

CARL J. KUNASEK  
CHAIRMAN  
JIM IRVIN  
COMMISSIONER  
WILLIAM A. MUNDELL  
COMMISSIONER



OPEN MEETING ITEM



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ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

DOCKETED

DEC 14 1999

DATE: December 14, 1999

DOCKET NO.: RS-00000A-98-0240

TO ALL PARTIES:

DOCKETED BY

Enclosed please find the recommendation of Hearing Officer Marc E. Stern. The recommendation has been filed in the form of an Opinion and Order on:

PROPOSED RULEMAKING A.A.C. R14-6-101 *ET SEQ.* UNDER THE  
INVESTMENT MANAGEMENT ACT

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Hearing Officer by filing an original and ten (10) copies of the exceptions with the Commission's Docket Control at the address listed below by 4:00 p.m. on or before:

DECEMBER 23, 1999

The enclosed is NOT an order of the Commission, but a recommendation of the Hearing Officer to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Working Session and Open Meeting to be held on:

JANUARY 5, 2000 AND JANUARY 6, 2000

For more information, you may contact Docket Control at (602) 542-3477 or the Hearing Division at (602) 542-4250.

BRIAN C. McNEIL  
EXECUTIVE SECRETARY

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**BEFORE THE ARIZONA CORPORATION COMMISSION**

CARL J. KUNASEK  
CHAIRMAN  
JIM IRVIN  
COMMISSIONER  
WILLIAM A. MUNDELL  
COMMISSIONER

IN THE MATTER OF:  
PROPOSED RULEMAKING  
A.A.C. R14-6-101 *et seq.* UNDER THE  
INVESTMENT MANAGEMENT ACT.

DOCKET NO. RS-00000A-98-0240  
DECISION NO. \_\_\_\_\_

**OPINION AND ORDER**

DATE OF HEARING: June 10, 1999  
PLACE OF HEARING: Phoenix, Arizona  
PRESIDING OFFICER: Marc E. Stern  
APPEARANCES: Ms. Cheryl T. Farson, General Counsel, on behalf of the Securities Division of the Arizona Corporation Commission.

**BY THE COMMISSION:**

On March 22, 1999, the Securities Division ("Division") of the Arizona Corporation Commission ("Commission") forwarded a proposal recommending that the Commission repeal and remake the Rules promogated under the Investment Management Act ("IMA"), A.A.C. R14-6-101, *et seq.* ("IM Rules") which deal with the regulation of the activities of investment advisers and investment adviser representatives.

On April 1, 1999, the Commission issued Decision No. 61613 which directed the Hearing Division to schedule a hearing on the Division's proposed rulemaking for the purpose of taking public comment with regard to the IM Rules.

On April 30, 1999, the Notice of Proposed Rulemaking was published by the Arizona Secretary of State's Office in the Arizona Administrative Register ("Register").

On May 27, 1999, the Division filed a written response to comments received pursuant to the Commission's Procedural Order.

On June 10, 1999, a public comment hearing was held before a duly authorized Hearing Officer of the Commission at its offices in Phoenix, Arizona. There were no interested parties in

1 attendance at the proceeding, but the Division has received six comment letters following the Notice  
 2 of Proposed Rulemaking from the following organizations: the Investment Counsel Association of  
 3 America, Inc. ("ICAA"); the Certified Financial Planner Board of Standards ("CFP"); the Institute of  
 4 Certified Financial Planners ("ICFP"); Benchmark Financial, Ltd. ("BFL"); a BFL follow up letter;  
 5 and a further BFL letter to which was attached a copy of the ICFP's comments. The Division also  
 6 received several informal written comments from members of the industry. Following the conclusion  
 7 of the proceeding, the matter was taken under advisement pending submission of a recommended  
 8 Opinion and Order to the Commission.

9 \* \* \* \* \*

10 Having considered the entire record herein and being fully advised in the premises, the  
 11 Commission finds, concludes, and orders that:

#### 12 FINDINGS OF FACT

13 1. On March 22, 1999, the Division forwarded to the Commission a proposal which  
 14 recommended that the Commission repeal and remake the Rules promogated under the IMA, A.A.C.  
 15 R14-6-101 *et seq.*, the IM Rules.<sup>1</sup>

16 2. The Division's proposal requires the repeal of A.A.C. R14-6-101 through R14-6-104  
 17 and R14-6-201 through R14-6-209 and the making of four new Rules, A.A.C. R14-6-106, R14-6-210  
 18 through R14-6-212.

19 3. The adoption of the recommended IM Rules will enable the Commission to  
 20 accomplish the following:

- 21 • acknowledge, and conform with, certain provisions of the federal National  
 22 Securities Markets Improvement Act of 1996 ("NSMIA") and Rules  
 promogated thereunder by the Securities and Exchange Commission ("SEC");
- 23 • provide instruction for Investment Advisers and Investment Adviser  
 24 Representatives who wish to advertise on the Internet;
- 25 • clarify the statutory definition of "Investment Adviser Representative";

26 <sup>1</sup> On June 30, 1999, the Division filed Notice of Termination of Rulemaking with respect to A.A.C. R14-  
 27 6-204 ("Rule 204") which deals with written examinations because, after the Division had commenced the above-  
 28 captioned proceeding, the North American Securities Administrators Association ("NASAA") had adopted a new  
 examination which was to be implemented after December 31, 1999 and thus, additional amendments to Rule 204 were  
 made necessary in a separate rulemaking package that resulted in Decision No. 62095 (November 19, 1999) in which the  
 Commission approved Rule 204.

- 1 • provide guidance concerning the term "solicit", as used in the IMA;
- 2 • clarify the filing requirements for licensure and notice filing; and
- 3 • make certain technical and grammatical changes.

4 4. The Division is proposing the repeal and replacement of the existing IM Rules  
5 because, when they were first adopted, the Commission's procedures for the Division's Rules did not  
6 include certification by the Attorney General's Office. The Commission now seeks approval for all  
7 Division Rules in accordance with A.R.S. § 41-1044 and believes that repealing and replacing the  
8 current IM Rules, rather than amending them, is the prudent procedural mechanism for effectively  
9 "amending" the current IM Rules.

10 5. On April 1, 1999, the Commission issued Decision No. 61613 which directed that a  
11 hearing be scheduled regarding the IM Rules for the purpose of taking public comment.

12 6. By Procedural Order issued April 8, 1999, a public comment hearing was scheduled  
13 for June 10, 1999.

14 7. Pursuant to law, Notice of Proposed Rulemaking was given on April 30, 1999 in the  
15 Register.

16 8. Subsequent to the Commission's Procedural Order, the following organizations  
17 submitted written comments: BFL on May 7, 1999 followed by two supplemental submissions on  
18 May 10 and May 18, 1999; the ICFP on May 12, 1999; the CFP on May 17, 1999; and the ICAA on  
19 May 19, 1999.

20 9. Generally, these comments were supportive of the Division's efforts, but the ICFP and  
21 the ICAA did suggest some changes which, in the case of the ICAA recommendations with respect to  
22 Rules R14-6-206 through R14-6-209, were substantive in nature and, if adopted by the Commission,  
23 would require renoticing in the Register.

24 10. Pursuant to the Commission's Procedural Order, the Division filed its Response to the  
25 comments on May 27, 1999.

26 11. On June 30, 1999, the Division filed a Notice of Termination of Rulemaking regarding  
27 A.A.C. R14-6-204. This notice was published in the Register on July 23, 1999.

28 12. In response to the written comments, the Division has proposed changes to the IM

1 Rules however; these revisions to the IM Rules by the Division are not substantially different from  
2 the IM Rules as filed with the Secretary of State's Office, and it will not be necessary to commence a  
3 new rulemaking proceeding.

4 13. The hearing was held as scheduled on June 10, 1999, and no members of the public  
5 appeared to comment on the proposed IM Rules.

6 14. Rule R14-6-106 ("Rule 106") provides that the general dissemination of information  
7 on the Internet by investment advisers or investment adviser representatives shall not be deemed  
8 transacting business in Arizona based solely on that activity if the conditions contained in Rule 106  
9 are observed.

10 15. The ICFP recommended three changes to Rule 106 as proposed by the Division in the  
11 following manner:

- 12 • that the Commission include the term "federal covered adviser" in the Rule to  
13 clarify that Rule 106 applies to both state and federally registered investment  
14 advisers;
- 15 • that the Commission delete the prohibition from effecting transactions in  
16 securities contained in Rule 106(A)(1)(b) and 106(A)(4) stating that,  
17 technically speaking, an adviser cannot execute a securities transaction under  
18 the IM Act; and
- 19 • that the Commission include in subsection (A)(4) the phrase "unless the  
20 investment adviser or investment adviser representative is compliant with or  
21 exempt from licensure or notice filing requirements" so that investment  
22 advisers are not precluded from a relying upon the de minimus exemption.

