

JOHN R. MCGINLEY, JR., ESQ., CHAIRMAN  
ALVIN C. BUSH, VICE CHAIRMAN  
ARTHUR COCCODRILLI  
ROBERT J. HARBISON, III  
JOHN F. MIZNER, ESQ.  
ROBERT E. NYCE, EXECUTIVE DIRECTOR  
MARY S. WYATTE, CHIEF COUNSEL



PHONE: (717) 783-5417  
FAX: (717) 783-2664  
irrc@irrc.state.pa.us  
<http://www.irrc.state.pa.us>

**INDEPENDENT REGULATORY REVIEW COMMISSION**  
333 MARKET STREET, 14TH FLOOR, HARRISBURG, PA 17101

July 6, 2000

Honorable Robert M. Lam, Chairman  
Pennsylvania Securities Commission  
Eastgate Office Building  
1010 North Seventh Street, 2<sup>nd</sup> Floor  
Harrisburg, PA 17102

Re: IRRC Regulation #50-114 (#2107)  
Pennsylvania Securities Commission  
Registration of Securities; Investment Adviser Representatives; and Administration

Dear Chairman Lam:

Enclosed are our Comments on the subject regulation. They are also available on our website at <http://www.irrc.state.pa.us>.

Our Comments list objections and suggestions for consideration when you prepare the final version of this regulation. We have also specified the regulatory criteria which have not been met. These Comments are not a formal approval or disapproval of the proposed version of this regulation.

If you would like to discuss these Comments, please contact James M. Smith at 783-5439.

Sincerely,

Robert E. Nyce  
Executive Director

wbg

Enclosure

cc: G. Philip Rutledge  
Rebecca Alford  
Office of General Counsel  
Office of Attorney General  
Lee Ann Labecki

**Comments of the Independent Regulatory Review Commission**

**on**

**Pennsylvania Securities Commission Regulation No. 50-114**

**Registration of Securities; Investment Adviser Representatives; and  
Administration**

**July 6, 2000**

We submit for your consideration the following objections and recommendations regarding this regulation. Each objection or recommendation includes a reference to the criteria in the Regulatory Review Act (71 P.S. § 745.5a(h) and (i)) which has not been met. The Pennsylvania Securities Commission (PSC) must respond to these Comments when it submits the final-form regulation. If the final-form regulation is not delivered by June 5, 2002, the regulation will be deemed withdrawn.

**1. Section 303.012. Investment adviser registration procedure. – Clarity.**

*Subsection (a) Registration depository*

This subsection requires forms to be filed with PSC or with a central repository designated by order of PSC. There are similar requirements in Sections 303.014, 303.015 and 306.061. The comments of the Investment Council Association of America, Inc. (ICAA) indicated the phrase “central registration depository” could be confused with the Central Registration Depository. PSC should explain what repository will be designated by order of PSC, and how notice will be given to the affected parties.

*Subsection (b) Audited balance sheet*

The Investment Company Institute (ICI) and the Financial Planning Association (FPA) commented the \$500 threshold to file an audited balance sheet in Paragraph (1) should be \$1,200 to be consistent with changes made by the Securities and Exchange Commission (SEC). PSC should increase the threshold to \$1,200 or explain why the \$500 threshold is appropriate.

Paragraph (1) requires an applicant to include an audited balance sheet under certain conditions. ICI and FPA suggest allowing out-of-state investment advisers to file copies of their home state audited balance sheet. Where out-of-state filing requirements are the same as Pennsylvania’s requirements, PSC should consider allowing copies.

Paragraph (2) appears to have a typographical error. It should state “...as of a date....”

**2. Section 303.014. Investment adviser representative registration procedures. – Need; Clarity.**

*Subsections (a) and (b) Federally covered advisers*

ICI commented these subsections should also apply to Federally covered advisers. PSC should amend the regulation to clarify the scope of these subsections.

*Subsection (b) Filing of forms*

In this subsection, ICI doesn't believe both the investment adviser and the investment adviser representative should have to file amendments to Form U-4. ICI believes "or" should be used to eliminate duplicative filings. PSC should explain why both filings are needed.

**3. Section 303.015. Notice filing for Federally covered advisers. – Economic Impact; Need; Clarity.**

*Subsection (b) Annual filings*

ICI commented the Investment Adviser Registration Depository (IARD) does not require a full filing each year. Only Items 2(A) and 5(F) of Part 1A of Form ADV are required. PSC should amend the regulation to be consistent with IARD or explain the need for a full filing each year.

**4. Section 303.021. Registration and notice filing procedures for successors to a broker-dealer, investment adviser or Federally covered adviser. – Reasonableness.**

*Subsection (c) Registered investment advisers*

ICI commented that registered investment advisers should be added to this subsection. PSC should add them or explain why registered investment advisers were not included.

**5. Section 303.032. Examination requirements for investment advisers and investment adviser representatives. – Economic Impact; Need; Reasonableness; Clarity.**

*Subsection (a) Out-of-state registrants*

ICI and FPA commented Subsections (a)(1) and (2) will require out-of-state registrants to re-take examinations after two years, which is inconsistent with the North American Securities Administrators Association, Inc. (NASAA) Model Rule. They suggest rewording the regulation to clarify how the two-year limit applies to out-of-state registrants. PSC should explain the intent of Subsections (a)(1) and (2).

