
2025 PIABA Mid-Year Meeting

RIAS NEED TO SUPERVISE TOO!

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Registered Investment Adviser Supervisory Obligations

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Discussion Outline:

a. What are the supervisory Obligations of Registered Investment Advisers?

- a. Discussion will compare and contrast federal and state laws and comment on the relevancy of each in a case. Discussion will also reference differences between FINRA Rules.

For example: IA Firms have a duty of supervision imposed by Rule 206(4)-7, adopted under the Investment Advisers Act of 1940 which requires that each investment adviser registered with the Commission adopt and implement written policies and procedures reasonably designed to prevent violation of the federal securities laws, review those policies and procedures annually for their adequacy and the effectiveness of their implementation, and designate a chief compliance officer to be responsible for administering the policies and procedures.

Red flags may be viewed as indicators that should alert a person familiar with the operations of a securities firm that further investigation of specific conduct is necessary to protect against the transgression of established standards. Red flags have routinely been described as “indications of violations” or “suggestions of irregularities.” Once such an indication or suggestion manifests itself, the need for prompt action arises. As stated by the Commission in *Kantor*:

Red flags and suggestions of irregularities demand inquiry as well as adequate follow-up and review. When indications of impropriety reach the attention of those in authority, they must act decisively to detect and prevent violations of the federal securities laws.

In the Matter of Edwin Kantor, 51 S.E.C. 440, Rel. No. 32341 (May 20, 1993).

Moreover, “Reliance on the unverified representations of supervised employees can provide a basis for a finding of deficient supervision.” See *In the Matter of Sandra Logay*, Init. Dec. Release No. 159 (Jan. 28, 2000) (finding that the supervisor had not discharged her obligations from a supervisory perspective when she merely quizzed the broker and relied on his unverified assurances); citing *In re John H. Gutfreund*, 51 S.E.C. at 108; and *Shearson Lehman Hutton, Inc.*, 49 S.E.C. at 1123 (1989). See also *Quest Capital Strategies*, 76 S.E.C. Docket No. 109, Exchange Act Release No. 44935 (October 15, 2001) at 6 (noting that the Commission has “repeatedly stressed that supervisors cannot rely on the unverified representations of their subordinates”).

Many states have additional guidance on supervisory obligations of IA Firms. For example, the Kansas Securities Division has issued guidance on how an investment advisory firm should conduct itself.

Transaction Review, K.A.R. 81-14-4(b)(3)(A); Advisers that execute securities trades for clients should conduct a periodic review of transactions for proper execution and suitability.

See Investment Adviser Guidelines, at *8, a copy of which is attached in the written materials. Advisers also need to supervise correspondence with customers and perform periodic audits of remote offices. *Id.* at *8 -9. Likewise, investment advisory firms must supervise new account approval:

New Account Approval, K.A.R. 81-14-5(d)(1); Advisers should have specific procedures for review and approval of all new client accounts by a supervisor. The supervisor should review new account documents to ensure that sufficient financial background and investment objective information has been gathered. A determination should be made as to whether the client is suitable for the services recommended, and whether the client meets the adviser's minimum net worth or account size standards.

Id. at *9-10. Finally, "Advisers should periodically review the activity in each client account to be sure that it is consistent with the client's investment objectives and financial profile. The adviser's procedures should indicate the schedule for these reviews." *Id.* at *10.

b. How do these supervisory obligations fit into cause of action?

a. **Discussion will relate to standards of care and private causes of action.**

b. **Liability under federal Investment Advisor's Act vs various state law remedies.**

c. How to Frame Your Case and Pitfalls:

a. **Claimant's Perspective** – Best Practices for framing your case, led by Courtney Werning.

b. **Expert's Perspective** – How to review and examine an IA firm's supervisory system.

c. **Compliance and Defense Perspective** – How these cases are defended and common problems with Claimants' cases.



3110. Supervision

(a) Supervisory System

Each member shall establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. Final responsibility for proper supervision shall rest with the member. A member's supervisory system shall provide, at a minimum, for the following:

(1) The establishment and maintenance of written procedures as required by this Rule.

(2) The designation, where applicable, of an appropriately registered principal(s) with authority to carry out the supervisory responsibilities of the member for each type of business in which it engages for which registration as a broker-dealer is required.

(3) The registration and designation as a branch office or an office of supervisory jurisdiction (OSJ) of each location, including the main office, that meets the definitions contained in paragraph (f) of this Rule.

(4) The designation of one or more appropriately registered principals in each OSJ and one or more appropriately registered representatives or principals in each non-OSJ branch office with authority to carry out the supervisory responsibilities assigned to that office by the member.

(5) The assignment of each registered person to an appropriately registered representative(s) or principal(s) who shall be responsible for supervising that person's activities.

(6) The use of reasonable efforts to determine that all supervisory personnel are qualified, either by virtue of experience or training, to carry out their assigned responsibilities.

(7) The participation of each registered representative and registered principal, either individually or collectively, no less than annually, in an interview or meeting conducted by persons designated by the member at which compliance matters relevant to the activities of the representative(s) and principal(s) are discussed. Such interview or meeting may occur in conjunction with the discussion of other matters and may be conducted at a central or regional location or at the representative's(') or principal's(') place of business.

(b) Written Procedures

(1) General Requirements

Each member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and the activities of its associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.

(2) Review of Member's Investment Banking and Securities Business

The supervisory procedures required by this paragraph (b) shall include procedures for the review by a registered principal, evidenced in writing, of all transactions relating to the investment banking or securities business of the member.

(3) Reserved.

(4) Review of Correspondence and Internal Communications

The supervisory procedures required by this paragraph (b) shall include procedures for the review of incoming and outgoing written (including electronic) correspondence and internal communications relating to the member's investment banking or securities business. The supervisory procedures must be appropriate for the member's business, size, structure, and customers. The supervisory procedures must require the member's review of:

(A) incoming and outgoing written (including electronic) correspondence to properly identify and handle in accordance with firm procedures, customer complaints, instructions, funds and securities, and communications that are of a subject matter that require review under FINRA rules and federal securities laws.

(B) internal communications to properly identify those communications that are of a subject matter that require review under FINRA rules and federal securities laws.

Reviews of correspondence and internal communications must be conducted by a registered principal and must be evidenced in writing, either electronically or on paper.

(5) Review of Customer Complaints

The supervisory procedures required by this paragraph (b) shall include procedures to capture, acknowledge, and respond to all written (including electronic) customer complaints.

(6) Documentation and Supervision of Supervisory Personnel

The supervisory procedures required by this paragraph (b) shall set forth the supervisory system established by the member pursuant to paragraph (a) above, and shall include:

(A) the titles, registration status, and locations of the required supervisory personnel and the responsibilities of each supervisory person as these relate to the types of business engaged in, applicable securities laws and regulations, and FINRA rules.

(B) a record, preserved by the member for a period of not less than three years, the first two years in an easily accessible place, of the names of all persons who are designated as supervisory personnel and the dates for which such designation is or was effective.

(C) procedures prohibiting associated persons who perform a supervisory function from:

(i) supervising their own activities; and

(ii) reporting to, or having their compensation or continued employment determined by, a person or persons they are supervising.

a. If a member determines, with respect to any of its supervisory personnel, that compliance with subparagraph (i) or (ii) above is not possible because of the member's size or a supervisory personnel's position within the firm, the member must document:

1. the factors the member used to reach such determination; and

2. how the supervisory arrangement with respect to such supervisory personnel otherwise complies with paragraph (a) of this Rule.

(D) procedures reasonably designed to prevent the supervisory system required pursuant to paragraph (a) of this Rule from being compromised due to the conflicts of interest that may be present with respect to the associated person being supervised, including the position of such person, the revenue such person generates for the firm, or any compensation that the associated person conducting the supervision may derive from the associated person being supervised.

(7) Maintenance of Written Supervisory Procedures

A copy of a member's written supervisory procedures, or the relevant portions thereof, shall be kept and maintained in each OSJ and at each location where supervisory activities are conducted on behalf of the member. Each member shall promptly amend its written supervisory procedures to reflect changes in applicable securities laws or regulations, including FINRA rules, and as changes occur in its supervisory system. Each member is responsible for promptly communicating its written supervisory procedures and amendments to all associated persons to whom such written supervisory procedures and amendments are relevant based on their activities and responsibilities.

(c) Internal Inspections

(1) Each member shall conduct a review, at least annually (on a calendar-year basis), of the businesses in which it engages. The review shall be reasonably designed to assist the member in detecting and preventing violations of, and achieving compliance with, applicable securities laws and regulations, and with applicable FINRA rules. Each member shall review the activities of each office, which shall include the periodic examination of customer accounts to detect and prevent irregularities or abuses. Each member shall also retain a written record of the date upon which each review and inspection is conducted.

(A) Each member shall inspect at least annually (on a calendar-year basis) every OSJ and any branch office that supervises one or more non-branch locations.

(B) Each member shall inspect at least every three years every branch office that does not supervise one or more non-branch locations. In establishing how often to inspect each non-supervisory branch office, the member shall consider whether the nature and complexity of the securities activities for which the location is responsible, the volume of business done at the location, and the number of associated persons assigned to the location require the non-supervisory branch office to be inspected more frequently than every three years. If a member establishes a more frequent inspection cycle, the member must ensure that at least every three years, the inspection requirements enumerated in paragraph (c)(2) have been met. The member's written supervisory and inspection procedures shall set forth the non-supervisory branch office examination cycle, an explanation of the factors the member used in determining the frequency of the examinations in the cycle, and the manner in which a member will comply with paragraph (c)(2) if using more frequent inspections than every three years.

(C) Each member shall inspect on a regular periodic schedule every non-branch location. In establishing such schedule, the member shall consider the nature and complexity of the securities activities for which the location is responsible and the nature and extent of contact with customers. The member's written supervisory and inspection procedures shall set forth the schedule and an explanation regarding how the member determined the frequency of the examination.

(2) An inspection and review by a member pursuant to paragraph (c)(1) must be reduced to a written report and kept on file by the member for a minimum of three years, unless the inspection is being conducted pursuant to paragraph (c)(1)(C) and the regular periodic schedule is longer than a three-year cycle, in which case the report must be kept on file at least until the next inspection report has been written.

(A) If applicable to the location being inspected, that location's written inspection report must include, without limitation, the testing and verification of the member's policies and procedures, including supervisory policies and procedures in the following areas:

(i) safeguarding of customer funds and securities;

(ii) maintaining books and records;

(iii) supervision of supervisory personnel;

(iv) transmittals of funds (e.g., wires or checks, etc.) or securities from customers to third party accounts; from customer accounts to outside entities (e.g., banks, investment companies, etc.); from customer accounts to locations other than a customer's primary residence (e.g., post office box, "in care of" accounts, alternate address, etc.); and between customers and registered representatives, including the hand-delivery of checks; and

(v) changes of customer account information, including address and investment objectives changes and validation of such changes.

(B) The policies and procedures required by paragraph (c)(2)(A)(iv) must include a means or method of customer confirmation, notification, or follow-up that can be documented. Members may use reasonable risk-based criteria to determine the authenticity of the transmittal instructions.