23 16. With respect to the ICFP's first recommendation, the Division recommended making  
24 no change because throughout the IMA and the IM Rules promulgated thereunder, the term  
25 "investment adviser" refers to all persons who fall within the statutory definition, whether federally  
26 registered or state licensed.

27 17. With respect to the ICFP's second recommendation, the Division revised Rule 106 to  
28 reflect the deletion of the language opposed by the ICFP.

18 18. With respect to the third recommendation by the ICFP, the Division pointed out the  
19 NASAA interpretive order upon which Rule 106(A)(4) is based does not include the suggested  
20 language and recommended no changes.

21 19. Rule R14-6-201 ("Rule 201") identifies the books and record keeping requirements

1 and imposes the same requirements as those imposed upon federally registered investment advisers  
2 under the federal rule and includes three additional books and records provisions.

3       20.     The ICAA indicated that it strongly supported the adoption of Rule 201, but the ICAA  
4 commented that the Commission should utilize the NASAA model language because it believes that  
5 the model language was less ambiguous.

6       21.     The Division disagreed with the ICAA stating that proposed Rule 201 is more concise  
7 than that of the NASAA model language.

8       22.     Rule R14-6-203 enumerates practices that are dishonest and unethical under A.R.S. §  
9 44-3201(A)(13) which provides that the license of an Arizona investment adviser or investment  
10 adviser representative may be denied, revoked, or suspended if the investment adviser or investment  
11 adviser representative engages in dishonest or unethical practices in the securities industry.

12       23.     The ICAA comments that it does not believe that subsection (B) of Rule 203 is  
13 adequate because it does not exclude from the Rule's purview investment adviser representatives of  
14 federal covered advisers. The ICAA sought the revision of Rule 203 to apply only to licensed  
15 investment advisers and their investment adviser representatives in order to avoid "back door"  
16 regulation of federal covered advisers under the jurisdiction of the SEC.

17       24.     In response to the comments of the ICAA, the Division deleted subsection (B) of Rule  
18 203 and revised subsection (A) consistent with its position that all investment adviser representatives  
19 who are licensed in Arizona are and should be subject to statutory and Rule provisions under which  
20 those licenses may be denied, suspended, or revoked.

21       25.     Rules R14-6-206 ("Rule 206"), R14-6-207 ("Rule 207"), R14-6-208 ("Rule 208") and  
22 R14-6-209 ("Rule 209") enumerate activities that constitute a fraudulent practice within the meaning  
23 of A.R.S. § 44-3241(A)(4), which states it is a fraudulent practice and unlawful to engage in any  
24 transaction, practice, or course of business that operates or would operate as a fraud or deceit.

25       26.     Rule 206 states that it is a fraudulent practice for an investment adviser to take or have  
26 custody of any securities or funds of any client unless the investment adviser complies with the  
27 provisions of Rule 206.

28       27.     The ICFP commented that the Commission should include a safe harbor in Rule 206

1 that would allow an investment adviser to accept third-party checks and endorsed stock certificates to  
2 forward to other persons as a service to its clients without being deemed to have custody of the  
3 checks and stock certificates and urged the Commission to adopt a provision similar to the safe  
4 harbor provisions contained in the SEC custody rule under the Securities Exchange Act of 1934 and  
5 the NASAA model rule for broker-dealers.

6 28. It is the Division's understanding that the ICFP has also approached the SEC and  
7 NASAA with respect to the inclusion of its proposed safe harbor in Rule 206. The SEC has taken the  
8 matter under advisement and NASAA is unwilling to advocate changes in the custody definition  
9 which are not accepted by the SEC. Thus, the Division concurs with NASAA that the adoption of the  
10 ICFP's proposed safe harbor prior to SEC action on the issue would be premature and does not  
11 recommend any changes to Rule 206.

12 29. With respect to Rules 206 through 209, the ICAA comments that federal covered  
13 advisers and their investment adviser representatives should be specifically excluded from the  
14 application of Rules 206 through 209.

15 30. The Division responded that with respect to federal covered advisers, it proposed a  
16 provision in each rule that limits the application of the rule to the extent permitted by Section 203A  
17 of the federal Investment Advisers Act of 1940 ("IAA") which was amended by the NSMIA that  
18 precludes state regulation of federal covered advisers except that "nothing in [section 203A] shall  
19 prohibit the securities commission (or any agency or office performing like functions) of any State  
20 from investigating and bringing enforcement actions with respect to fraud or deceit against an  
21 investment adviser or person associated with an investment adviser."

22 31. The Division's position is that the interpretation of Section 203A and the extent of  
23 State jurisdiction under that statute should be left to more appropriate forums, i.e. the courts and  
24 Congress. However, with respect to the ICAA comments, the Division did propose simplification of  
25 the language contained in subsections (B) in Rules 206 and 207, subsection (D) in Rule 208, and in  
26 subsection (F) in Rule 209.

27 32. Proposed Rule A.A.C. R14-6-210 ("Rule 210") relates to the licensure of investment  
28 adviser representatives and defines them based on the definition contained in federal Rule 203A-3

1 under the IAA and the NASAA model language that establishes certain dollar thresholds under  
2 management with the investment adviser.

3 33. Both the ICFP and the ICAA commented that the dollar thresholds as set forth in  
4 proposed Rule 210 should be modified since the sums referenced in the federal rule had been  
5 amended since the drafting of the Division's proposed Rule 210, and in response thereto, the Division  
6 agreed and revised Rule 210 to reflect the amendments to the dollar threshold amounts referenced in  
7 the federal amendment.

8 34. Proposed Rule A.A.C. R14-6-212 ("Rule 212") sets forth the filing requirements for  
9 applications for licensure, notice filings, and renewals.

10 35. In its comment letter, the ICAA requested that the filing requirements be listed with  
11 greater specificity than in proposed Rule 212, and in response thereto, the Division made a number of  
12 revisions setting forth with specificity the requirements for the applications covered by proposed Rule  
13 212.

14 36. At the request of the presiding Hearing Officer, the Division provided a revised copy  
15 of its proposed IM Rules which reflect the Division's changes after written comments were filed.

16 37. The IM Rules are set forth in Appendix A, attached hereto and incorporated herein by  
17 reference.

18 38. Pursuant to A.R.S. § 41-1055(D)(3), no Economic, Small Business, and Consumer  
19 Impact Statement is required.

20 39. The Concise Explanatory Statement is set forth in Appendix B, attached hereto and  
21 incorporated by reference.

#### 22 CONCLUSIONS OF LAW

23 1. Pursuant to A.R.S. § 44-3131 and Article XV Sections 4, 6, and 13 of the Arizona  
24 Constitution, the Commission has jurisdiction to adopt the proposed IM Rules.

25 2. Notice of the hearing was given in the manner prescribed by law.

26 3. Adoption of the proposed IM Rules is in the public interest.

27 4. The Concise Explanatory Statement as set forth in Appendix B should be adopted.

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**ORDER**

IT IS THEREFORE ORDERED that the IM Rules, as set forth in Appendix A, and the Concise Explanatory Statement, as set forth in Appendix B, are hereby adopted.

IT IS FURTHER ORDERED that the Commission's Securities Division shall submit the IM Rules to the Attorney General's Office for certification.

IT IS FURTHER ORDERED that the Commission's Securities Division is authorized to make changes in the adopted IM Rules and to the adopted Concise Explanatory Statement in response to comments received by the Attorney General's Office during the approval process under A.R.S. § 41-1044 unless, after notification of those changes, the Commission requires otherwise.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN

COMMISSIONER

COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this \_\_\_\_ day of \_\_\_\_\_, 2000.

\_\_\_\_\_  
BRIAN C. McNEIL  
EXECUTIVE SECRETARY

DISSENT \_\_\_\_\_  
MES:bbs

1 SERVICE LIST FOR: A.A.C. R14-6-101 *et seq.* UNDER THE INVESTMENT  
2 MANAGEMENT ACT.

3 DOCKET NO. RS-00000A-98-0240

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**APPENDIX A**

**TITLE 14. PUBLIC SERVICE CORPORATIONS; CORPORATIONS**

**AND ASSOCIATIONS; SECURITIES REGULATION**

**CHAPTER 6. INVESTMENT MANAGEMENT**

**ARTICLE 1. GENERAL PROVISIONS RELATING TO THE ARIZONA**

**INVESTMENT MANAGEMENT ACT**

- R14-6-101. Definitions
- R14-6-102. Scope of Provisions Rules
- R14-6-103 Severability
- R14-6-104 Enforcement of the Arizona Investment Management Act
- R14-6-106 General Dissemination of Information on the Internet

