for not less than five years, the first two years in an appropriate office of the investment adviser, and subsequently in an easily accessible place. The retention period begins at the end of the fiscal year during which the last entry was made on the record.

Ohio Administrative Code 1301:6-3-15.1 requires that all books and records be kept current. The Division shares the view of the Commission that primary records of transactions such as invoices, logs, confirmations, certain journals and other memoranda must be created concurrently with the transaction or as soon as practicable thereafter. Primary records of transactions must be kept up-to-date at all times.

Further, secondary records such as ledgers or other comparable records to which transactional data are posted, must be updated at least quarterly, and if the needs of the business require it, updates should occur more frequently. Under no circumstances should these records be updated less frequently than quarterly.

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[i] The adviser’s performance figures must be presented net of fees and expenses. A written explanation of the existence and amount of fees and expenses does not suffice to meet this requirement.