(C) The policies and procedures required by paragraph (c)(2)(A)(v) must include, for each change processed, a means or method of customer confirmation, notification, or follow-up that can be documented and that complies with SEA Rules 17a-3(a)(17)(i)(B)(2) and 17a-3(a)(17)(i)(B)(3).

(D) If a member does not engage in all of the activities enumerated in paragraphs (c)(2)(A)(i) through (c)(2)(A)(v) at the location being inspected, the member must identify those activities in the member's written supervisory procedures or the location's written inspection report and document in the member's written supervisory procedures or the location's written inspection report that supervisory policies and procedures for such activities must be in place at that location before the member can engage in them.

(3) For each inspection conducted pursuant to paragraph (c), a member must:

(A) have procedures reasonably designed to prevent the effectiveness of the inspections required pursuant to paragraph (c)(1) of this Rule from being compromised due to the conflicts of interest that may be present with respect to the location being inspected, including but not limited to, economic, commercial, or financial interests in the associated persons and businesses being inspected; and

(B) ensure that the person conducting an inspection pursuant to paragraph (c)(1) is not an associated person assigned to the location or is not directly or indirectly supervised by, or otherwise reporting to, an associated person assigned to the location.

(C) If a member determines that compliance with paragraph (c)(3)(B) is not possible either because of a member's size or its business model, the member must document in the inspection report both the factors the member used to make its determination and how the inspection otherwise complies with paragraph (c)(1).

(d) Transaction Review and Investigation

(1) Each member shall include in its supervisory procedures a process for the review of securities transactions that are reasonably designed to identify trades that may violate the provisions of the Exchange Act, the rules thereunder, or FINRA rules prohibiting insider trading and manipulative and deceptive device that are effected for the:

(A) accounts of the member;

(B) accounts introduced or carried by the member in which a person associated with the member has a beneficial interest or the authority to make investment decisions;

(C) accounts of a person associated with the member that are disclosed to the member pursuant to [Rule 3210](#); and

(D) covered accounts.

(2) Each member must conduct promptly an internal investigation into any such trade to determine whether a violation of those laws or rules has occurred.

(3) A member engaging in investment banking services must file with FINRA, written reports, signed by a senior officer of the member, at such times and, without limitation, including such content, as follows:

(A) within ten business days of the end of each calendar quarter, a written report describing each internal investigation initiated in the previous calendar quarter pursuant to paragraph (d)(2), including the identity of the member, the date each internal investigation commenced, the status of each open internal investigation, the resolution of any internal investigation reached during the previous calendar quarter, and, with respect to each internal investigation, the identity of the security, trades, accounts, associated persons of the member, or associated person of the member's family members holding a covered account, under review, and that includes a copy of the member's policies and procedures required by paragraph (d)(1).

(B) within five business days of completion of an internal investigation pursuant to paragraph (d)(2) in which it was determined that a violation of the provisions of the Exchange Act, the rules thereunder, or FINRA rules prohibiting insider trading and manipulative and deceptive devices had occurred, a written report detailing the completion of the investigation, including the results of the investigation, any internal disciplinary action taken, and any referral of the matter to FINRA, another self-regulatory organization, the SEC, or any other federal, state, or international regulatory authority.

(4) Definitions

For purposes of this Rule:

(A) The term "covered account" shall include any account introduced or carried by the member that is held by:

(i) the spouse of a person associated with the member;

(ii) a child of the person associated with the member or such person's spouse, provided that the child resides in the same household as or is financially dependent upon the person associated with the member;

(iii) any other related individual over whose account the person associated with the member has control; or

(iv) any other individual over whose account the associated person of the member has control and to whose financial support such person materially contributes.

(B) The term "investment banking services" shall include, without limitation, acting as an underwriter, participating in a selling group in an offering for the issuer, or otherwise acting in furtherance of a public offering of the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital or equity lines of credit or serving as placement agent for the issuer or otherwise acting in furtherance of a private offering of the issuer.

(e) Responsibility of Member to Investigate Applicants for Registration

Each member shall ascertain by investigation the good character, business reputation, qualifications and experience of an applicant before the member applies to register that applicant with FINRA and before making a representation to that effect on the application for registration.

If the applicant previously has been registered with FINRA or another self-regulatory organization, the member shall review a copy of the applicant's most recent Form U5, including any amendments thereto, within 60 days of the filing date of an application for registration, or demonstrate to FINRA that it has made reasonable efforts to do so. In conducting its review of the Form U5, the member shall take such action as may be deemed appropriate.

The member shall also review an applicant's employment experience to determine if the applicant has been recently employed by a Futures Commission Merchant or an Introducing Broker that is notice-registered with the SEC pursuant to Section 15(b)(11) of the Exchange Act. In such a case, the member shall also review a copy of the applicant's most recent CFTC Form 8-T, including any amendments thereto, within 60 days of the

filing date of an application for registration, or demonstrate to FINRA that it has made reasonable efforts to do so. In conducting its review of a Form 8-T, the member shall take such action as may be deemed appropriate.

In addition, each member shall establish and implement written procedures reasonably designed to verify the accuracy and completeness of the information contained in an applicant's initial or transfer Form U4 no later than 30 calendar days after the form is filed with FINRA. Such procedures shall, at a minimum, provide for a search of reasonably available public records to be conducted by the member, or a third-party service provider, to verify the accuracy and completeness of the information contained in the applicant's initial or transfer Form U4.

(f) Definitions

(1) "Office of Supervisory Jurisdiction" means any office of a member at which any one or more of the following functions take place:

(A) order execution or market making;

(B) structuring of public offerings or private placements;

(C) maintaining custody of customers' funds or securities;

(D) final acceptance (approval) of new accounts on behalf of the member;

(E) review and endorsement of customer orders, pursuant to paragraph (b)(2) above;

(F) final approval of retail communications for use by persons associated with the member, pursuant to [Rule 2210\(b\)\(1\)](#), except for an office that solely conducts final approval of research reports; or

(G) responsibility for supervising the activities of persons associated with the member at one or more other branch offices of the member.

(2)

(A) A "branch office" is any location where one or more associated persons of a member regularly conducts the business of effecting any transactions in, or inducing or attempting to induce the purchase or sale of, any security, or is held out as such, excluding:

- (i) Any location that is established solely for customer service or back office type functions where no sales activities are conducted and that is not held out to the public as a branch office;
- (ii) Any location that is the associated person's primary residence; provided that
 - a. Only one associated person, or multiple associated persons who reside at that location and are members of the same immediate family, conduct business at the location;
 - b. The location is not held out to the public as an office and the associated person does not meet with customers at the location;
 - c. Neither customer funds nor securities are handled at that location;
 - d. The associated person is assigned to a designated branch office, and such designated branch office is reflected on all business cards, stationery, retail communications and other communications to the public by such associated person;
 - e. The associated person's correspondence and communications with the public are subject to the firm's supervision in accordance with this Rule;
 - f. Electronic communications (e.g., e-mail) are made through the member's electronic system;
 - g. All orders are entered through the designated branch office or an electronic system established by the member that is reviewable at the branch office;
 - h. Written supervisory procedures pertaining to supervision of sales activities conducted at the residence are maintained by the member; and
 - i. A list of the residence locations is maintained by the member;
- (iii) Any location, other than a primary residence, that is used for securities business for less than 30 business days in any one calendar year, provided the member complies with the provisions of subparagraphs (2)(A)(ii)a. through h. above;
- (iv) Any office of convenience, where associated persons occasionally and exclusively by appointment meet with customers, which is not held out to the public as an office; *
- (v) Any location that is used primarily to engage in non-securities activities and from which the associated person(s) effects no more than 25 securities transactions in any one calendar year; provided that any retail communication identifying such location also sets forth the address and telephone number of the location from which the associated person(s) conducting business at the non-branch locations are directly supervised;
- (vi) The Floor of a registered national securities exchange where a member conducts a direct access business with public customers; or
- (vii) A temporary location established in response to the implementation of a business continuity plan.

(B) Notwithstanding the exclusions in subparagraph (2)(A), any location that is responsible for supervising the activities of persons associated with the member at one or more non-branch locations of the member is considered to be a branch office.

(C) The term "business day" as used in paragraph (f)(2)(A) of this Rule shall not include any partial business day provided that the associated person spends at least four hours on such business day at his or her designated branch office during the hours that such office is normally open for business.

••• Supplementary Material: -----

.01 Registration of Main Office. A member's main office location is required to be registered and designated as a branch office or OSJ if it meets the definitions of a "branch office" or "office of supervisory jurisdiction" as set forth in Rule 3110(f). In general, the nature of activities conducted at a main office will satisfy the requirements of such terms.

.02 Designation of Additional OSJs. In addition to the locations that meet the definition of OSJ in Rule 3110(f), each member shall also register and designate other offices as OSJs as is necessary to supervise its associated persons in accordance with the standards set forth in Rule 3110. In making a determination as to whether to designate a location as an OSJ, the member should consider the following factors:

- (a) whether registered persons at the location engage in retail sales or other activities involving regular contact with public customers;
- (b) whether a substantial number of registered persons conduct securities activities at, or are otherwise supervised from, such location;
- (c) whether the location is geographically distant from another OSJ of the firm;
- (d) whether the member's registered persons are geographically dispersed; and
- (e) whether the securities activities at such location are diverse or complex.

.03 Supervision of Multiple OSJs by a Single Principal. Rule 3110(a)(4) requires a member to designate one or more appropriately registered principals in each OSJ with the authority to carry out the supervisory responsibilities assigned to that office ("on-site principal"). The designated on-site principal for each OSJ must have a physical presence, on a regular and routine basis, at each OSJ for which the principal has supervisory responsibilities. Consequently, there is a general presumption that a principal will not be designated and assigned to be the on-site principal pursuant to Rule 3110(a)(4) to supervise more than one OSJ. If a member determines it is necessary to designate and assign one appropriately registered principal to be the on-site principal pursuant to Rule 3110(a)(4) to supervise two or more OSJs, the member must take into consideration, among others, the following factors:

- (a) whether the on-site principal is qualified by virtue of experience and training to supervise the activities and associated persons in each location;
- (b) whether the on-site principal has the capacity and time to supervise the activities and associated persons in each location;
- (c) whether the on-site principal is a producing registered representative;
- (d) whether the OSJ locations are in sufficiently close proximity to ensure that the on-site principal is physically present at each location on a regular and routine basis; and
- (e) the nature of activities at each location, including size and number of associated persons, scope of business activities, nature and complexity of products and services offered, volume of business done, the disciplinary history of persons assigned to such locations, and any other indicators of irregularities or misconduct.

The member must establish, maintain, and enforce written supervisory procedures regarding the supervision of all OSJs. In all cases where a member designates and assigns one on-site principal to supervise more than one OSJ, the member must document in the member's written supervisory and inspection procedures the factors used to determine why the member considers such supervisory structure to be reasonable and the determination by the member will be subject to scrutiny.