**ARTICLE 2. DUTIES OF INVESTMENT ADVISERS AND**

**INVESTMENT ADVISER REPRESENTATIVES**

- R14-6-201. Books and Records of Investment Advisers
- R14-6-202. Supervision
- R14-6-203. Dishonest and Unethical Practices
- R14-6-205. Information to be Furnished to Clients ("Brochure Rule")
- R14-6-206. Custody of Client Funds or Securities by Investment Advisers
- R14-6-207. Suitability of Investment Advisory Services
- R14-6-208. Advertisements by Investment Advisers or Investment Adviser Representatives
- R14-6-209. Financial and Disciplinary Information that Investment Advisers Shall Disclose to  
Clients
- R14-6-210. Licensure of Investment Adviser Representatives

R14-6-211. Solicitation

R14-6-212. Application, Notice Filing, and Renewal Filing Requirements

ARTICLE 1. GENERAL PROVISIONS RELATING TO THE ARIZONA  
INVESTMENT MANAGEMENT ACT

R14-6-101. Definitions

- A. The definitions set forth in A.R.S. §§ 44-1801 and 44-3101 shall apply to the rules promulgated under A.R.S. title 44, chapter 13.
- B. The following definitions shall apply to all rules promulgated under A.R.S. title 44, chapter 13, unless the context otherwise requires:
- ~~1.~~ "IM Act" means the ~~Arizona Investment Management Act, A.R.S. § 44-3101 et seq.~~
  12. "Advertisement" means, except as set forth in subsections (d) and (e), any notice, circular, letter, or other written, oral, or electronically-generated communication addressed to or reasonably designed by the investment adviser or investment adviser representative to be accessed by more than 1 person, or any notice or other announcement in any publication or by radio or television, that ~~which~~ directly or indirectly offers:
    - a. Any analysis, report, or publication that either concerns concerning securities, or ~~which~~ is to be used in making any determination as to when to buy or sell any security; or which security to buy or sell; or
    - b. Any graph, chart, formula, or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell; or
    - c. Any other investment advisory service with regard to securities; or
    - d. A communication over a computer on-line service including, but not limited to, an electronic bulletin board shall not be deemed to be an advertisement when an investment adviser or an investment adviser representative is either:
      - i. Engaged in a discussion regarding securities and does not receive compensation from any person for the discussion; or
      - ii. Responds to unsolicited inquiries regarding the provision of investment advisory services.
    - e. A communication by 1 or more investment advisers or investment adviser representatives shall not be deemed to be an advertisement when the communication is addressed solely to or is reasonably designed to be accessed solely by other investment advisers or investment adviser representatives.

23. “Certified public accountant” or “CPA” means an accountant who has been registered or licensed to practice public accounting and is permitted to use the title “certified public accountant” and to use the initials “CPA” after the accountant’s name.
- ~~4.~~ “Chapter 13” means A.R.S. title 44, chapter 13.
- ~~5.~~ “Commodity Exchange Act” means ~~7 U.S.C. 1 et seq. (1988 & Supp. V 1993), which is incorporated by reference, does not contain any later amendments or editions, and is on file in the Office of the Secretary of state. Copies of the Commodity Exchange Act are available from the Securities Division of the Corporation Commission and from the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402.~~
- ~~6.~~ “Division” means ~~the Securities Division of the Corporation Commission.~~
3. “Federal covered adviser” means an investment adviser registered under the investment advisers act of 1940.
47. “Fixed fee basis” means an investment advisory fee ~~that which~~ at any given time can be precisely established in a dollar amount without regard to the investment performance or value of an account and ~~that which~~ is not based on the purchase or sale of specific securities.
58. “Form ADV” means the Uniform Application for Investment Adviser Registration, 17 CFR 279.1, (1994) (Form amended at 59 FR 21657 (1994) and 59 FR 27659 (1994)); ~~which is incorporated by reference, does not contain any later amendments or editions, and is on file in the Office of the Secretary of state. Copies of Form ADV are available from the Division and from the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402.~~
6. “IM Act” means the Arizona Investment Management Act, A.R.S. § 44-3101 et seq.
79. “Impersonal advisory services” means investment advisory services provided solely:
- By means of written material or oral statements that do not purport to meet the objectives or needs of specific individuals or accounts;
  - Through the issuance of statistical information containing no expression of opinion as to the investment merits of a particular security; or
  - Any combination of the foregoing services.
8. “Internet” means all proprietary or common carrier electronic systems, or similar media.
9. “Internet communication” means the distribution of information on the Internet.
10. “Investment-related” means pertaining to securities, commodities, banking, insurance, or real estate, including but not limited to acting as or being associated with a broker-

dealer, investment company, investment adviser, government securities broker or dealer, municipal securities dealer, bank, savings and loan association, entity, or person required to be registered under the Commodity Exchange Act, or fiduciary.

11. “Involved” means acting or aiding, abetting, causing, counseling, commanding, inducing, conspiring with, or failing reasonably to supervise another in doing an act.
12. “Management person” means a person with power to exercise, directly or indirectly, a controlling influence over the management or policies of an investment adviser that is a company or to determine the general investment advice given to clients.
1310. “NASAA” means the North American Securities Administrators Association, Inc., or any successor organization.
1411. “NASD” means the National Association of Securities Dealers, Inc., or any successor or subsidiary organization.
1512. “Relative” means any relationship by blood, marriage, or adoption, not more remote than 1st cousin.
1613. “Rule 204-2” means United States securities and exchange commission rule 204-2, 17 CFR 275.204-2 (1998+1994), which is incorporated by reference, does not contain any later amendments or editions, and is on file in the office of the secretary of state. Copies of Rule 204-2 are available from the Division and from the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402.
- ~~14. “Rule 204-3” means United States Securities and Exchange Commission Rule 204-3, 59 FR 21661 (1994) (to be codified at 17 CFR 275.204.3), which is incorporated by reference, does not contain any later amendments or editions, and is on file in the Office of the Secretary of State. Copies of Rule 204-3 are available from the Division and from the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402.~~
1715. “SEC” means United States Securities and Exchange Commission.
1816. “Securities Act” means the Securities Act of Arizona, A.R.S. § 44-1801 *et seq.*
19. “Self-regulatory organization” or “SRO” means any national securities or commodities exchange, registered association, or registered clearing agency.
2017. “Unincorporated organization” includes a limited liability company for purposes of the definition of “person,” as defined in A.R.S. § 44-1801(13).
21. “Wrap fee program” means a program under which any client is charged a specified fee or fees not based directly upon transactions in a client’s account for investment advisory services, which may include portfolio management or advice concerning the selection of other investment advisers, and execution of client transactions.

R14-6-102. Scope of Provisions this Article

The following Sections rules are adopted by the Commission under the authority granted pursuant to A.R.S. title 44, chapter 13. Such Sections All rules shall be generally applicable to the administration of the IM Act, but the Commission may at any time abrogate or waive strict adherence to any particular provision when rule in any specific instance where the Commission deems may deem it advisable for the equitable administration of the law. When not in conflict with these Sections rules, the applicable provisions of A.A.C. R14-3-101 through R14-3-113 also shall apply.

R14-6-103. Severability

The provisions of the Sections rules promulgated under A.R.S. title 44, chapter 13, are severable. If any provision of a Section rule is held to be invalid, such invalidity shall not affect other provisions that which can be given effect without the invalid provision.

R14-6-104. Enforcement of the Arizona Investment Management Act

The provisions rules relating to investigations and examinations conducted pursuant to and orders issued under the IM Act are contained at A.A.C. R14-4-301 through R14-4-308.

R14-6-106. General Dissemination of Information on the Internet

A. Investment advisers and investment adviser representatives who use the Internet to distribute information on products and services directed generally to anyone having access to the Internet shall not be deemed to be transacting business in Arizona for purposes of Article 4 of the IM Act based solely on that activity if the following conditions are observed:

1. The Internet communication includes clear and prominent statements that:
  - a. The investment adviser or investment adviser representative may only transact business in Arizona if first compliant with or exempt from licensure or notice filing requirements.
  - b. The investment adviser or investment adviser representative may only communicate with persons in Arizona individually about rendering investment advice for compensation, or solicit or negotiate for the sale of investment advisory services if first compliant with or exempt from licensure or notice filing requirements.
2. The investment adviser or investment adviser representative complies with the statements contained in the Internet communication under subsection (A)(1).
3. The Internet communication is subject to a mechanism, policy, or procedure reasonably designed to ensure that, prior to any subsequent, direct communication with prospective customers or clients in Arizona, the investment adviser or investment

adviser representative is first compliant with or exempt from the licensure or notice filing requirements of the IM Act.

4. The Internet communication does not involve either the rendering of investment advice for compensation or individualized solicitation or negotiations for the sale of investment advisory services in Arizona.

5. In the case of an investment adviser representative:

a. The affiliation with an investment adviser is prominently disclosed in the Internet communication.

b. The investment adviser with whom the investment adviser representative is associated first authorizes the Internet communication.

c. The investment adviser with whom the investment adviser representative is associated retains responsibility for reviewing and approving the content of any Internet communication.

d. In distributing information through the Internet, the investment adviser representative acts within the scope of the authority granted by the investment adviser.