*Subsection (c) Waivers of examination requirements*

FPA commented that Certified Public Accountants (CPA) and Attorneys should not qualify for waiver from examination requirements under Subsection (c). FPA believes the CPA and the bar examinations do not test the same information as the Series 65 examination. PSC should explain why CPAs and attorneys qualify for waivers.

The Certified Financial Planners Board of Standards commented the NASAA model rule has been updated, and the appropriate board in Section (c)(1)(ii)(A) is the Certified Financial Planner Board of Standards, Inc. PSC should review Section (c)(1)(ii)(A) for consistency with the NASAA model rule.

## **6. Section 303.042. Investment adviser capital requirements. – Reasonableness.**

### *Subsection (a)(5) Net worth requirements*

This subsection requires an investment adviser who meets certain conditions to maintain a positive net worth at all times. This provision applies when:

- The adviser’s principal place of business is in Pennsylvania; and
- The adviser accepts prepayment of advisory fees more than six months in advance and in an amount of more the \$500 per client.

This provision is consistent with the NASAA Model Rule on Capital and Bonding Requirements of Investment Advisers. However, ICI and FPA commented that the Federal SEC is proposing to increase the \$500 threshold to \$1200 for Federally registered advisers. PSC should increase the threshold to \$1,200 or explain why the \$500 threshold is appropriate.

### *Subsection (d) Appraisal of assets*

Under this subsection, PSC “may” require an appraisal to determine the net worth of an asset under the net worth formulation. The conditions which would trigger the appraisal requirement are not included in the regulation. We request PSC explain when an appraisal would be required.

## **7. Section 303.051. Surety bonds. – Reasonableness; Clarity.**

### *Subsection (a)(1) Bonding requirement*

This subsection provides that an investment adviser who does not meet the minimum net worth requirements “may” be required to maintain a surety bond to cover the net worth deficiency. Section 202(e)-1(a)(2) of the NASAA model rule on “Bonding Requirements for Certain Investment Advisers” states that the investment advisers who do not meet the minimum net worth requirements “shall” be bonded. We request PSC explain why the requirements in the proposed regulation and the model rule are different and under what circumstances a bond would not be necessary.

### *Subsection (c) Evidence*

Under this subsection, a broker-dealer or investment adviser “shall provide evidence of the existence of a surety bond” at PSC’s request. Under what circumstances would PSC make this request?

**8. Section 304.012. Investment adviser required records. – Consistency with the statute; Clarity.**

*Subsection (a) Recordkeeping*

Subsection (a) contains an extensive list of recordkeeping requirements. In its comments, ICI pointed out that Subsection (j) lists the instances in which the recordkeeping requirements do not apply. ICI suggested that the exemptions in Subsection (j) be referenced in Subsection (a). For improved clarity, PSC should add this reference to Subsection (a).

Subsections (a)(12)(iv) and (a)(13)(v) both contain definitions of “investment adviser representative.” Although these definitions are consistent with the NASSA Model Rule, they are inconsistent with the definition of “investment adviser representative” in the Pennsylvania Securities Act (70 P.S. § 1-102(j.1)). We object to a definition that is inconsistent with the statutory definition. If PSC does not reference the statutory definition of this term in the final regulation, it should justify any changes made to the definition.

**9. Section 304.052. Investment adviser compensation. – Clarity.**

*Disclosure of charges*

This section requires investment advisers to “adequately” disclose their charges for providing investment advice in writing to each client. For improved clarity, PSC should specify what constitutes “adequate” disclosure.

**10. Section 305.011. Supervision of agents, investment adviser representatives and employes. – Clarity.**

*Subsection (a) Supervision requirements*

In Subsection (a)(1) the term “timely” is used to require broker-dealers and investment advisers to “timely detect and prevent any violations of statutes, rules regulations or orders ....” The term “timely” is vague. PSC should consider establishing a specific period of time.

*Subsection (c) Out-of-state investment advisers*

This subsection establishes the requirements for written procedures. In its comments, ICI expressed concern regarding imposing recordkeeping requirements on out-of-state investment advisers when the investment advisers are registered in the state where they maintain a place of business. For improved clarity, PSC should add language that clarifies what requirements apply to out-of-state investment advisers.

*Subsection (c) Recordkeeping*

Subsections (c)(9) and (c)(10)(iii) require written records to be maintained. However, the requirements do not specify the amount of time that the records should be kept. PSC should clarify in these two subsections how long the written records must be maintained.

**11. Section 305.061. Withdrawal of registration or notice filing. – Clarity.**

*Form filing*

Subsection (c) provides that a Federally covered adviser is to file Form ADV-W to withdraw a notice filing. In its comments, ICAA suggests that PSC amend the language to allow for the electronic version of the form to be filed. To avoid confusion, the regulation should list the acceptable methods by which the forms may be submitted.

**12. Section 404.011. Investment adviser brochure disclosure. and Section 404.012. Wrap fee brochure disclosure. – Clarity.**

*Disclosure*

These sections establish the disclosure that investment advisers must provide to their clients. In its comments, ICI recommends that PSC incorporate the proposed changes to the Federal rules which govern an adviser's disclosure obligations. To avoid potential confusion and to avoid the final regulation being inconsistent with Federal rules, we suggest PSC monitor SEC action on this issue, and if the SEC rules are finalized, amend the final regulation to be consistent with Federal rule changes.