.04 Annual Compliance Meeting. A member is not required to conduct in-person meetings with each registered person or group of registered persons to comply with the annual compliance meeting (or interview) required by Rule 3110(a)(7). A member that chooses to conduct compliance meetings using other methods (e.g., on-demand webcast or course, video conference, interactive classroom setting, telephone, or other electronic means) must ensure, at a minimum, that each registered person attends the entire meeting (e.g., an on-demand annual compliance webcast would require each registered person to use a unique user ID and password to gain access and use a technology platform to track the time spent on the webcast, provide click-as-you go confirmation, and have an attestation of completion at the end of a webcast) and is able to ask questions regarding the presentation and receive answers in a timely fashion (e.g., an on-demand annual compliance webcast that allows registered persons to ask questions via an email to a presenter or a centralized address or via a telephone hotline and receive timely responses directly or view such responses on the member's intranet site).

.05 Risk-based Review of Member's Investment Banking and Securities Business. A member may use a risk-based review system to comply with Rule 3110(b)(2)'s requirement that a registered principal review, all transactions relating to the investment banking or securities business of the member. A member is not required to conduct detailed reviews of each transaction if a member is using a reasonably designed risk-based review system that provides a member with sufficient information that permits the member to focus on the areas that pose the greatest numbers and risks of violation.

.06 Risk-based Review of Correspondence and Internal Communications. By employing risk-based principles, a member must decide the extent to which additional policies and procedures for the review of:

(a) incoming and outgoing written (including electronic) correspondence that fall outside of the subject matters listed in Rule 3110(b)(4) are necessary for its business and structure. If a member's procedures do not require that all correspondence be reviewed before use or distribution, the procedures must provide for:

- (1) the education and training of associated persons regarding the firm's procedures governing correspondence;
- (2) the documentation of such education and training; and
- (3) surveillance and follow-up to ensure that such procedures are implemented and followed.

(b) internal communications that are not of a subject matter that require review under FINRA rules and federal securities laws are necessary for its business and structure.

.07 Evidence of Review of Correspondence and Internal Communications. The evidence of review required in Rule 3110(b)(4) must be chronicled either electronically or on paper and must clearly identify the reviewer, the internal communication or correspondence that was reviewed, the date of review, and the actions taken by the member as a result of any significant regulatory issues identified during the review. Merely opening a communication is not sufficient review.

.08 Delegation of Correspondence and Internal Communication Review Functions. In the course of the supervision and review of correspondence and internal communications required by Rule 3110(b)(4), a supervisor/principal may delegate certain functions to persons who need not be registered. However, the supervisor/principal remains ultimately responsible for the performance of all necessary supervisory reviews, irrespective of whether he or she delegates functions related to the review. Accordingly, supervisors/principals must take reasonable and appropriate action to ensure delegated functions are properly executed and should evidence performance of their procedures sufficiently to demonstrate overall supervisory control.

.09 Retention of Correspondence and Internal Communications. Each member shall retain the internal communications and correspondence of associated persons relating to the member's investment banking or securities business for the period of time and accessibility specified in SEA Rule 17a-4(b). The names of the persons who prepared outgoing correspondence and who reviewed the correspondence shall be ascertainable from the retained records, and the retained records shall be readily available to FINRA, upon request.

.10 Supervision of Supervisory Personnel. A member's determination that it is not possible to comply with paragraphs (b)(6)(C)(i) or (b)(6)(C)(ii) of Rule 3110 prohibiting supervisory personnel from supervising their own activities and from reporting to, or otherwise having compensation or continued employment determined by, a person or persons they are supervising generally will arise in instances where:

- (a) the member is a sole proprietor in a single-person firm;
- (b) a registered person is the member's most senior executive officer (or similar position); or
- (c) a registered person is one of several of the member's most senior executive officers (or similar positions).

.11 Use of Electronic Media to Communicate Written Supervisory Procedures. A member may use electronic media to satisfy its obligation to communicate its written supervisory procedures, and any amendment thereto, pursuant to Rule 3110(b)(7), provided that: (1) the written supervisory procedures have been promptly communicated to, and are readily accessible by, all associated persons to whom such supervisory procedures apply based on their activities and responsibilities through, for example, the member's intranet system; (2) all amendments to the written supervisory procedures are promptly posted to the member's electronic media; (3) associated persons are notified that amendments relevant to their activities and responsibilities have been made to the written supervisory procedures; (4) the member has reasonable procedures to monitor and maintain the security of the material posted to ensure that it cannot be altered by unauthorized persons; and (5) the member retains current and prior versions of its written supervisory procedures in compliance with the applicable record retention requirements of SEA Rule 17a-4(e)(7).

.12 Standards for Reasonable Review. In fulfilling its obligations under Rule 3110(c), each member must conduct a review, at least annually, of the businesses in which it engages. The review must be reasonably designed to assist in detecting and preventing violations of and achieving compliance with applicable securities laws and regulations and with FINRA rules. Each member shall establish and maintain supervisory procedures that must take into consideration, among other things, the firm's size, organizational structure, scope of business activities, number and location of the firm's offices, the nature and complexity of the products and services offered by the firm, the volume of business done, the number of associated persons assigned to a location, the disciplinary history of registered representatives or associated persons, and any indicators of irregularities or misconduct (i.e., "red flags"), etc. The procedures established and reviews conducted must provide that the quality of supervision at remote locations is sufficient to ensure compliance with applicable securities laws and regulations and with FINRA rules. A member must be especially diligent in establishing procedures and conducting reasonable reviews with respect to a non-branch location where a registered representative engages in securities activities. Based on the factors outlined above, members may need to impose reasonably designed supervisory procedures for certain locations or may need to provide for more frequent reviews of certain locations.

.13 General Presumption of Three-Year Limit for Periodic Inspection Schedules. Rule 3110(c)(1)(C) requires a member to inspect on a regular periodic schedule every non-branch location. In establishing a non-branch location inspection schedule, there is a general presumption that a non-branch location will be inspected at least every three years, even in the absence of any indicators of irregularities or misconduct (i.e., "red flags"). If a member establishes a longer periodic inspection schedule, the member must document in its written supervisory and inspection procedures the factors used in determining that a longer periodic inspection cycle is appropriate.

.14 Exception to Persons Prohibited from Conducting Inspections. A member's determination that it is not possible to comply with Rule 3110(c)(3)(B) with respect to who is not allowed to conduct a location's inspection will generally arise in instances where:

- (a) the member has only one office; or

(b) the member has a business model where small or single-person offices report directly to an OSJ manager who is also considered the offices' branch office manager.

.15 Temporary Program to Address Underreported Form U4 Information. FINRA is establishing a temporary program that will issue a refund to members of Late Disclosure Fees assessed for the late filing of responses to Form U4 Question 14M (unsatisfied judgments or liens) if the Form U4 amendment is filed between April 24, 2014 and December 1, 2015 and one of the following conditions is met: (1) the judgment or lien has been satisfied, and at the time it was unsatisfied, it was under \$5,000 and the date the judgment or lien was filed with a court (as reported on Form U4 Judgment/Lien DRP, Question 4.A.) was on or before August 13, 2012; or (2) the unsatisfied judgment or lien was satisfied within 30 days after the individual learned of the judgment or lien (as reported on Form U4 Judgment/Lien DRP, Question 4.B.). This program has a retroactive effective date of April 24, 2014, and it will automatically sunset on December 1, 2015. Members will not be able to use the program after December 1, 2015.

.16 Temporary Extension of Time to Complete Office Inspections. Each member obligated to complete an inspection of an office of supervisory jurisdiction, branch office or non-branch location in calendar year 2020 pursuant to, as applicable, paragraphs (c)(1)(A), (B) and (C) under Rule 3110, shall be deemed to have satisfied such obligation if the applicable inspection is completed on or before March 31, 2021.

.17 Temporary Relief to Allow Remote Inspections for Calendar Years 2020, 2021, 2022, 2023, and Through the Earlier of the Effective Date of the Remote Inspections Pilot Program, if Approved, or June 30, 2024.

(a) Use of Remote Inspections. Each member obligated to conduct an inspection of an office of supervisory jurisdiction, branch office or non-branch location in the calendar years specified in this supplementary material pursuant to, as applicable, paragraphs (c)(1)(A), (B) and (C) under Rule 3110 may, subject to the requirements of this Rule 3110.17, satisfy such obligation by conducting the applicable inspection remotely, without an on-site visit to the office or location. In accordance with Rule 3110.16, inspections for calendar year 2020 must have been completed on or before March 31, 2021. Inspections for calendar year 2021 must have been completed on or before December 31, 2021, for calendar year 2022, on or before December 31, 2022, and for calendar year 2023, on or before December 31, 2023. With respect to a member's obligation to conduct an inspection of an office or location in calendar year 2024, a member has the option to conduct those inspections remotely through the earlier of the effective date of the Remote Inspections Pilot Program proposed in File No. SR-FINRA-2023-007, if approved, or June 30, 2024. Notwithstanding Rule 3110.17, a member shall remain subject to the other requirements of Rule 3110(c).

(b) Written Supervisory Procedures for Remote Inspections. Consistent with a member's obligation under Rule 3110(b)(1), a member that elects to conduct its inspections remotely for any of the calendar years specified in this supplementary material must amend or supplement its written supervisory procedures to provide for remote inspections that are reasonably designed to assist in detecting and preventing violations of and achieving compliance with applicable securities laws and regulations, and with applicable FINRA rules. Reasonably designed procedures for conducting remote inspections of offices or locations should include, among other things: (1) a description of the methodology, including technologies permitted by the member, that may be used to conduct remote inspections; and (2) the use of other risk-based systems employed generally by the member firm to identify and prioritize for review those areas that pose the greatest risk of potential violations of applicable securities laws and regulations, and of applicable FINRA rules.

(c) Effective Supervisory System. The requirement to conduct inspections of offices and locations is one part of the member's overall obligation to have an effective supervisory system and therefore, the member must continue with its ongoing review of the activities and functions occurring at all offices and locations, whether or not the member conducts inspections remotely. A member's use of a remote inspection of an office or location will be held to the same standards for review as set forth under Rule 3110.12. Where a member's remote inspection of an office or location identifies any indicators of irregularities or misconduct (i.e., "red flags"), the member may need to impose additional supervisory procedures for that office or location or may need to provide for more frequent monitoring of that office or location, including potentially a subsequent physical, on-site visit on an announced or unannounced basis. The temporary relief provided by this Rule 3110.17 does not extend to a member's inspection requirements beyond the earlier of the effective date of the Remote Inspections Pilot Program proposed in File No. SR-FINRA-2023-007, if approved, or June 30, 2024, and such inspections must be conducted in compliance with Rule 3110(c).

(d) Documentation Requirement. A member must maintain and preserve a centralized record for the calendar years specified in this supplementary material that separately identifies: (1) all offices or locations that had inspections that were conducted remotely; and (2) any offices or locations for which the member determined to impose additional supervisory procedures or more frequent monitoring, as provided in Rule 3110.17(c). A member's documentation of the results of a remote inspection for an office or location must identify any additional supervisory procedures or more frequent monitoring for that office or location that were imposed as a result of the remote inspection.