B. Compliance with this Section relieves the investment adviser or investment adviser representative of licensure or notice filing requirements only. The investment adviser or investment adviser representative is subject to Article 9 of the IM Act and related regulations.

## ARTICLE 2. DUTIES OF INVESTMENT ADVISERS AND INVESTMENT ADVISER REPRESENTATIVES

### R14-6-201. Books and Records of Investment Advisers

A. Except as provided in subsection (G), each ~~Each~~ investment adviser licensed or required to be licensed under the IM Act shall make, maintain, and preserve books and records in accordance with the requirements imposed on federal covered advisers under ~~compliance with rule 204-2~~. The investment adviser shall ~~concurrently~~ file with the Commission ~~commission~~ a copy of any notices or written undertakings required to be filed by federal covered advisers with the SEC under rule 204-2.

B. To the extent that the SEC amends rule 204-2, investment advisers in compliance with the requirements contained in rule 204-2 as amended shall not be deemed to be in violation of this Section and shall not be subject to enforcement action by the Commission for violation of this Section to the extent that the violation results solely from the investment adviser's compliance with the requirements contained in the amended rule 204-2.

- C. ~~As of the effective date of this Section, Except as provided in subsection (G),~~ each investment adviser licensed or required to be licensed under the IM Act shall make, maintain, and preserve for at least 5 years the following additional books and records:
1. A file containing each customer complaint received relating to advisory activities conducted by the investment adviser, its investment advisory representatives, or its employees, and all correspondence relating to such complaint.;
  2. A file containing all advertisements used by the investment adviser or any investment adviser representative, including any radio or television transcripts and advertisements placed on computer or electronic bulletin boards.;
  3. In each client file, all correspondence received or sent by the investment adviser, any investment adviser representative, or any employee, that related to any client account, securities, or funds.
- D. Books and records that are required to be maintained pursuant to subsection (A) shall be available for inspection by the Commission ~~commission~~ in accordance with the provisions of rule 204-2. Books and records that are required to be maintained pursuant to subsection (C) shall be readily accessible and may be preserved in accordance with rule 204-2(g). Notwithstanding other record preservation requirements of this Section, the following records or copies shall be maintained at the business location of the investment adviser from which the customer or client is being provided or has been provided with investment advisory services:
1. Records required to be preserved under rule 204-2(a)(3), (a)(7) through (10), (a) (14 through (15), (b), and (c).
  2. Records required to be preserved under subsection (C) of this Section.
- E. A record made and kept under a provision of subsections (A) or (C) that contains all of the information required under any other provision of subsections (A) or (C) in a readily accessible format need not be maintained in duplicate in order to meet the requirements of the other provision.
- F. Any book or other record made, kept, maintained, and preserved in compliance with A.A.C. R14-4-132 that is substantially the same as the book or other record required to be made, kept, maintained, and preserved under this Section shall be deemed to be made, kept, maintained, and preserved in compliance with this Section.
- G. Every investment adviser licensed or required to be licensed in Arizona that has its principal place of business in a state other than Arizona shall be exempt from the requirements of this Section, provided the investment adviser is licensed in such other state and is in compliance with that state's recordkeeping requirements.

## R14-6-202. Supervision

For purposes of A.R.S. § 44-3201(A)(12), no investment adviser shall be deemed to have failed to reasonably supervise its investment adviser representatives or employees if:

1. ~~The investment adviser has~~ There have been established and maintained written procedures, and a system for applying such procedures, ~~that which would~~ reasonably may be expected to prevent and detect, insofar as practicable, any violation of the IM Act or any rule adopted thereunder by such investment adviser representatives or employees ~~of the IM Act, or any rule adopted thereunder;~~ and
2. Such investment adviser has ~~reasonably discharged~~ reasonably the duties and obligations incumbent upon it by reason of such procedures and system without reasonable cause to believe that the investment adviser representatives or employees are not complying with such procedures and system ~~were not being complied with.~~

## R14-6-203. Dishonest and Unethical Practices

“Dishonest and unethical practices<sup>2</sup>,” with respect to investment advisers and investment adviser representatives subject to ~~under~~ A.R.S. § 44-3201(A)(13), shall include, but not be limited to, the following:

1. Refusing to allow or otherwise impeding ~~designees of the Commission~~ from conducting an investigation or examination under the IM Act or any rule adopted thereunder.;
2. Placing an order to purchase or sell a security for the account of a client without authority to do so.;
3. Placing an order to purchase or sell a security for the account of a client upon instruction of a 3rd party without first obtaining a written 3rd-party trading authorization from the client.;
4. Exercising any discretionary power in placing an order for the purchase or sale of securities for a client without first obtaining written discretionary authority, unless the discretionary power relates solely to the price at which, or the time when, an order involving a definite amount of specified securities shall be executed, or both.;
5. Inducing trading in a client’s account that is excessive in size or frequency in view of the financial resources, investment objectives, and character of the account.;
6. Borrowing money or securities from a client or client’s account unless the client has authorized the borrowing in writing and is a dealer, an affiliate, or relative of the investment adviser or investment adviser representative, or a financial institution or other entity engaged in the business of loaning funds or securities.;
7. Loaning money to a client unless the investment adviser or investment adviser representative is a financial institution or other entity engaged in the business of

- loaning funds or the client is an affiliate or relative of the investment adviser or investment adviser representative.;
8. Misrepresenting to any client, or prospective client, the qualifications of the investment adviser, the investment adviser representative, or an employee, or misrepresenting the nature of the investment advisory services being offered or fees to be charged for such services, or omitting to state a material fact necessary to make the statements made regarding qualifications, services, or fees, in light of the circumstances under which they were made, not misleading.;
  9. Providing a report or recommendation to any client prepared by someone other than the investment adviser or investment adviser representative without disclosing that fact. This prohibition does not apply to a situation where the investment adviser or investment adviser representative uses published research reports or statistical analyses to render investment advice or where the investment adviser or investment adviser representative orders such a report in the ordinary course of providing service.;
  10. Charging a client an investment advisory fee that is unreasonable in light of the type of services to be provided, the experience and expertise of the investment adviser or the investment adviser representative, and the sophistication and bargaining power of the client, ~~and whether the investment adviser has disclosed that lower fees for comparable services may be available from other sources;~~
  11. Failing to disclose to a client in writing before entering into or renewing an investment advisory agreement with that client, or before any investment advice is rendered, any material conflict of interest relating to the investment adviser, the investment adviser representative, or an employee that ~~which~~ could reasonably be expected to impair the rendering of unbiased and objective advice including, but not limited to:
    - a. Compensation arrangements connected with investment advisory services to clients that ~~which~~ are in addition to compensation from such clients for those services; and
    - b. Charging a client an investment advisory fee for rendering investment advice without disclosing that compensation for executing securities transactions pursuant to such investment advice will be received by the investment adviser, the investment adviser representative, or an employee.;
  12. ~~Guaranteeing~~ Promising or guaranteeing a client that a gain, loss, or other outcome will be achieved as a result of the investment advice.;
  13. Disclosing the identity, affairs, or investments of a client to any 3<sup>rd</sup> party unless required by law to do so, or ~~unless~~ consented to by the client.;
  14. With respect to any client initially retained after July 19, 1996, ~~the effective date of this rule~~, entering into, extending, modifying, or renewing any investment advisory contract except a contract for impersonal advisory services unless such contract is in writing and discloses all the material terms of the contract including but not limited to

the services to be provided, the investment advisory fee or the formula for computing the fee, the amount or the manner of calculation of the amount of the prepaid fee to be returned in the event of contract termination or non-performance, and that of any grant of any discretionary power to the investment adviser;

15. ~~With respect to any client initially retained after July 19, 1996, the effective date of this rule, entering into, extending, modifying, or renewing any investment advisory contract without disclosing, in writing to the client, any affirmative answers to disciplinary questions numbered 11A and 11K in Part I of the Form ADV;~~
16. ~~Entering into, extending, modifying, or renewing any investment advisory contract that which allows the assignment of such contract by the investment adviser without the prior written consent of the client;~~
17. ~~Committing any act that results in denial, revocation, or suspension by an agency of any state of a license or registration relating to securities ~~by an agency of any state~~, where such denial, revocation, or suspension arises out of any scheme, act, practice, or course of business that operates or would operate as a fraud or deceit, or arises out of a violation of Article 13 of the Securities Act or the rules promulgated thereunder; ~~and~~~~
18. ~~Failing to comply with any arbitration award issued in connection with doing business as an investment adviser or investment adviser representative or as a dealer or salesman as defined in A.R.S. title 44, chapter 12.~~

1918. ~~For any investment adviser to, in any manner, request, or require, in any contract, agreement, or otherwise, any condition, stipulation, or provision binding on Requesting or requiring any person to waive compliance with any provision of the IM Act or the rules thereunder. Any such waiver shall be void.~~

R14-6-205. Information to be Furnished to Clients ("Brochure Rule")

- A. ~~Each investment adviser licensed or required to be licensed under the IM Act shall comply with the provisions of Rule 204-3 furnish each client and prospective client with a written disclosure statement that may be either a copy of Part II of its Form ADV or a written document containing at least the information required by Part II of Form ADV.~~
- B. ~~To the extent that the SEC amends Rule 204-3, investment advisers in compliance with Rule 204-3 as amended shall not be deemed to be in violation of this Section and shall not be subject to enforcement action by the Commission for violation of this Section to the extent that the violation results solely from the investment adviser's compliance with the amended Rule 204-3.~~
- B. The information required to be disclosed by subsection (A) shall be disclosed to clients not less than 48 hours prior to entering into any written or oral investment advisory contract, or no later than the time of entering into such contract if the client has the right to terminate the contract without penalty within 5 business days after entering into the contract.