.18 Remote Inspections Pilot Program

(a) Scope. This Supplementary Material establishes a Remote Inspections Pilot Program with respect to the required inspection of OSJs, branch offices and non-branch locations pursuant to, as applicable, paragraphs (c)(1)(A), (B) and (C) under Rule 3110. The Remote Inspections Pilot Program shall cover required inspections of such offices or locations for a period of three years starting on July 1, 2024 ("pilot period"), and such pilot period shall expire on June 30, 2027. If the pilot period is not extended or Rule 3110.18, as may be amended, is not approved as permanent by the Commission, this Supplementary Material will automatically sunset on June 30, 2027. Members will not be able to participate in the Remote Inspections Pilot Program after such date.

(b) Risk Assessment

(1) Standards for Reasonable Review. Subject to paragraphs (c), (f) and (g) of this Supplementary Material, each member obligated to conduct an inspection of an office or location pursuant to, as applicable, paragraphs (c)(1)(A), (B) and (C) under Rule 3110 may, subject to the requirements of this Rule 3110.18, elect to conduct the applicable inspection remotely, without necessarily an on-site visit for an office or location, when the member reasonably determines that the purposes of this Supplementary Material can be accomplished by conducting such required inspection remotely. Prior to electing a remote inspection for an office or location, rather than an on-site inspection, the firm must develop a reasonable risk-based approach to using remote inspections, and conduct and document a risk assessment for that office or location. The assessment must document the factors considered, including the factors set forth in Rule 3110.12 and must take into account any higher risk activities that take place at, or higher risk associated persons that are assigned to, that office or location. A member or its office or location that is ineligible for remote inspections because of either paragraphs (f) or (g) of this Supplementary Material must conduct an on-site inspection of that office or location on the applicable mandatory schedule under Rule 3110(c)(1). Notwithstanding Rule 3110.18, a member shall remain subject to the other requirements of Rule 3110(c).

(2) Other Factors to Consider for Risk Assessment. In addition to the requirements under paragraph (b)(1) of this Supplementary Material, a member shall consider, among other things, the following factors with respect to an office or location in making its risk assessment for remotely inspecting an office or location: (A) the volume and nature of customer complaints; (B) the volume and nature of outside business activities, particularly investment-related; (C) the volume and complexity of products offered; (D) the nature of the customer base, including vulnerable adult investors; (E) whether associated persons are subject to heightened supervision; (F) failures by associated persons to comply with the member's written supervisory procedures; and (G) any recordkeeping violations. In addition, consistent with Rule 3110.12, members should conduct on-site inspections or make more frequent use of unannounced, on-site inspections for high-risk offices or locations or where there are indicators of irregularities or misconduct (i.e., "red flags"). Moreover, consistent with Rule 3110(a), the member's supervisory system must take into consideration any red flags when determining whether to conduct a remote inspection of an office or location.

(c) Written Supervisory Procedures for Remote Inspections. Consistent with a member's obligation under Rule 3110(b), a member that elects to participate in the Remote Inspections Pilot Program must establish, maintain, and enforce written supervisory procedures regarding remote inspections that are reasonably designed to detect and prevent violations of and achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. Reasonably designed procedures for conducting remote inspections of offices or locations must address, among other things: (1) the methodology, including technology, that may be used to conduct remote inspections; (2) the factors considered in the risk assessment made for each applicable office or location pursuant to paragraph (b) of this Supplementary Material; (3) the procedures specified in paragraph (h)(1)(G) and (h)(4) of this Supplementary Material; and (4) the use of other risk-based systems employed generally by the member to identify and prioritize for review those areas that pose the greatest risk of potential violations of applicable securities laws and regulations, and of applicable FINRA rules.

(d) Effective Supervisory System. The requirement to conduct inspections of offices and locations is one part of the member's overall obligation to have an effective supervisory system and therefore the member must maintain its ongoing review of the activities and functions occurring at all offices and locations, whether or not the member conducts inspections remotely. A member's use of a remote inspection of an office or location will be held to the same standards for review as set forth under Rule 3110.12. Where a member's remote inspection of an office or location identifies any "red flags," the member may need to impose additional supervisory procedures for that office or location or may need to provide for more frequent monitoring of that office or location, including potentially a subsequent on-site visit on an announced or unannounced basis.

(e) Documentation Requirement. A member must maintain and preserve a centralized record for each of the Pilot Years specified in this Remote Inspections Pilot Program that separately identifies: (1) all offices or locations that were inspected remotely; and (2) any offices or locations for which the member determined to impose additional supervisory procedures or more frequent monitoring, as provided in paragraph (d) of this Supplementary Material. A member's documentation of the results of a remote inspection for an office or location must identify any additional supervisory procedures or more frequent monitoring for that office or location that were imposed as a result of the remote inspection, including whether an on-site inspection was conducted at such office or location.

(f) Firm Level Requirements

(1) Firm Level Ineligibility Criteria

A member shall not be eligible to conduct remote inspections of any of its offices or locations in accordance with this Supplementary Material if any time during the pilot period the member:

(A) is or becomes designated as Restricted Firm under Rule 4111;

(B) is or becomes designated as a Taping Firm under Rule 3170;

(C) receives a notice from FINRA pursuant to Rule 9557 regarding compliance with Rule 4110 (Capital Compliance), Rule 4120 (Regulatory Notification and Business Curtailment) or Rule 4130 (Regulation of Activities of Section 15C Members Experiencing Financial and/or Operational Difficulties);

(D) is or becomes suspended from membership by FINRA;

(E) based on the date in the Central Registration Depository (CRD), had its FINRA membership become effective within the prior 12 months; or

(F) is or has been found within the past three years by the SEC or FINRA to have violated Rule 3110(c) (Internal Inspections).

(2) Firm Level Conditions

As part of the requirements in paragraph (b) to develop a reasonably designed risk-based approach to using remote inspections and to conduct and document a risk assessment for each office or location, the member must satisfy the following conditions:

(A) Recordkeeping System

The member must have a recordkeeping system:

(i) to make and keep current, and preserve records required to be made and kept current, and preserved under applicable securities laws and regulations, FINRA rules, and the member's own written supervisory procedures under Rule 3110;

(ii) such records are not physically or electronically maintained and preserved at the office or location subject to the remote inspection; and

(iii) the member has prompt access to such records; and

(B) Surveillance and Technology Tools

The member must determine that its surveillance and technology tools are appropriate to supervise the types of risks presented by each such remotely supervised office or location. These tools may include but are not limited to:

(i) firm-wide tools such as electronic recordkeeping systems; electronic surveillance of e-mail and correspondence; electronic trade blotters; regular activity-based sampling reviews; and tools for visual inspections;

(ii) tools specifically applied to such office or location based on the activities of associated persons, products offered, restrictions on the activity of the office or location (including holding out to customers and handling of customer funds or securities); and

(iii) system security tools such as secure network connections and effective cybersecurity protocols.

(g) Location Level Requirements

(1) Location Level Ineligibility Criteria

Subject to paragraph (f) of this Supplementary Material, a member's office or location shall not be eligible for a remote inspection in accordance with this Supplementary Material if at any time during the pilot period:

(A) one or more associated persons at such office or location is or becomes subject to a mandatory heightened supervisory plan under the rules of the SEC, FINRA or a state regulatory agency;

(B) one or more associated persons at such office or location is or becomes statutorily disqualified, unless such disqualified person has been approved (or is otherwise permitted pursuant to FINRA rules and the federal securities laws) to associate with a member and is not subject to a mandatory heightened supervisory plan under paragraph (g)(1)(A) of this Supplementary Material or otherwise as a condition to approval or permission for such association;

(C) the firm is or becomes subject to Rule 1017(a)(7) as a result of one or more associated persons at such office or location;

(D) one or more associated persons at such office or location has an event in the prior three years that required a "yes" response to any item in Questions 14A(1)(a) and 2(a), 14B(1)(a) and 2(a), 14C, 14D and 14E on Form U4;

(E) one or more associated persons at such office or location is or becomes subject to a disciplinary action taken by the member that is or was reportable under Rule 4530(a)(2);

(F) one or more associated persons at such office or location is engaged in proprietary trading, including the incidental crossing of customer orders, or the direct supervision of such activities; or

(G) the office or location handles customer funds or securities.

(2) Location Level Conditions

As part of the requirement to develop a reasonably designed risk-based approach to using remote inspections, and the requirement to conduct and document a risk assessment for each office or location in accordance with paragraph (b) of this Supplementary Material, a specific office or location of the member must also satisfy the following conditions:

(A) electronic communications (e.g., e-mail) are made through the member's electronic system;

(B) the associated person's correspondence and communications with the public are subject to the firm's supervision in accordance with Rule 3110; and

(C) no books or records of the member required to be made and kept current, and preserved under applicable securities laws and regulations, FINRA rules and the member's own written supervisory procedures under Rule 3110 are physically or electronically maintained and preserved at such office or location.

(h) Data and Information Collection Requirement

(1) Data and Information. A member that elects to participate in the Remote Inspections Pilot Program shall collect the following data and information and provide such data and information to FINRA, on a quarterly basis, and in the manner and format determined by FINRA. For the items referenced in paragraphs (h)(1)(A) through (F) of this Supplementary Material, a member shall provide separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations consistent with paragraphs (c)(1)(A), (B) and (C) under Rule 3110. For purposes of this paragraph, the term "finding" means a discovery made during an inspection that led to a remedial action or was listed on the member's inspection report:

(A) number of offices and locations with an inspection completed during each calendar quarter;

(B) number of offices and locations in paragraph (h)(1)(A) that were inspected remotely;

(C) number of offices and locations in paragraph (h)(1)(A) that were inspected on-site;

(D) number of offices and locations in paragraph (h)(1)(C) that were inspected on-site because of a finding;

(E) number of offices and locations in paragraph (h)(1)(B) where findings were identified, the number of those findings and a list of the significant findings;

(F) number of offices and locations in paragraph (h)(1)(C) where findings were identified, the number of those findings and a list of the significant findings; and

(G) requirements of the written supervisory procedures for Remote Inspections in each of the four areas below. This information should be provided with the first delivery of data made pursuant to this paragraph, and thereafter with the first delivery of such data made after any amendments to the written supervisory procedures for Remote Inspections:

(i) procedures for escalating significant findings;

(ii) procedures for new hires;

(iii) procedures for supervising brokers with a significant history of misconduct; and

(iv) procedures related to outside business activities (OBAs) and doing business as (DBA) designations.

(2) Additional Data and Information for Pilot Year 1, if Less Than Full Calendar Year. In addition to the information set forth in paragraph (h)(1) of this Supplementary Material, if Pilot Year 1 covers a period that is less than a full calendar year, a member that elects to participate in the Remote Inspections Pilot Program shall collect the following data and information and provide such data and information to FINRA no later than December 31 of such first Pilot Year in the manner and format determined by FINRA. For the items referenced in paragraphs (h)(2)(A) through (E) of this Supplementary Material, a member shall provide separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations consistent with paragraphs (c)(1)(A), (B) and (C) under Rule 3110:

(A) the number of offices and locations with an inspection completed between January 1 of Pilot Year 1 and the day before the effective date of the Remote Inspections Pilot Program;

(B) the number of offices and locations in paragraph (h)(2)(A) that were inspected remotely between January 1 of Pilot Year 1 and the day before the effective date of the Remote Inspections Pilot Program;

(C) the number of offices and locations in paragraph (h)(2)(A) that were inspected on-site between January 1 of Pilot Year 1 and the day before the effective date of the Remote Inspections Pilot Program;

(D) the number of offices and locations in paragraph (h)(2)(B) where findings were identified, the number of those findings and a list of the significant findings; and

(E) the number of offices and locations in paragraph (h)(2)(C) where findings were identified, the number of those findings and a list of the significant findings.

(3) Additional Data and Information for Calendar Year 2019. In addition to the information set forth in paragraphs (h)(1) and (h)(2) of this Supplementary Material, for calendar year 2019, a member that elects to participate in the Remote Inspections Pilot Program shall act in good faith using best efforts to collect the following data and information and provide such data and information to FINRA no later than December 31 of Pilot Year 1 in the manner and format determined by FINRA. For the items referenced in paragraphs (h)(3)(A) and (B) of this Supplementary Material, a member shall provide separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations consistent with paragraphs (c)(1)(A), (B) and (C) under Rule 3110:

(A) the number of offices and locations with an inspection completed during calendar year 2019; and

(B) the number of offices and locations referenced in paragraph (h)(3)(A) where findings were identified, the number of those findings and a list of the significant findings.

(4) Written Policies and Procedures. A member shall establish, maintain and enforce written policies and procedures that are reasonably designed to comply with the data and information collection, and transmission requirements of paragraph (h) of this Supplementary Material.

(i) Election to Participate in Remote Inspections Pilot Program. A member that elects to participate in the Remote Inspections Pilot Program for any Pilot Year shall, at least five calendar days before the beginning of such Pilot Year, provide FINRA an "opt-in notice" in the manner and format determined by FINRA. By providing such opt-in notice to FINRA, the member agrees to participate in the Remote Inspections Pilot Program for the duration of such Pilot Year and to comply with the requirements of Rule 3110.18. A member that provides an opt-in notice for a Pilot Year shall be automatically deemed to have elected and agreed to participate in the Remote Inspections Pilot Program for subsequent Pilot Years until the Remote Inspections Pilot Program expires. A member that elects to withdraw from subsequent Pilot Years (i.e., Pilot Year 2, Pilot Year 3, and Pilot Year 4, if applicable) shall, at least five calendar days before the end of the then current Pilot Year, provide FINRA with a "opt-out notice" in the manner and format determined by FINRA. FINRA may, in exceptional cases and where good cause is shown, waive the applicable timeframes for the required opt-in or opt-out notices.

(j) Failure to Satisfy Conditions. A member that fails to satisfy the conditions of Rule 3110.18, including the requirement to timely collect and submit the data and information to FINRA as set forth in paragraph (h) of this Supplementary Material, shall be ineligible to participate in the Remote Inspections Pilot Program and must conduct on-site inspections of each office and location on the required cycle in accordance with Rule 3110(c).

(k) Determination of Ineligibility. FINRA may make a determination in the public interest and for the protection of investors that a member is no longer eligible to participate in the Pilot Program if the member fails to comply with the requirements of Rule 3110.18. In such instances, FINRA will provide written notice to the member of such determination and the member would no longer be eligible to participate in the Pilot Program and must conduct on-site inspections of required offices and locations in accordance with Rule 3110(c).

(l) Definitions. For purposes of this Supplementary Material, the term "Pilot Year" shall mean the following:

(1) Pilot Year 1 is the period beginning on July 1, 2024 and ending on December 31 of the same year;

(2) Pilot Year 2 means the calendar year period following Pilot Year 1, beginning on January 1 and ending on December 31;

(3) Pilot Year 3 means the calendar year period following Pilot Year 2, beginning on January 1 and ending on December 31; and

(4) If applicable, where Pilot Year 1 covers a period that is less than a full calendar year, then Pilot Year 4 means the period following Pilot Year 3, beginning on January 1 and ending on June 30, 2027.

(m) Sunset of Rule 3110.17. If Rule 3110.17 has not already expired by its own terms, Rule 3110.17 will automatically sunset on June 30, 2024.

.19 Residential Supervisory Location

(a) Conditions for Designation as a Residential Supervisory Location (RSL). Notwithstanding any other provisions of Rule 3110(f) and subject to paragraphs (b), (c) and (d) of this Supplementary Material, a location that is the associated person's private residence where supervisory activities are conducted, including those described in Rule 3110(f)(1)(D) through (G) or in Rule 3110(f)(2)(B), shall be considered for those activities a non-branch location, provided that:

(1) only one associated person, or multiple associated persons who reside at that location and are members of the same immediate family, conduct business at the location;

(2) the location is not held out to the public as an office;

(3) the associated person does not meet with customers or prospective customers at the location;

(4) any sales activity that takes place at the location complies with the conditions set forth under Rule 3110(f)(2)(A)(ii) or (iii);

(5) neither customer funds nor securities are handled at that location;

(6) the associated person is assigned to a designated branch office, and such designated branch office is reflected on all business cards, stationery, retail communications and other communications to the public by such associated person;

(7) the associated person's correspondence and communications with the public are subject to the firm's supervision in accordance with this Rule;

(8) the associated person's electronic communications (e.g., e-mail) are made through the member's electronic system;

(9)(A) the member must have a recordkeeping system to make and keep current, and preserve records required to be made and kept current, and preserved under applicable securities laws and regulations, FINRA rules, and the member's own written supervisory procedures under Rule 3110; (B) such records are not physically or electronically maintained and preserved at the office or location; and (C) the member has prompt access to such records; and

(10) the member must determine that its surveillance and technology tools are appropriate to supervise the types of risks presented by each Residential Supervisory Location, and these tools may include but are not limited to: (A) firm-wide tools such as, electronic recordkeeping system; electronic surveillance of e-mail and correspondence; electronic trade blotters; regular activity-based sampling reviews; and tools for visual inspections; (B) tools specific to the RSL based on the activities of associated person assigned to the location, products offered, restrictions on the activity of the RSL; and (C) system tools such as secure network connections and effective cybersecurity protocols.

(b) Member Firm Ineligibility Criteria. A member shall not be eligible to designate an office or location as an RSL in accordance with Rule 3110.19 if the member:

(1) is currently designated as a Restricted Firm under Rule 4111;

(2) is currently designated as a Taping Firm under Rule 3170;

(3) is currently undergoing, or is required to undergo, a review under Rule 1017(a)(7) as a result of one or more associated persons at such location;

(4) receives a notice from FINRA pursuant to Rule 9557 (Procedures for Regulating Activities under Rule 4110 (Capital Compliance), Rule 4120 (Regulatory Notification and Business Curtailment) or Rule 4130 (Regulation of Activities of Section 15C Members Experiencing Financial and/or Operational Difficulties)), unless FINRA has otherwise permitted activities in writing pursuant to such rule;

(5) is or becomes suspended by FINRA;

(6) based on the date in the Central Registration Depository (CRD), had its FINRA membership become effective within the prior 12 months; or

(7) is or has been found within the past three years by the SEC or FINRA to have violated Rule 3110(c).

(c) Location Ineligibility Criteria. An office or location shall not be eligible for designation as an RSL in accordance with Rule 3110.19 if one or more associated persons at such office or location:

(1) is a designated supervisor who has less than one year of direct supervisory experience with the member, or an affiliate or subsidiary of the member that is registered as a broker-dealer or investment adviser;

(2) is functioning as a principal for a limited period in accordance with Rule 1210.04;

(3) is subject to a mandatory heightened supervisory plan under the rules of the SEC, FINRA or state regulatory agency;

(4) is statutorily disqualified, unless such disqualified person has been approved (or is otherwise permitted pursuant to FINRA rules and the federal securities laws) to associate with a member and is not subject to a mandatory heightened supervisory plan under paragraph (c)(3) of this Supplementary Material or otherwise as a condition to approval or permission for such association;

(5) has an event in the prior three years that required a "yes" response to any item in Questions 14A(1)(a) and 2(a), 14B(1)(a) and 2(a), 14C, 14D and 14E on Form U4; or

(6) has been notified in writing that such associated person is now subject to, any Investigation or Proceeding, as such terms are defined in the Explanation of Terms for the Form U4 (Uniform Application for Securities Industry Registration or Transfer), by the SEC, a self-regulatory organization, including FINRA, or state securities commission (or agency or office performing like functions) (each, a "Regulator") expressly alleging they have failed reasonably to supervise another person subject to their supervision, with a view to preventing the violation of any provision of the Securities Act, the Exchange Act, the Investment Advisers Act, the Investment Company Act, the Commodity Exchange Act, any state law pertaining to the regulation of securities or any rule or regulation under any of such Acts or laws, or any of the

rules of the MSRB or other self-regulatory organization, including FINRA; provided, however, such office or location may be designated or redesignated as an RSL subject to the requirements of this Supplementary Material upon the earlier of: (i) the member's receipt of written notification from the applicable Regulator that such Investigation has concluded without further action; or (ii) one year from the date of the last communication from such Regulator relating to such Investigation.

(d) Obligation to Provide Information Identifying RSLs to FINRA. A member that elects to designate any office or location of the member as an RSL pursuant to this Supplementary Material shall provide FINRA with current information identifying all locations designated as RSLs in the frequency, manner and format (e.g., through an electronic process or such other process) as FINRA may prescribe.

(e) Risk Assessment. Subject to the requirements of this Supplementary Material, prior to designating an office or location as an RSL, the member must develop a reasonable risk-based approach to designating such office or location as an RSL, and conduct and document a risk assessment for the associated person assigned to that office or location. The assessment must document the factors considered, including among others, whether the associated person at such office or location is now subject to: (1) customer complaints, taking into account the volume and nature of the complaints; (2) heightened supervision other than where such office or location is ineligible for RSL designation under paragraph (c)(3) of this Supplementary Material; (3) any failure to comply with the member's written supervisory procedures; (4) any recordkeeping violation; and (5) any regulatory communications from a Regulator, indicating that the associated person at such office or location failed reasonably to supervise another person subject to their supervision, including but not limited to, subpoenas, preliminary or routine regulatory inquiries or requests for information, deficiency letters, "blue sheet" requests or other trading questionnaires, or examinations. The member must take into account any higher risk activities that take place or a higher risk associated person that is assigned to that office or location. Consistent with its obligation under Rule 3110(a), the member's supervisory system must take into consideration any indicators of irregularities or misconduct (i.e., "red flags") when designating an office or location as an RSL. Red flags should also be reviewed in determining whether it is reasonable to maintain the RSL designation of such office or location in accordance with the requirements of this Supplementary Material and the member should consider evidencing steps taken to address those red flags where appropriate.

* Where such office of convenience is located on bank premises, signage necessary to comply with applicable federal and state laws, rules and regulations and applicable rules and regulations of other self-regulatory organizations, and securities and banking regulators may be displayed and shall not be deemed "holding out" for purposes of this section.