- C. An investment adviser need not deliver the statement required by subsection (A) in connection with entering into an investment company contract or a contract for impersonal advisory services. The investment adviser shall, however, offer in writing to deliver the statement within 7 business days upon receipt of a written request.
- D. Without charge and to each of its clients, an investment adviser licensed or required to be licensed under the IM Act shall deliver annually within 7 business days upon receipt of a written request or offer in writing to deliver the statement required by this Section.
- E. If an investment adviser licensed or required to be licensed under the IM Act renders substantially different types of investment advisory services to different clients, any information required by Part II of Form ADV may be omitted from the statement furnished to the client or prospective client if such information is applicable only to a type of investment advisory service or fee that is not rendered or charged, or proposed to be rendered or charged, to that client or prospective client.
- F. Nothing in this Section shall relieve any investment adviser from any obligation pursuant to any provision of the IM Act or the rules and regulations thereunder or other federal or state law to disclose any information to its clients or prospective clients not specifically required by this Section.
- G. An investment adviser licensed or required to be licensed under the IM Act that is compensated under a wrap fee program for sponsoring, organizing, or administering the program, or for selecting, or providing advice to clients regarding the selection of, other investment advisers in the programs, shall, in lieu of the written disclosure statement required by subsection (A) and in accordance with the other subsections of this Section, furnish each client and prospective client of the wrap fee program with a written disclosure statement containing at least the information required by Schedule H of Form ADV. Any additional information included in such disclosure shall be limited to information concerning wrap fee programs sponsored by the investment adviser.
- H. If the investment adviser is required under subsection (G) to furnish disclosure statements to clients or prospective clients of more than 1 wrap fee program, the investment adviser may omit from the disclosure statement furnished to clients and prospective clients of a wrap fee program or programs any information required by Schedule H that is not applicable to clients or prospective clients of that wrap fee program or programs.
- I. An investment adviser need not furnish the written disclosure statement required by subsection (G) to clients and prospective clients of a wrap fee program if another investment adviser is required to furnish and does furnish the written disclosure statement to all clients and prospective clients of the wrap fee program.

R14-6-206. Custody of Client Funds or Securities by Investment Advisers

- A. Except as otherwise provided in subsection (B), it shall constitute a fraudulent practice within the meaning of A.R.S. § 44-3241(A)(4) for any investment adviser to take or have custody of any securities or funds of any client unless:

1. The investment adviser notifies the Commission in writing that the investment adviser has or may have custody of client funds or securities. Such notification may be given on Form ADV.;
2. The securities of each client are segregated, marked to identify the particular client having the beneficial interest therein, and held in safekeeping in some place reasonably free from risk of destruction or other loss.;
3. All client funds are deposited in 1 or more bank or similar accounts containing only clients' funds, such accounts are maintained in the name of the investment adviser as agent or trustee for such clients, and the investment adviser maintains a separate record for each such account showing the name and address of the bank or similar institution where the account is maintained, the dates and amounts of deposits into and withdrawals from the account, and the exact amount of each client's beneficial interest in the account.;
4. Immediately after accepting custody or possession of funds or securities from any client, the investment adviser notifies the client in writing of the place where and the manner in which the funds and securities will be maintained and, subsequently, if and when there is a change in the place where or the manner in which the funds or securities are maintained, the investment adviser gives written notice to the client within prompt (but in no event more than 10 business days.) ~~written notice thereof to the client;~~
5. At least once every 3 months, the investment adviser sends each client an itemized statement showing the client's funds and securities in the investment adviser's custody at the end of such period and all debits, credits, and transactions in the client's account during such period.;
6. At least once every calendar year, an independent CPA or public accountant verifies all client funds and securities by actual examination at a time chosen by the independent CPA or public accountant without prior notice to the investment adviser. The independent CPA's or public accountant's report stating that such CPA or public accountant has made an examination of such funds and securities, and describing the nature and extent of the examination, shall be filed with the Commission within 30 calendar days promptly (but in no event more than 30 days) after the each such examination.

B. With respect to federal covered advisers, the provisions of this Section only apply to the extent permitted by Section 203A of the investment advisers act of 1940.

R14-6-207. Suitability of Investment Advisory Services

A. Except as otherwise provided in subsection (B), it shall constitute a fraudulent practice within the meaning of A.R.S. § 44-3241(A)(4) for any person providing investment advisory services to provide investment advisory services to any client, other than in connection with impersonal advisory services, unless the person:

1. Before providing any investment advisory services, and as appropriate thereafter, makes a reasonable inquiry of the client as to the financial situation, investment experience, and investment objectives of the client; and
2. Reasonably determines that the investment advisory services are suitable for the client based upon the information obtained from the client in accordance with subsection (1) above.

B. With respect to federal covered advisers, the provisions of this Section only apply to the extent permitted by Section 203A of the investment advisers act of 1940.

R14-6-208. Advertisements by Investment Advisers or Investment Adviser Representatives

A. Except as otherwise provided in subsection (D), it shall constitute a fraudulent practice within the meaning of A.R.S. § 44-3241(A)(4) for any investment adviser or investment adviser representative, directly or indirectly, to use any advertisement:

1. Which refers, directly or indirectly, to any testimonial of any kind concerning the investment adviser or investment adviser representative or concerning any advice, analysis, report, or other service rendered by such investment adviser or investment adviser representative; ~~or~~
2. Which refers, directly or indirectly, to past specific recommendations of the such investment adviser or investment adviser representative that which were or would have been profitable to any person; except that an investment adviser or investment adviser representative may provide, however, that this shall not prohibit an advertisement which sets out or offers to furnish or offer to furnish a list of all recommendations made by the such investment adviser or investment adviser representative within the immediately preceding period of not less than 1 year if the investment adviser or investment adviser representative also furnishes; if such advertisement, and such list if it is furnished separately:
  - a. The States ~~the~~ name of each such security recommended, the date and nature of each such recommendation (for example, whether to buy, sell, or hold), the market price at that time, the price at which the recommendation was to be acted upon, and the most recently available market price of each such security ~~as of the most recent practicable date;~~ and
  - b. The Contains ~~the~~ following cautionary legend on the 1st page thereof in prominent print or type ~~as large as the largest print or type used in the body or text thereof:~~ "It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities in this list;" ~~or~~
3. Which represents, directly or indirectly, that any graph, chart, formula, or other device being offered can in and of itself be used to determine which securities to buy or sell, or when to buy or sell them; or which represents, directly or indirectly, that any graph, chart, formula, or other device being offered will assist any person in making that person's ~~his or her~~ own decisions as to which securities to buy or sell, or when to buy

or sell them, without prominently disclosing in such advertisement the limitations thereof and the difficulties with respect to its use; ~~or~~

4. Which ~~represents, directly or indirectly, that contains any statement to the effect that any report, analysis, or other service will be furnished for free or without charge, unless such report, analysis, or other service actually is or will be furnished entirely free and without any direct or indirect condition or obligation, directly or indirectly;~~ ~~or~~
  5. Which states that the Commission has approved any advertisement.
- B. When requested by the Commission, any advertisement used directly or indirectly in connection with the provision of investment advisory services shall be filed with the Commission at least 10 business days prior to its proposed use.
- C. Any advertisement that has been requested by the Commission pursuant to the provisions of subsection (B) but that has not been filed with the Commission shall not be used.
- D. With respect to federal covered advisers, the provisions of this Section only apply to the extent permitted by Section 203A of the investment advisers act of 1940.