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 Amended by SR-FINRA-2023-007 eff. July 1, 2024.
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 Amended by SR-FINRA-2022-030 eff. Jan. 1, 2023.
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 Amended by SR-FINRA-2013-025 eff. Dec. 1, 2014.
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 Amended by SR-FINRA-2007-008 eff. Dec. 19, 2007.
 Amended by SR-NASD-2006-037 eff. July 3, 2006.
 Amended by SR-NASD-2005-033 eff. Aug. 1, 2005.
 Amended by SR-NASD-2005-004 eff. July 25, 2005
 Amended by SR-NASD-2002-162 and SR-NASD-2004-116 eff. Jan. 31, 2005.
 Amended by SR-NASD-2002-40 eff. Oct. 15, 2002.
 Amended by SR-NASD-2002-04 eff. Oct. 14, 2002.
 Amended by SR-NASD-99-28 eff. Aug. 16, 1999.
 Amended by SR-NASD-98-52 eff. March 15, 1999.
 Amended by SR-NASD-98-86 eff. Nov. 19, 1998.
 Amended by SR-NASD-97-69 eff. August 17, 1998.
 Amended by SR-NASD-98-45 postponed eff. date of provision in Notice to Members 98-11.
 Amended by SR-NASD-98-31 eff. Apr. 7, 1998, postponed eff. date of provision in Notice to Members.
 Amended by SR-NASD-98-10 postponed eff. date.
 Amended by SR-NASD-97-24 eff. Feb. 15, 1998.
 Amended by SR-NASD-97-41 eff. Sept. 4, 1997.
 Amended by SR-NASD-91-42 eff. Apr. 30, 1992.
 Amended by SR-NASD-88-31 eff. June 12, 1989.

Selected Notices to Members: [86-65](#), [87-41](#), [88-11](#), [88-44](#), [88-68](#), [88-84](#), [89-23](#), [89-34](#), [89-57](#), [91-48](#), [92-18](#), [96-33](#), [96-59](#), [96-82](#), [98-11](#), [98-18](#), [98-38](#), [98-52](#), [98-96](#), [99-03](#), [99-45](#), [04-71](#), [05-67](#), [06-13](#), [07-64](#), [14-10](#), [24-02](#).

VERSIONS

Nov 26, 2024 onwards

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INVESTMENT ADVISER GUIDELINES

Securities Division
of the Kansas Department of Insurance



An overview of rules and regulations for *Kansas Investment Advisers*

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NOTICE: The information contained in this guide is provided solely for educational and informational purposes, and may not be construed or relied upon as individual legal counsel.

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ABOUT THE OFFICE OF THE KANSAS SECURITIES COMMISSIONER

Kansas Securities Regulation

In 1911, Kansas became the first state to pass a law regulating the sale of investments. According to J.N. Dolley, a driving force for the law's passage, it was an effort to prevent the sale of securities by promoters who promised rain, but delivered only "blue sky".

In the next few years, other states passed similar laws and today, all states' securities laws are referred to as "blue sky laws". Following the great stock market crash of 1929, the federal government began to regulate investment activity with the passage of the Securities Act of 1933, and the creation of the U.S. Securities & Exchange Commission in 1934.

Roles of the Office of the Kansas Securities Commissioner

The Office of the Kansas Securities Commissioner is a division of the Kansas Department of Insurance and funded entirely by industry fees.

The division regulates and monitors the offering of securities and financial services within Kansas by registering securities, broker dealers and their agents, and investment advisers and their representatives. Division staff conduct periodic examinations to determine whether registered persons comply with

industry, legal and accounting standards specified by the Kansas Uniform Securities Act (KUSA) and Kansas Administrative Regulations (KARs). Staff also investigate potential violations of statutes and regulations under KUSA, and Special Agents with law enforcement powers conduct criminal investigations of alleged frauds or other unlawful acts. The staff has the authority to investigate any investment-related activity that occurs in Kansas, even when companies or individuals from outside of the state are involved.

Assistance

Division staff is available any time to assist you in understanding and complying with the provisions of the Kansas Uniform Securities Act or to make presentations to groups of industry professionals regarding regulatory issues pertaining to the securities industry in Kansas.

ETHICAL STANDARDS

An investment advisor or investment advisor representative is a fiduciary and shall act primarily for the benefit of its clients.

K.A.R. 81-14-5(c); Each person registered as an investment advisor or investment representative shall not fail to observe high standards of commercial honor and just and equitable principles of trade in the conduct of the person's business.

REGULATORY FILINGS

Form ADV consists of Parts 1, 2A and 2B, all of which must be filed electronically through IARD.

Annual Renewal

A letter is sent annually from the KSC office reminding investment advisers of the renewal requirement. Questions related to electronic filing of the forms can be answered by the FINRA Call Center at 240-386-4848.

K.A.R. 81-14-1(b)(2); The application for annual renewal registration as an investment adviser shall be filed with the IARD along with the fee required by K.A.R. 81-14-2, (current fees for an investment adviser and an investment adviser representative can be found on our website at insurance.kansas.gov), and any reasonable fee charged by FINRA for filing through the IARD.

Annual Updating Amendments to Form ADV

Investment advisers are required to file an annual updating amendment to form ADV Parts 1 & 2A within 90 days after the end of the investment adviser's fiscal year. The annual updating amendment requires that the adviser review the information contained in each ADV filing to ensure that it is current and accurate. This filing must not be submitted until after the end of the adviser's fiscal year.

K.A.R. 81-14-1(b)(3)(B); Within 90 days after the end of the investment adviser's fiscal year, the investment adviser shall file with the IARD an annual updating amendment to form ADV.

ADV Updates and Amendments

Investment advisers are required to update their form ADV Part 1, in accordance with the ADV instructions and by submitting an "Other-than-annual" amendment on the IARD system. The instructions for Part 1 provide specific items that must be updated promptly if changes occur. If any information in Parts 2A or 2B becomes materially inaccurate, appropriate updates must be submitted on the IARD and delivered to clients promptly (within 30 days). Changes made to Parts 2A or 2B require that the date on the cover page be changed.

K.A.R. 81-14-1(b)(3)(A); Each investment adviser shall file with IARD, in accordance with the instructions in form ADV, any amendments to the investment adviser's form ADV. An amendment shall be considered to be filed promptly if the amendment is filed within 30 days of the event that requires the filing of the amendment.

Professional Liability Insurance Disclosure

Each investment adviser registered in Kansas is required to provide an addendum

or supplement to the form ADV, Part 2A for delivery to all clients or prospective clients disclosing the presence or absence of professional liability insurance coverage for its investment advisory services. If a client or prospective client requests proof of the professional liability insurance coverage, the investment adviser shall, within 30 days, provide a copy of the insurance agreement that is in effect.

Form U-4 Filings

K.A.R. 81-14-1(c)(3); Each investment adviser representative shall be under a continuing obligation to update the information required by form U-4 as changes occur. Each investment adviser representative and any associated investment adviser shall file promptly with CRD any amendments to the representative's form U-4. An amendment shall be considered to be filed promptly if the amendment is filed with 30 days of the event that requires the filing of the amendment.

Form U-5 Filings

K.A.R. 81-14-1(f)(2); When an investment adviser representative's association with an investment adviser is discontinued or terminated, the investment adviser shall immediately file a form U-5 with the CRD. If the investment adviser representative commences association with another investment adviser, that investment adviser shall file a form U-4 as an initial application for registration for the investment adviser representative.

Form ADV-W Filings

K.A.R. 81-14-1(f)(3); If an investment adviser desires to withdraw from registration or if registration is terminated by the administrator, the investment adviser shall immediately file a form ADV-W with the IARD. The form ADV-W shall be completed in accordance with the instructions to the form.

K.A.R. 81-14-1(f)(4); Termination of an investment adviser's registration for any reason shall automatically constitute cancellation of the registration of each investment adviser representative that is affiliated with the investment adviser.

RECORDKEEPING AND RETENTION REQUIREMENTS

Recordkeeping

K.A.R. 81-14-4; Investment advisers should review the regulation in detail periodically to ensure that records pertaining to their business model are being maintained as required. Generally, the following records must be maintained:

- Journals, including cash receipts and disbursements records;
- General ledgers reflecting asset, liability, equity, capital, income and expense accounts;
- Memoranda regarding orders, instructions, modifications or cancellations;

- Bank statements, canceled checks, and cash reconciliations;
- Bills or statements, paid or unpaid, regarding the business;
- Trial balances, financial statements and internal working papers;
- Written communications received and sent, including recommendations, orders, receipt/disbursement of funds/securities, and lists of persons receiving notices/advertisements;
- A list of discretionary accounts and evidence of discretionary authority;
- Client agreements and other agreements related to business of the firm;
- Copies of notices, circulars, advertisements, and articles sent to persons not connected to the adviser and reasons for any specific recommendations made;
- A record of every transaction in a security;
- Copies of the adviser's brochure, including amendments or revisions sent to clients or prospective clients;
- Documents related to clients obtained for the adviser by a solicitor to whom a cash fee was paid;
- Accounts, books, internal working papers and other documents that form the basis for or calculations of performance or rate of return for 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 supervisory procedures;
- 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;
- Records related to inadvertent custody of securities or funds, records related to exceptions to the custody rules, as well as documents required to be kept if an adviser has custody

Record Retention

K.A.R. 81-14-4(f); Subsection (f) of the regulation specifies requirements for the preservation of records, which includes the length of time the records must be maintained in the principal office of the investment adviser and the length of time that they must be maintained and preserved in an easily accessible place.

Electronic Records

K.A.R. 81-14-4(h); The required records listed above may be maintained and preserved in electronic form. If in the ordinary course of the adviser's business, the records are created or copied by the adviser on electronic media or received by the adviser solely on electronic media or by electronic data transmission, criteria for maintenance of these records include:

- Arranging and indexing the records to permit the immediate location of that record;
- Being able to promptly provide a copy as requested by the Administrator;
- Storing, separately from the original, one other copy of each record for the time required;
- Creating procedures for the maintenance and preservation of, and access to, the records in order to safeguard them from loss, alteration or destruction;
- Having the facilities available for immediate, readable projection of film and facsimile enlargements

EXAMINATIONS

The compliance staff conducts periodic examinations or examinations for cause of broker-dealer and investment adviser offices inside and outside of Kansas. An examination may be conducted at any time and without advance notice. The compliance staff may copy and remove for examination copies of all records that are determined to be reasonably necessary or appropriate to conduct the examination. Examinations by the compliance staff are authorized under the Kansas Uniform Securities Act.