R14-6-209. Financial and Disciplinary Information that Investment Advisers Shall Disclose to Clients

~~A. The following definitions shall apply to this Section:~~

- ~~1. "Investment related" means pertaining to securities, commodities, banking, insurance, or real estate (including, but not limited to, acting as or being associated with a broker-dealer, investment company, investment adviser, government securities broker or dealer, municipal securities dealer, bank, savings and loan association, entity, or person required to be registered under the Commodity Exchange Act, or fiduciary).~~
- ~~2. "Involved" means acting or aiding, abetting, causing, counseling, commanding, inducing, conspiring with, or failing reasonably to supervise another in doing an act.~~
- ~~3. "Management person" means a person with power to exercise, directly or indirectly, a controlling influence over the management or policies of an investment adviser which is a company or to determine the general investment advice given to clients.~~
- ~~4. "Self regulatory Organization" or "SRO" means any national securities or commodities exchange, registered association, or registered clearing agency.~~

AB. Except as otherwise provided in subsection (F), it shall constitute a fraudulent practice within the meaning of A.R.S. § 44-3241(A)(4) for any investment adviser to fail to disclose to any client or prospective client all material facts with respect to:

1. A financial condition of the investment adviser that is reasonably likely to impair the ability of the investment adviser to meet contractual commitments to clients, if the

investment adviser has discretionary authority (express or implied) or custody over ~~such~~the client's funds or securities, or requires prepayment of advisory fees of more than \$500 from such client, 6 months or more in advance;~~;~~~~or~~

2. A legal or disciplinary event that is material to an evaluation of the investment adviser's or an investment adviser representative's integrity or ability to meet contractual commitments to clients.
3. A failure to comply with any arbitration award issued in connection with doing business as an investment adviser or investment adviser representative or as a dealer or salesman as defined in A.R.S. title 44, chapter 12.

BC. It shall constitute a rebuttable presumption that the following legal or disciplinary events involving the investment adviser, an investment adviser representative, or a management person of the investment adviser (any of the foregoing being referred to hereafter as a "person") that were not resolved in the person's favor or subsequently reversed, suspended, or vacated are material within the meaning of subsection (AB)(2) for a period of 10 years from the time of the event. No affirmative or negative presumption of materiality shall be created under subsection (AB)(2) for events not specifically set forth in this subsection.

1. A criminal or civil action in a court of competent jurisdiction in which the person:
  - a. Was convicted, ~~or~~ pleaded guilty or nolo contendere ("no contest") to a felony or misdemeanor, or is the named subject of a pending criminal proceeding (any of the foregoing referred to hereafter as "action"), and such action involved: an investment-related business; fraud, false statements, or omissions; wrongful taking of property; or bribery, forgery, counterfeiting, or extortion;
  - b. Was found to have been involved in a violation of an investment-related statute or rule; or
  - c. Was the subject of any order, judgment, or decree permanently or temporarily enjoining the person ~~from~~, or otherwise limiting the person from, engaging in any investment-related activity.
2. An administrative ~~Administrative~~ proceeding before the SEC, Securities and Exchange Commission, ~~the Commission~~, or any federal or state ~~regulatory~~ agency ~~or any state agency~~ (any of the foregoing being referred to hereafter as "agency") in which the person:
  - a. Was found to have caused an investment-related business to lose its authorization to do business; or
  - b. Was found to have been involved in a violation of an investment-related statute or rule, and was the subject of an order by the agency denying, suspending, or revoking the authorization of the person to act in, or barring or suspending the person's association with, an investment-related business; or otherwise significantly limiting the person's investment-related activities.

3. Self-regulatory Organization ("SRO") proceedings in which the person:
- a. Was found to have caused an investment-related business to lose its authorization to do business; or
  - b. Was found to have been involved in a violation of the SRO's rules and was the subject of an order by the SRO barring or suspending the person from membership or from association with other members, or expelling the person from membership; fining the person more than \$2,500; or otherwise significantly limiting the person's investment-related activities.

CD. The information required to be disclosed by subsection (AB) shall be disclosed to clients within 30 calendar ~~promptly but in no event later than 30~~ days after the occurrence of the event requiring disclosure, and to prospective clients not less than 48 hours prior to entering into any written or oral investment advisory contract, or no later than the time of entering into such contract if the client has the right to terminate the contract without penalty within 5 business days after entering into the contract.

DE. For purposes of calculating the 10-year period during which events are presumed to be material under subsection (BC), the date of the reportable event shall be the date on which the final order, judgment, or decree was entered, or the date on which any rights of appeal from preliminary orders, judgments, or decrees lapsed.

EF. Compliance with subsection (BC) shall not relieve any investment adviser from the disclosure obligations of subsection (AB); compliance with subsection (AB) shall not relieve any investment adviser from any other disclosure requirement under the IM Act, the rules thereunder, or under any other state or federal law. ~~Note:~~ Investment advisers may disclose this information to clients and prospective clients in their "brochure," the written disclosure statement to clients under R14-6-205, provided, that the delivery of the brochure satisfies the timing of disclosure requirements described in subsection (CD).

F. With respect to federal covered advisers, the provisions of this Section only apply to the extent permitted by Section 203A of the investment advisers act of 1940.

R14-6-210. Licensure of Investment Adviser Representatives

A. The definition of investment adviser representative in A.R.S. § 44-1301 includes an individual employed by a federal covered adviser only if the individual has a place of business in Arizona and either:

1. Is a supervised person and meets all of the following conditions:
  - a. Has more than 5 clients who are natural persons, other than excepted persons.
  - b. Has clients more than 10% of whom are natural persons, other than excepted persons.

c. On a regular basis, solicits, meets with, or otherwise communicates with clients of the investment adviser or provides other than impersonal advisory services.

2. Is not a supervised person.

B. For purposes of this Section:

1. "Excepted person" means a natural person who:

a. Immediately after entering into the investment advisory contract with the investment adviser has at least \$750,000 under management with the investment adviser, or

b. The investment adviser reasonably believes, immediately prior to entering into the advisory contract, has a net worth, together with assets held jointly with a spouse, at the time the contract is entered into of more than \$1,500,000.

2. "Supervised person" means any partner, officer, director, or other person occupying a similar status or performing similar functions, or employees of an investment adviser, or other person who provides investment advice on behalf of the investment adviser and is subject to the supervision and control of the investment adviser.

3. "Place of business" means:

a. An office at which the investment adviser representative regularly provides investment advisory services, solicits, meets with, or otherwise communicates with clients, or

b. Any other location that is held out to the general public as a location at which the investment adviser representative provides investment advisory services, solicits, meets with, or otherwise communicates with clients.

C. A person that employs 1 or more investment adviser representatives who solicit, offer, or negotiate for the sale of or sell investment advisory services on behalf of an investment adviser shall license as an investment adviser unless each investment adviser representative is also employed by the investment adviser on whose behalf the activity is conducted.

R14-6-211. Solicitation

A. An individual shall not be included in the definition of investment adviser representative under A.R.S. § 44-3101(3)(d) if that individual meets both of the following conditions:

1. The individual does not on a regular basis give advice regarding, or recommend the services of, an investment adviser or an investment adviser representative.

2. The individual does not accept or receive directly or indirectly any commission, fee, or other remuneration in connection with a referral to or recommendation of the services of an investment adviser or an investment adviser representative.

B. The term "remuneration" shall be broadly construed, but shall not include the exchange of client referrals between professionals without an exchange of additional compensation.

C. No individual or entity subject to an order or finding that denies, revokes, or suspends licensure or registration under the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, the Securities Act, the IM Act, or the rules or regulations of an SRO may solicit, offer, or negotiate for the sale of or sell investment advisory services.

R14-6-212. Application, Notice Filing, and Renewal Filing Requirements

A. An application for licensure as an investment adviser under A.R.S. § 44-3153(B) shall include the following:

1. An original typewritten Form ADV with all information and exhibits required by the form.
2. An audited balance sheet if the investment adviser will have custody of client funds or if the investment adviser requires the payment of advisory fees six months or more in advance and in excess of \$500 for each client. The audited balance sheet shall be based on the investment adviser's fiscal year end, shall be prepared in accordance with generally accepted accounting principles, and shall be audited by an independent certified public accountant. The notes to the balance sheet shall state the principles used to prepare the balance sheet, the basis of included securities, and any other explanation required for clarity.
3. A notarized affidavit of any officer, director, partner, member, trustee, or manager of the applicant stating:
  - a. That a review of the records of the investment adviser has been conducted.
  - b. Whether any investment adviser activity has been conducted with residents of Arizona prior to licensure as an investment adviser.
4. If the applicant intends to have a branch office in Arizona, the address and name of a contact individual located at such branch.
5. If part II of the Form ADV is not completed, the applicant shall submit a copy of the disclosure brochure the applicant gives or will give to clients.
6. The documents and fees required for each investment adviser representative as described in subsection C.
7. The annual licensure fee required by A.R.S. § 44-3181(A).

B. A notice filing under A.R.S. § 44-3153(D) shall include the following:

1. A manually signed and notarized Form ADV, part 1, page 1, or a copy of Form ADV, part 1, page 1, and an originally executed consent to service of process.
2. The documents and fees required for each investment adviser representative as described in subsection C.
3. The annual notice filing fee required by A.R.S. § 44-3181(A).

C. An application for an investment adviser representative licensure under A.R.S. § 44-3156 shall include the following:

1. A complete Form U-4.
2. Proof of successful completion of required examinations in accordance with A.A.C. R14-6-204.
3. The annual licensure fee required by A.R.S. § 44-3181(A).

D. For purposes of A.R.S. § 44-3158(A), a license of an investment adviser or an investment adviser representative shall be renewed upon receipt of the nonrefundable license fee prescribed in A.R.S. § 44-3181.

E. For purposes of A.R.S. § 44-3153(E), a notice filing shall be renewed upon receipt of the nonrefundable license fee prescribed in A.R.S. § 44-3181.

APPENDIX B

CONCISE EXPLANATORY STATEMENT

A. CHANGES IN THE TEXT OF THE PROPOSED RULES THAT WERE CONTAINED IN DECISION NO. 61613 (PUBLISHED ON APRIL 30, 1999, VOL. 5, ISSUE 18 OF THE ARIZONA ADMINISTRATIVE REGISTER).

To comply with format Rules of the Secretary of State, the Division has reformatted the capitalization of section headings. In response to written comments, the Division has proposed changes to text in several sections, which are not substantially different from the proposed rules. In addition, the Division has corrected a typographical error in one section. The following sections have been modified as indicated in the text of the rules set forth in Appendix A hereto, and incorporated herein by reference:

- Article 1. General Provisions relating to the Arizona Investment Management Act
- R14-6-101 Definitions
- R14-6-102 Scope of Provisions
- R14-6-103 Severability
- R14-6-104 Enforcement of the Arizona Investment Management Act
- R14-6-106 General Dissemination of Information on the Internet
  
- Article 2. Duties of Investment Advisers and Investment Adviser Representatives
- R14-6-201 Books and Records of Investment Advisers
- R14-6-202 Supervision
- R14-6-203 Dishonest and Unethical Practices
- R14-6-205 Information to be Furnished to Clients ("Brochure Rule")
- R14-6-206 Custody of Client Funds or Securities by Investment Advisers
- R14-6-207 Suitability of Investment Advisory Services
- R14-6-208 Advertisements by Investment Advisers or Investment Adviser Representatives
- R14-6-209 Financial and Disciplinary Information that Investment Advisers Shall Disclose to Clients

1 R14-6-210 Licensure of Investment Adviser Representatives

2 R14-6-211 Solicitation

3 R14-6-212 Application, Notice Filing, and Renewal Requirements

4 **B. EVALUATION OF THE ARGUMENTS FOR AND AGAINST THE PROPOSED**  
5 **RULES**

6 **Article 1. General Provisions relating to the Arizona Investment Management Act**

7 **R14-6-101 Definitions**

8 Issue: This rule applies to the various definitions and terms used throughout the sections with  
9 respect to regulation under the Investment Management Act (“IMA”) and the duties of investment  
10 advisers and investment adviser representatives.

11 The Division received no comments.

12 Evaluation: We concur with the Division.

13 Resolution: No change in the proposed rule is required.

14 **R14-6-102 Scope of Provisions**

15 Issue: This rule states the legal authority for the sections, provides for the waiver of strict  
16 adherence to a provision, and provides that the Commission’s Rules of Practice and Procedure apply  
17 when not in conflict with the proposed sections.

18 The Division received no comments.

19 Evaluation: We concur with the Division.

20 Resolution: No change in the proposed rule is required.

21 **R14-6-103 Severability**

22 Issue: This rule establishes the severability of the sections and the provisions thereof in case  
23 any section or subsection is deemed to be invalid.

24 The Division received no comments.

25 Evaluation: We concur with the Division.

26 Resolution: No change in the proposed rule is required.

27 **R14-6-104 Enforcement of the Arizona Investment Management Act**

28 Issue: Applicable provisions relating to the conduct of enforcement actions are contained at

1 A.A.C. R14-4-301 through R14-4-308.

2 The Division received no comments.

3 Evaluation: We concur with the Division.

4 Resolution: No change in the proposed rule is required.

5 **R14-6-106 General Dissemination of Information on the Internet**

6 Issue: A.A.C. R14-6-106 ("Rule 106") provides that the general dissemination of  
7 information on the internet by investment advisers and investment adviser representative shall not be  
8 deemed transacting business in Arizona based solely on that activity if the conditions contained in  
9 Rule 106 are observed.

10 Rule 106 is generally supported by the industry, but the ICFP recommended three changes as  
11 follows: that the Commission include the term "federal covered adviser" in Rule 106 to clarify that it  
12 applies to both state and federally registered investment advisers; that the Commission delete the  
13 prohibition from effecting transactions in securities contained in Rule 106(A)(1)(b) and 106(A)(4)  
14 stating that, technically speaking, an adviser cannot execute a securities transaction under the IMA;  
15 and that the Commission include in subsection (A)(4) the phrase "unless the investment adviser or  
16 investment adviser representative is compliant with or exempt from licensure or notice filing  
17 requirements" so that investment advisers are not precluded from relying upon the de minimus  
18 exemption.

19 With respect to the ICFP's first recommendation, the Division argued that no change be made  
20 because throughout the IMA and the Investment Management Rules ("IM Rules") promulgated there-  
21 under, the term "investment adviser" refers to all persons who fall within the statutory definition,  
22 whether federally registered or state licensed. With respect to the ICFP's second recommendation,  
23 the Division revised Rule 106 to reflect the deletion of the language opposed by the ICFP because the  
24 Division does not believe that the deletion requested would change the impact or application of the  
25 rule. With respect to the third recommendation of the ICFP, the Division recommended that since the  
26 North American Securities Administrators Association ("NASAA") interpretive order upon which  
27 Rule 106(A)(4) is based does not include the suggested language that no change should be made.

28 Evaluation: We concur with the Division.

1        Resolution:    Modify Rule 106 as discussed above.

2        **Article 2.        Duties of Investment Advisers and Investment Adviser Representatives**

3        **R14-6-201        Books and Records of Investment Advisers**

4        Issue:    A.A.C. R14-6-201 (“Rule 201”) identifies the books and record keeping requirements  
5 and proposes the same requirements as those imposed upon federally registered investment advisers  
6 by federal Rule 204-2 under the federal Investment Advisers Act of 1940 (“IAA”), and includes three  
7 additional books and records provisions.

8        The ICAA, while indicating that it strongly supported the adoption of Rule 201, had concerns  
9 with the Division’s proposed language arguing that the Commission should utilize the NASAA  
10 model language because the ICAA believes that the model language was less ambiguous.

11        The Division argued that proposed Rule 201 is more concise than the NASAA model  
12 language and recommended that no changes be made.

13        Evaluation:    We concur with the Division.

14        Resolution:    No change to the proposed rule is required.

15        **R14-6-202        Supervision**

16        Issue:    A.A.C. R14-6-202 (“Rule 202”) provides a safe harbor for investment advisers  
17 regarding their supervisory responsibilities by prescribing procedures for investment advisers to  
18 follow in the supervision of investment adviser representatives if the requirements of Rule 202 are  
19 met.

20        The Division received no comments.

21        Evaluation:    We concur with the Division.

22        Resolution:    No change in the proposed rule is required.

23        **R14-6-203        Dishonest and Unethical Practices**

24        Issue:    A.A.C. R14-6-203 (“Rule 203”) sets forth the practices that are dishonest and  
25 unethical under A.R.S. § 44-3201(A)(13) which provides that the license of an Arizona investment  
26 adviser or investment adviser representative may be denied, revoked, or suspended if the investment  
27 adviser or investment adviser representative engages in dishonest or unethical practices in the  
28 securities industry.

1 The ICAA expressed concern that it does not believe that subsection (B) of Rule 203 is  
 2 adequate because it does not exclude from Rule 203's purview investment adviser representatives or  
 3 federal covered advisers. The ICAA argued that Rule 203 should be revised to apply only to licensed  
 4 investment advisers and their investment adviser representatives in order to avoid "back door"  
 5 regulation of federal covered advisers under the jurisdiction of the Securities and Exchange  
 6 Commission ("SEC").

7 After considering the comments of the ICAA, the Division deleted subsection (B) of Rule 203  
 8 and revised subsection (A) consistent with its position that all investment adviser representatives who  
 9 are licensed in Arizona are and should be subject to statutory and rule provisions under which those  
 10 licenses may be denied, suspended or revoked.

11 Evaluation: We concur with the Division's modifications.

12 Resolution: Modify Rule 203 as discussed above.

13 **R14-6-205 Information to be Furnished to Clients ("Brochure Rule")**

14 Issue: This rule prescribes information that must be furnished to clients and the timing and  
 15 method of such disclosure.

16 The Division received no comments.

17 Evaluation: We concur with the Division.

18 Resolution: No change in the proposed rule is required.

19 **R14-6-206 Custody of Client Funds or Securities by Investment Advisers**

20 Issue: A.A.C. R14-6-206 ("Rule 206") provides that it is a fraudulent practice under the IMA  
 21 for an investment adviser to fail to comply with the procedures established in this Section when  
 22 maintaining custody of a client's funds or securities.