K.S.A. 17-12a411(d); The records of every investment adviser or investment adviser representative are subject to such reasonable periodic, special, or other audits or inspections by a representative

of the Securities Commissioner, either inside or outside of Kansas, as the Commissioner considers necessary or appropriate in the public interest and for the protection of investors. An audit or inspection may be made at any time and without prior notice, The Commissioner's staff may copy, and remove for audit or inspection copies of, all records considered reasonably necessary or appropriate to conduct the audit or inspection. Any documents removed or copied during an audit or inspection will be maintained by the KSC staff and are not considered public records, however, the Commissioner has the discretion to disclose the records for the purposes of a civil, administrative, or criminal investigation, action or proceeding per **K.S.A. 17-12a607**

Common Deficiencies Noted During Examinations:

- Failure to file timely updates to forms ADV and U-4;
- Discrepancies between disclosures in forms AV Part 1 and Part 2A;
- Failure to maintain financial statements according to GAAP;
- Failure to prepare a monthly balance sheet;
- Failure to disclosure Custody, as required by **K.A.R. 81-14-9**;
- Misrepresentations on advertising or marketing materials;
- Website not updated periodically;
- Failure to maintain updated suitability information for each client;
- Missing signed client agreements;

- Billing errors and incorrect free calculations;
- Lack of documentation regarding yearly privacy policy dissemination and offering of the brochure;
- Supervisory procedures unrelated to the firm's investment activities and personnel;
- Failure to register or license investment adviser representatives;
- Failure to conduct an internal annual review of the adviser's activities to ensure compliance with industry rules and regulations

Audits and/or inspections are resolved by issuing a deficiency letter to the examinee with corrective action to be taken, or, for more egregious or substantive violations, a formal administrative action may be filed and disciplinary sanctions imposed.

DISHONEST AND UNETHICAL PRACTICES

K.A.R. 81-14-5 lists prohibited conduct considered to be dishonest or unethical practices of investment advisers and their representatives. Dishonest or unethical practices include, but are not limited to, the following:

Unsuitable Recommendations

It is unethical for an investment adviser or investment adviser representative to recommend the purchase or sale of a security without reasonable grounds to believe that the recommendation is suitable for the client.

K.A.R. 81-14-4(b)(18); Each investment adviser shall maintain written information about each investment advisory client that is the basis for making any recommendation or providing any investment advice to the client. At a minimum, such information should include:

- Date of Birth
- Financial Information (i.e. liquid net worth, annual salary)
- Employment Information
- Investment Objectives
- Investment Experience
- Risk Tolerance
- Tax Bracket
- Anticipated Needs

Improper Advisory Contract

An investment adviser may not enter into, extend or renew any investment advisory contract unless the contract is in writing and discloses the services to be provided, the term of the contract, the advisory fee, the formula for computing the fee, the amount of prepaid fee to be returned in the event of contract termination or nonperformance, an indication whether the contract grants discretionary power to

the adviser and that no assignment of the contract shall be made by the investment adviser without the consent of the other party to the contract.

Cash Payments for Client Solicitations

Paying a cash fee or other compensation, directly or indirectly, to a solicitor is not allowed unless the solicitation arrangements meet the specifications provided in **K.A.R. 81-14-5(f)**. The solicitor must be registered as an investment adviser representative and a separate written disclosure document is required to be furnished to the client with detailed information regarding the parties involved, the nature of the relationships, and the fees charged. An investment adviser cannot pay an unregistered person any compensation for soliciting clients.

Other Prohibited Practices:

- Improper use of discretionary authority
- Excessive trading
- Unauthorized trading
- Borrowing from or loaning to a client
- Misrepresenting qualifications, services, or fees
- Failure to disclose the source of a report
- Unreasonable fees
- Failure to disclose conflicts of interest
- Guaranteeing performance
- Deceptive advertising
- Failure to protect confidential information
- Indirect misconduct

- Failure to disclose financial condition and disciplinary history
- Use of misleading senior-specific certifications and professional designations

OPERATIONAL REQUIREMENTS

K.A.R. 81-14-4(b)(19); Each investment adviser shall maintain written procedures to supervise the activities of employees and investment adviser representatives that are reasonably designed to achieve compliance with the Kansas Uniform Securities Act and other applicable laws. These procedures are intended to govern the operations of the investment adviser, including sole proprietors.

An investment adviser has a duty to supervise its employees, as part of its overall duty to protect the interests of its clients and ensure compliance with regulatory requirements. Each adviser must create its own supervisory procedures, tailored to the needs of its business. A large adviser with multiple investment adviser representatives will have more procedures than a sole proprietor will need. The procedures should be an effective tool for conducting business of behalf of the firm, identifying conflicts of interest, and preventing violations of securities law and regulations.

The investment adviser representatives of many advisers are also registered as agents of separate broker-dealers. All FINRA member firms must comply with the supervisory requirements spelled out in the FINRA Conduct Rules. FINRA Notice to Members 94-44 and 96-33 provide specific guidance on a broker-dealer's obligation to supervise the outside securities business of its agents, including investment advisory business. However, just because the broker-dealer's compliance department may be reviewing the investment adviser representative's conduct does not mean that the adviser can abdicate its own supervisory responsibilities.

K.A.R. 81-14-10(a)(2); Factors to be considered when determining whether supervisory procedures are reasonably designed are:

- The firm's size
- The organizational structure
- The scope of business activities
- The number and location of the offices
- The nature and complexity of products and services offered
- The volume of business done
- The number of investment adviser representatives assigned to a location
- The specification of the office as a non-branch location
- The disciplinary history of the registered investment adviser representatives

Guidelines for developing written supervisory procedures should include what needs to be done, who will be responsible for the task, how often it will be reviewed and what record will be maintained to evidence the review.

Areas of Consideration for Supervision

Hiring and Training, K.A.R. 81-14-1;

Advisers with more than one employee should have procedures for hiring new personnel; Confirming qualifications and reviewing disciplinary history. Many advisers have minimum education and experience standards for investment adviser representatives. The adviser should develop a system for training new employees and keeping its other employees current on new regulations and other industry issues.

Investment Adviser Representative

Registration, K.A.R. 81-14-1(c); Advisers should have procedures to ensure that all investment adviser representatives are properly registered. These procedures should provide for timely disclosure of disciplinary events and other material changes on form U-4 and the timely filing of form U-5 for terminated investment adviser representatives.

Transaction Review, K.A.R.

81-14-4(b)(3)(A); Advisers that execute securities trades for clients should conduct a periodic review of transactions for proper execution and suitability.

Correspondence Review, K.A.R.

81-14-4(b)(7)(A); Advisers with multiple investment adviser representatives should have procedures for monitoring incoming and outgoing correspondence. This review enables the adviser's management to detect evidence of unethical conduct, identify possible complaints and discover other

violations of the adviser's policies or regulatory requirements.

Advertising and Sales Literature Review, K.A.R. 81-14-5(d)(11); All advertising and sales literature used by the adviser should be approved by a supervisor prior to use. Testimonials must be prohibited. The supervisor should carefully review advertising using past recommendations and performance information to ensure that it is not misleading and contains the proper disclosures.

Keeping Disclosure Document Current, K.A.R. 81-14-1(b)(3)(A); The adviser's supervisory procedures should indicate who is responsible for keeping the form ADV up to date and for filing annual and other updates to its disclosure documents.

Distribution of Disclosure Document, K.A.R. 81-14-10(b)(3); The adviser should have procedures designed to ensure that new clients receive the adviser's disclosure document. An investment adviser shall, at least once a year and without charge, deliver or offer in writing to deliver to each of its clients the current brochure and any current brochure supplements. If a client accepts the written offer, the investment adviser shall send the current brochure and supplements to that client within seven days after the investment adviser is notified of the acceptance.

Remote Office Audits, K.A.R. 81-14-10(a); Advisers that maintain branch offices should conduct periodic audits of these offices. The adviser's producers should include the audit schedule,

a description of the areas to be reviewed during an audit, and a system for maintaining internal audit records.

Investment Adviser Representative Securities Activity Review, K.A.R. 81-14-4(b)(12)(B); All advisers should have policies regarding the personal securities transactions of their investment adviser representatives. This is particularly important for advisers that execute trades for their clients. Advisers must be careful that their investment adviser representatives do not make personal trades ahead of client trades, or in any way seek to benefit from knowledge of the advice given to clients. Advisers should receive copies of statements for all investment adviser representatives with knowledge of advice given to clients. These statements should be reviewed, and this review should be documented.

Complaint Review, K.A.R. 81-14-4(b)(17); A supervisor should review all complaints against the adviser and/or adviser representatives. The complaint review procedure should indicate who conducts this review, how the adviser communicates with the client, how complaints are resolved, and how complaint-related records are maintained.

New Account Approval, K.A.R. 81-14-5(d)(1); Advisers should have specific procedures for review and approval of all new client accounts by a supervisor. The supervisor should review new account documents to ensure that sufficient financial background and investment objective information has been gathered.

A determination should be made as to whether the client is suitable for the services recommended, and whether the client meets the adviser's minimum net worth or account size standards.

Client Account Activity Review, K.A.R. 81-14-4(b)(7)(A); Advisers should periodically review the activity in each client account to be sure that it is consistent with the client's investment objectives and financial profile. The adviser's procedures should indicate the schedule for these reviews. These procedures should be consistent with the account review procedures disclosed on form ADV Part 2A, Item 13.

Handling of Client Funds and Securities, K.A.R. 81-14-9; All advisers should have detailed procedures for the handling of client funds and securities. For the protection of the client and of the adviser, these procedures should include internal controls appropriate for the size of the adviser and its business. At a minimum, the procedures should specify who is responsible for each step of the process, from receiving a deposit from client to forwarding or depositing the item. The procedures should also indicate the records maintained to document this process. If possible, one person should not be responsible for the entire process.

Maintenance of Books and Records, K.A.R. 81-14-4; The adviser should have a system for maintaining its books and records.

The books and records procedures should specify who is responsible for each type of record, and how long the records are maintained. If possible, one person should not be responsible for creating, maintaining, and destroying records.

Segregation of Incompatible Duties, K.A.R. 81-14-10; To the greatest extent possible, duties pertaining to cash transactions, custody, recording and reconciling of client funds and securities, and the creation, maintenance and destruction of records should be performed by different persons so that one person is not responsible for all duties.

Misuse of Nonpublic Information, K.A.R. 81-14-5(d)(12); All advisers should establish, maintain, and enforce written procedures designed to prevent the misuse of material nonpublic information and prohibit trading on "inside information".

Supervisory System Review, K.A.R. 81-14-4(b)(19); One of the adviser's principals should be responsible for keeping the firm's supervisory procedures up to date. The adviser should document when revised procedures have been distributed to its investment adviser representatives.

Suitability, K.A.R. 81-14-4(b)(18); Each investment adviser shall maintain written information about each investment advisory client that is the basis for making any recommendation or providing any investment advice to the client.

FINANCIAL REQUIREMENTS

Cybersecurity, K.S.A 50-6, 139b;

Requires any person who, in the ordinary course of their business, collects, maintains, or possesses the personal information of any other person, to implement and maintain reasonable procedures and practices appropriate to protect the personal information from unauthorized access, use, modification or disclosure.

Financial Exploitation; The Protect Vulnerable Adults from Financial Exploitation Act, enacted by the Kansas Legislature through House Bill No. 2562 and effective as of July 1, 2024, requires investment advisers (and broker-dealers) registered under the Kansas Uniform Securities Act to report potential financial exploitation of adults aged 60 and older and other vulnerable adults to the Securities Commissioner of Kansas and the Kansas Department for Children and Families.