23 The ICFP commented that a safe harbor should be included by the Commission in Rule 206  
 24 that would allow an investment adviser to accept third-party checks and endorsed stock certificates  
 25 that are to be forwarded to other persons as a service to its clients without being deemed to have  
 26 custody of the checks and stock certificates. The ICFP argued that the Commission should adopt a  
 27 provision similar to the safe harbor provisions which are contained in the SEC custody rule under the  
 28 Securities Exchange Act of 1934 and the NASAA model rule for broker-dealers.

1 The Division argued that the ICFP has also approached the SEC and NASAA with respect to  
2 the inclusion of its proposed safe harbor in Rule 206 and that although the SEC has taken the matter  
3 under advisement, NASAA is unwilling to advocate changes in the custody definition which are not  
4 accepted by the SEC. Therefore, the Division recommends that no changes be made in Rule 206 with  
5 respect to the ICFP's proposal prior to any SEC action being taken on the issue.

6 The ICAA commented that federal covered advisers and their investment adviser  
7 representatives should be specifically excluded from the application of Rule 206.

8 In response to the ICAA's comments, the Division argued that it does not agree with the  
9 ICAA's position with respect to investment adviser representatives for reasons stated previously for  
10 Rule 203 and that all investment adviser representatives who are licensed in Arizona are and should  
11 be subject to statutory and rule provisions under which those licenses may be denied, suspended, or  
12 revoked. The Division stated that with respect to federal covered advisers, it has proposed a  
13 provision that limits the application of the rule to the extent permitted by Section 203A of the IAA  
14 which was amended by the federal National Securities Markets Improvement Act of 1996  
15 ("NSMIA") that precludes state regulation of federal covered advisers except that "nothing in  
16 [section 203A] shall prohibit the securities commission (or any agency or office performing like  
17 functions) of any State from investigating and bringing enforcement actions with respect to fraud or  
18 deceit against an investment adviser or person associated with an investment adviser." The Division  
19 believes that the interpretation of section 203A and the extent of state jurisdiction should be left to  
20 forums such as the courts and Congress. However, the Division did propose a revision to simplify  
21 subsection (B) with respect to federal covered advisers in that it only applies to the extent permitted  
22 by section 203A.

23 Evaluation: We concur with the Division.

24 Resolution: Modify Rule 206 as discussed above.

25 **R14-6-207 Suitability of Investment Advisory Services**

26 Issue: A.A.C. R14-6-207 ("Rule 207") provides that it is a fraudulent practice under the IMA  
27 for an investment adviser or investment adviser representative to provide investment advisory  
28 services unless the services are suitable based on a reasonable prior inquiry of the client's financial

1 situation, investment experience, and investment objectives.

2 The ICAA again argued that federal covered advisers and their investment adviser  
3 representatives should be specifically excluded from the application of Rule 207.

4 The Division argued that all investment adviser representatives who are licensed in Arizona  
5 are and should be subject to statutory and rule provisions under which those licenses may be denied,  
6 suspended, or revoked. The Division pointed that with respect to federal covered advisers, it has  
7 proposed a provision that limits the application of the rule to the extent provided by section 203A of  
8 the IAA which was amended by the NSMIA that precludes state regulation of federal covered  
9 advisers except that "nothing in [section 203A] shall prohibit the securities commission (or any  
10 agency or office performing like functions) of any State from investigating and bringing enforcement  
11 actions with respect to fraud or deceit against an investment adviser or person associated with an  
12 investment adviser." The Division believes that the interpretation of section 203A and the extent of  
13 State jurisdiction under the statute should be left to more appropriate forums such as the courts and  
14 Congress. However, the Division did propose a simplification of the language of subsection (B) of  
15 Rule 207.

16 Evaluation: We concur with the Division's action.

17 Resolution: Modify Rule 207 as discussed above.

18 **R14-6-208 Advertisements by Investment Advisers or Investment Adviser**  
19 **Representatives**

20 Issue: A.A.C. R14-6-208 ("Rule 208") provides that it is a fraudulent practice under the IMA  
21 for an investment adviser or investment adviser representative to fail to comply with the limitations  
22 on advertising and the requirements prescribed in Rule 208.

23 The ICAA commented that federal covered advisers and their investment adviser  
24 representatives should be specifically excluded from the application of Rule 208.

25 The Division argued that all investment adviser representatives who are licensed in Arizona  
26 are and should be subject to statutory and rule provisions under which those licenses may be denied,  
27 suspended, or revoked. The Division acknowledged that with respect to federal covered advisers it  
28 has proposed a provision that limits the application of the rule to the extent permitted by Section

1 203A of the IAA which was amended by the NSMIA that precludes state regulation of federal  
2 covered advisers except that “nothing in [section 203A] shall prohibit the securities commission (or  
3 any agency or office performing like functions) of any State from investigating and bringing  
4 enforcement actions with respect to fraud or deceit against an investment adviser or person associated  
5 with an investment adviser.” The Division believes that the interpretation of section 203A and the  
6 extent of state jurisdiction should be left to the courts and Congress. However, the Division did  
7 propose simplification of the language contained in subsection (D) of Rule 208.

8 Evaluation: We concur with the Division’s action.

9 Resolution: Modify Rule 208 as discussed above.

10 **R14-6-209 Financial and Disciplinary Information that Investment Advisers Shall**  
11 **Disclose to Clients**

12 Issue: A.A.C. R14-6-209 (“Rule 209”) provides that it is a fraudulent practice for an  
13 investment adviser to fail to disclose to any client or prospective client all material facts with respect  
14 to (1) a financial condition that is likely to impair the adviser’s ability to meet contractual  
15 commitments to clients where the adviser has discretionary authority, custody, or requires pre-  
16 payments of fees, (2) a legal or disciplinary event that is material to the evaluation of the adviser’s  
17 integrity or ability to meet contractual commitments to clients, or (3) a failure to comply with an  
18 arbitration award.

19 The ICAA commented that federal covered advisers and their investment adviser  
20 representatives should be specifically excluded from the application of Rule 209.

21 The Division argued that all investment adviser representatives who are licensed in Arizona  
22 are and should be subject to statutory and rule provisions under which those licenses may be denied,  
23 suspended, or revoked. The Division further argued that with respect to federal covered advisers, it  
24 had proposed a provision that limits the application of the rule to the extent permitted by section  
25 203A of the IAA which was amended by the NSMIA that precludes state regulation of federal  
26 covered advisers except that “nothing in [section 203A] shall prohibit the securities commission (or  
27 any agency or office performing like functions) of any State from investigating and bringing  
28 enforcement actions with respect to fraud or deceit against an investment adviser or person associated

1 with an investment adviser.” The Division believes that the interpretation of section 203A and the  
 2 extent of state jurisdiction thereunder should be left to the courts and to Congress. However, the  
 3 Division did propose a simplification of subsection (F) of Rule 209.

4 Evaluation: We concur with the Division’s action.

5 Resolution: Modify Rule 209 as discussed above.

6 **R14-6-210 Licensure of Investment Adviser Representatives**

7 Issue: A.A.C. R14-6-210 (“Rule 210”) relates to the licensure of investment adviser  
 8 representatives and defines the requirements for licensure based on the definition contained in federal  
 9 Rule 203A3 and the NASAA model language that establishes certain dollar thresholds under  
 10 management with the investment adviser.

11 Both the ICFP and ICAA commented that the dollar thresholds as set forth in proposed Rule  
 12 210 should be modified since the sums referenced in the federal rule had been amended since the  
 13 drafting of the Division’s proposed Rule 210.

14 In response to these comments, the Division agreed and revised Rule 210 to reflect the  
 15 amendments to the dollar threshold amount referenced in the federal amendment by increasing from  
 16 \$500,000 to \$750,000 the amount which an investment adviser has under management and increasing  
 17 the amount that an investment adviser reasonably believes to be an investor’s net worth of jointly  
 18 held assets with a spouse from \$1,000,000 to \$1,500,000.

19 Evaluation: We concur with the Division’s modifications.

20 Resolution: Modify Rule 210 as discussed above.

21 **R14-6-211 Solicitation**

22 Issue: This rule defines the activities that do not constitute solicitation for purposes of A.R.S.  
 23 § 44-3101(3)(d).

24 The Division received no comments.

25 Evaluation: We concur with the Division.

26 Resolution: No change in the proposed rule is required.

27 **R14-6-212 Application, Notice Filing, Renewal Requirements**

28 Issue: A.A.C. R14-6-212 (“Rule 212”) enumerates the filing requirements for applications

1 for licensure by investment adviser representatives, notice filings, and renewal filings.

2       The ICAA commented that filing requirements should be listed with greater specificity in  
3 either the statute, A.R.S. § 44-3153, or in the proposed Rule 212.

4       In response, the Division agreed with the ICAA, listing with specificity the filing  
5 requirements required as set forth in Appendix A.

6       Evaluation:   We concur with the Division's revision to proposed Rule 212.

7       Resolution:   Modify Rule 212 as discussed above.

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