ANNUAL REVIEW

K.A.R. 81-14-10(a)(1); Each investment adviser shall conduct a review, at least annually, of the businesses in which the adviser engages, which shall be reasonably designed to assist in detecting and preventing violations of and achieving compliance with the Kansas Uniform Securities Act and regulations, and other applicable laws and regulations.

It is suggested that a record be maintained to document and support the review.

K.A.R. 81-14-9(c); This regulation subsection specifies financial reporting requirements for investment advisers based in Kansas and specifies that a balance sheet as requires by **K.A.R. 81-14-4(b)(6)** shall be prepared monthly, dated the last day of the month, and completed within 10 business days after the end of the month. Upon request of the Commissioner's staff for any month, the investment adviser shall file the balance sheet within five days after the request.

K.A.R. 81-14-4(b)(6); Each investment adviser shall maintain all trial balances, financial statements and internal audit working papers relating to its investment adviser business.

"Financial Statements" means a balance sheet prepared in accordance with GAAP, an income statement and a cash flow statement. The income and cash flow statements should also be prepared in accordance with GAAP.

K.A.R. 81-14-9(d); Investment advisers based and registered in Kansas shall maintain a positive net worth at all times. If at any time an investment adviser determines that it is insolvent because its net worth is negative as determined in conformity with GAAP, it shall notify the Commissioner by the close of business on the next business day.

K.S.A 17-12a412(d)(7); This statute subsection specifies that one of the grounds for discipline of an investment adviser is insolvency, either because the investment adviser's liabilities exceed its assets or because it cannot meet its obligations as they become due. However, an order against the investment adviser may not be entered without a finding of insolvency as a matter of due process, and correction of the insolvency within a reasonable time frame may prevent a reportable action.

CUSTODY

If an investment adviser has custody of client funds or securities, as defined by K.A.R. 81-14-9(a)(1), disclosure is required on form ADV, Parts 1 & 2A.

Investment advisers with custody must comply with several requirements for safekeeping of client funds and securities as specified in K.A.R. 81-14-9(b)(1), unless an exception provided by (b)(2) under that regulation is met. Safekeeping requirements include the following which are specified in more detail within the regulation:

- A qualified custodian, as defined in K.A.R. 81-14-9(a)(4), is required to maintain funds and securities in separate accounts for each client, or in accounts that contain only funds and securities of the investment adviser's clients under the name of the investment adviser
- A notice to clients with information about the qualified custodian is required at the time their account is established and whenever information changes
- Account statements must be sent at least quarterly by the qualified custodian to each client or their independent representative, or by the investment adviser in an independent CPA is engaged annually to attest to the accuracy of the statements in comparison with the qualified custodian records and the CPA firm's report is filed with the Commissioner within 30 days after completion of the attest engagement
- Investment adviser managers of pooled investment vehicles (PIVs) must send account statements to each participant in the PIV or their independent representative
- Prior written authorization from clients is required for the investment adviser's fee to be directly deducted from their account held by a qualified custodian
- Investment adviser managers of pooled investment vehicles must engage an independent party to review all fees, expenses and withdrawals from pooled accounts unless the pooled investment vehicle is subject to an annual audit and its audited financial statements presented in conformity with GAAP are sent to all participants in the pooled investment within 120 days after the end of its fiscal year

- Investment advisers subject to the safekeeping requirements shall notify the Commissioner on form ADV that they intend to comply with those requirements

K.A.R. 81-14-9 was amended in October 2013 to eliminate or modify various requirements for balance sheets, adjusted net worth and surety bonds.

EXEMPTION FROM REGISTRATION

The Kansas Private Adviser Exemption under K.A.R. 81-14-11 provides an exemption from registration for investment adviser firms if they:

- Maintain their principal place of business in Kansas
- Provide investment advice solely to fewer than 15 clients
- Do not hold themselves out generally to the public as an investment adviser
- Do not act as an investment adviser to any investment company registered under the Investment Company Act of 1940 or a company that has elected and has not withdrawn its election to be a business development company pursuant to section 54 of the Investment Company Act of 1940

In order to qualify for this exemption, neither the investment adviser nor any of its advisory affiliates or associated investment adviser representatives shall be subject to disqualification.

If a firm elects to use this exemption from registration and manages assets of no more than \$25 million on December 31 of each year, the identifying information required by form ADV Part 1A, Item 1 must be completed and the printed form filed with the KSC office on or before February 1 of the following year. The notice filing should include a cover letter with reference to K.A.R. 81-14-11 and the investment adviser's claim of exemption as a private investment adviser. No filing fee is required with the notice. Firms that manage assets in excess of \$25 million and are registered with the SEC or have filed as an exempt reporting adviser with the SEC are exempt from this notice filing requirement.

Investment adviser representatives that are employed by or associated with an investment adviser that meets this exemption are also exempt from registration requirements if they are not subject to disqualification or otherwise act as an investment adviser representative.

Firms and investment adviser representatives that become ineligible for the exemption must comply with registration requirements within 90 days after the date of ineligibility.



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LII > State Regulations > Indiana Administrative Code > Title 710 - SECURITIES DIVISION
> Article 4 - UNIFORM SECURITIES > Rule 710 IAC 4-9 - Investment Advisers
> **710 IAC 4-9-8 - Supervision of investment adviser representatives and employees**

710 IAC 4-9-8 - Supervision of investment adviser representatives and employees

State Regulations Compare

Authority: IC 23-19-6-5

Affected: IC 23-19

Sec. 8.

(a) Every investment adviser registered or required to be registered under IC 23-19 shall exercise diligent supervision over the investment advisory activities of its investment adviser representatives and employees. Each investment adviser representative and other office employees shall be subject to the supervision of a designated supervisor.

(b) Written procedures, a copy of which shall be kept in each business office, shall be maintained and enforced and shall set forth the standards and procedures adopted to comply with IC 23-19 and this rule, including, but not limited to, the following:

- (1) Administrative review and written approval of all new client accounts.
- (2) Periodic examination of client accounts to detect and prevent irregularities or abuse.
- (3) Prompt administrative review of all customer complaints.

- (4) Prompt administrative review of correspondence pertaining to the solicitation and execution of any securities transactions effected on behalf of clients.
- (5) The review and written approval, by the designated supervisor, of the delegation by any client of discretionary investment authority with respect to his or her account, and the frequent, periodic examination of all the discretionary accounts to prevent irregularities or abuses.
- (c) Each office location shall be periodically inspected by the investment adviser to assure that the written procedures are enforced.
- (d) It shall be the responsibility of each investment adviser to ascertain that investment adviser representatives have been properly registered prior to rendering investment advice and that proof of registration is immediately accessible prior to rendering the advice.
- (e) It shall be the responsibility of each investment adviser and their supervisory personnel to ensure that all employees are properly trained regarding the disclosure requirements and the:
- (1) administrative;
 - (2) civil; and
 - (3) criminal;
- liability provisions of IC 23-19.
- (f) For the purposes of this section, no person shall be deemed to have failed to diligently supervise any other person if as follows:
- (1) There have been established procedures, and a system for applying the procedures, that would reasonably be expected to prevent and detect, insofar as practicable, any violation by the other persons.
 - (2) The person has reasonably discharged the duties and obligations incumbent upon him or her by reason of the procedures and without reasonable cause to believe that the procedures were not being complied with.

Notes

710 IAC 4-9-8

Securities Division; 710 IAC [4-9-8](#); filed Jun 28, 2010, 2:36 p.m.: 20100728-IR-710100044FRA
Readopted filed 5/12/2016, 1:47 p.m.: 20160608-IR-710160136RFA Readopted filed
11/30/2022, 4:01 p.m.: 20221228-IR-710220301RFA



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Virginia Administrative Code

Title 21. Securities And Retail Franchising

Agency 5. State Corporation Commission, Division of Securities And Retail Franchising

Chapter 80. Investment Advisors

21VAC5-80-170. Supervision of investment advisor representatives.

A. An investment advisor shall be responsible for the acts, practices, and conduct of its investment advisor representatives in connection with advisory services until such time as the investment advisor representatives have been properly terminated as provided by [21VAC5-80-110](#).

B. Every investment advisor shall exercise diligent supervision over the advisory activities of all of its investment advisor representatives.

C. Every investment advisor representative employed by an investment advisor shall be subject to the supervision of a supervisor designated by such investment advisor. The supervisor may be the investment advisor in the case of a sole proprietor, or a partner, officer, office manager or any qualified investment advisor representative in the case of entities other than sole proprietorships. All designated supervisors shall exercise reasonable supervision over the advisory activities of all investment advisor representatives under their responsibility.

D. As part of its responsibility under this section, every investment advisor, except entities employing more than one investment advisor representative, shall establish, maintain and enforce written procedures, a copy of which shall be kept in each business office, which shall set forth the procedures adopted by the investment advisor to comply with the Act and associated regulations, which shall include but not be limited to the following duties imposed by this section; provided that an investment advisor having its principal place of business outside this Commonwealth and registered or licensed, and in compliance with the applicable books and records requirements, in the state where its principal place of business is located, shall only be required to make, keep current, maintain and preserve such of the following required books, ledgers and records as are not in addition to those required under the law of the state in which it maintains its principal place of business:

1. The review and written approval by the designated supervisor of the opening of each new client account;
2. The frequent examination of all client accounts to detect and prevent irregularities or abuses;
3. The prompt review and written approval by a designated supervisor of all advisory transactions by investment advisor representatives and of all correspondence pertaining to the solicitation or execution of all advisory transactions by investment advisor representatives;

4. The prompt review and written approval of the handling of all client complaints.

E. Every investment advisor who has designated more than one supervisor pursuant to subsection C of this section shall designate from among its partners, officers, or other qualified investment advisor representatives, a person or group of persons, independent from the designated business supervisor or supervisors who shall supervise and periodically review the activities of the supervisors designated pursuant to subsection C of this section. All supervisors designated pursuant to this subsection E shall exercise reasonable supervision over the supervisors under their responsibility to ensure compliance with this subsection.

F. Every investment advisor who has more than one business office where its investment advisor representatives offer investment advisory related services shall no less often than annually, conduct an independent physical inspection of each business office under his supervision to ensure (i) investment advisor representatives at the respective business office are in compliance with the statutory provisions of the Act or associated regulations promulgated by the commission and (ii) the written procedures and compliance requirements are being enforced.

Statutory Authority

§§ 12.1-13 and 13.1-523 of the Code of Virginia.

Historical Notes

Derived from Rule 1203, Case No. SEC870040, eff. July 2, 1987; amended, Virginia Register [Volume 13, Issue 25](#), eff. September 1, 1997; [Volume 14, Issue 22](#), eff. July 1, 1998; [Volume 26, Issue 22](#), eff. July 1, 2010; [Volume 29, Issue 20](#), eff. June 3, 2013; Errata, 29:24 VA.R. 3429 July 29, 2013.

Website addresses provided in the Virginia Administrative Code to documents incorporated by reference are for the reader's convenience only, may not necessarily be active or current, and should not be relied upon. To ensure the information incorporated by reference is accurate, the reader is encouraged to use the source document described in the regulation.

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1/29/2025