Interactive Brokers

SPOTLIGHT ON

Advisors' Recordkeeping Obligations

The contents of this Spotlight have been prepared for informational purposes only, and should not be construed as legal or compliance advice.

Advisors have recordkeeping obligations under the Investment Advisers Act (the "Act") and similar state provisions. All regulatory exams involve requests for documentation from advisors so recordkeeping violations are relatively easy for regulators to detect. The state of advisors' recordkeeping and their ability to respond to record requests will often determine the regulators' first impression of a firm's internal controls. Adequate records are also one of the best ways, and in some cases the only way, for advisors to demonstrate compliance with substantive provisions of the Act or similar state statutes. On the other hand, failing to maintain proper books and records provides an easy avenue for regulators to sanction the advisor even if the advisor is otherwise running a compliant business.

Rule 204-2 of the Investment Advisers Act requires advisors to make and keep certain records at specified locations for specified periods of time. Most of the rule's provisions do not require advisors to create additional records, just to preserve records already prepared. Many advisors choose to maintain additional records not specified in the rule for business and other reasons.

What records must be kept.

The SEC Books and Records Rule requires advisors to make and maintain **true, accurate, and current** books and records related to their investment advisory business, including:

- **Financial records**, including journals, any original records underlying ledger entries, ledgers, bank statements, trial balances, financial statements, and internal audit working papers;

- **Corporate records**, including written agreements relating to the advisory business, partnership agreements, articles of incorporation, charters, meeting minutes, and stock certificate books;

- **Order memoranda** concerning the purchase, sale, receipt, or delivery of a security that identify orders entered on behalf of clients;
    - Interactive provides advisors and customers access to the audit trails for orders placed within the last seven days.

What records must be kept (con't)

- Originals of **all written communications** received by the advisor and copies of all written communications sent by the advisor regarding:
    - Recommendations or advice offered;
    - Receipt, disbursement, or delivery of funds or securities; and
    - The placing or execution of any trade orders (e.g., order tickets and trade confirmations).

- **Written agreements** entered into between the advisor and clients or agreements otherwise relating to the business of the advisor;
    - The best practice is to enter into written agreements with advisory clients.

- Copies of **advertisements** (*i.e.,* any notice, circular, advertisement, newspaper article, investment letter, bulletin, or other communication) circulated or delivered to 10 or more persons;
    - If the ad recommends the purchase or sale of a specific security but does not state the reasons for the recommendation, a separate memorandum indicating the reasons must be created and maintained.
    - If an advisor sends an advertisement to more than 10 persons and uses a list to do so, the advisor must keep the ad, the list, and a memorandum describing the list and its source.
    - Some states require advisors to retain ads that go to fewer than 10 people.

- **All records** (accounts, books, internal working papers) **supporting performance calculations** used in advertisements communicated to 10 or more persons.
    - Regulators prefer third-party records such as custodial or brokerage statements confirming the accuracy of client account statements or other internally generated documents.
    - Advisors must also keep any reports prepared by independent auditors verifying performance information.

- **Client disclosures**, including:
    - The Form ADV Part 2 Brochure, Brochure Supplements and amendments; and
    - A record of the date when each brochure, supplement, amendment, and summary of material changes not contained in the brochure was provided to clients or any prospective clients who became clients.

What records must be kept (con't)

- **A memo or other document describing any legal or disciplinary event** listed in the Form ADV Part 2A if the event is not disclosed in the Brochure or Brochure Supplement.

- **Documents showing the advisor's discretionary authority**, including:
    - Powers of attorney or other evidence of clients' grant of authority to the advisor; and
    - A list or record of all accounts for which the advisor has discretionary authority.

- **Referral fee records**, including:
    - Copies of the disclosure documents the advisor's solicitors delivered to clients; and
    - Written client acknowledgements of receipt of the advisor's disclosure document and the solicitor's written disclosure document.

- **Code of Ethics and related records**, including:
    - Copies of each version of the firm's Code of Ethics in effect in the past five years;
    - Records of employee violations of the Code and the firm's responses to those violations;
    - Supervised persons' written acknowledgments of receipt of the Code of Ethics;
    - Personal holding and transaction reports filed by access persons; *i.e.,* employees with access to non-public information about the firm's trading, which we define in detail in our Spotlight on Compliance Systems and Documentation.
    - Records of the advisor's employees who are or have been access persons during the past five years; and
    - Records of decisions to approve security purchases by access persons for at least five years after the end of the fiscal year of each approval.

- **Advisors deemed to have "custody" over client assets under the Custody Rule** must retain:
    - Records showing all purchases, sales, receipts, and deliveries of securities for accounts over which the advisor has "custody";
    - A separate ledger record for each client over which the advisor has custody, which shows all purchases, sales, receipts, and deliveries of securities, the date and price of each purchase and sale, and all debits and credits;
    - Copies of confirmations of transactions in each account;
    - Position records for each security held by the client showing the name of the client, amount of interest and location of the security; and
    - Internal control reports prepared by an independent public accountant registered with and subject to regular inspection by the Public Company Accounting Oversight Board.

- Copies of **compliance policies and procedures** and records documenting their **mandatory annual review**.

What records must be kept (con't)

- **Proxy voting records**, including:
    - Proxy voting policies and procedures;
    - Proxy statements received regarding client securities;
    - Records of votes cast for clients;
    - Records of clients' requests for voting information; and
    - Documents prepared by the advisor that were material to the advisor's decision on how to vote or a document memorializing the basis for the decision; and

- **Records of certain political contributions**.

Where and for how long records must be kept.

Generally, advisors must keep most of these records in an easily accessible place for at least five years from the end of the fiscal year in which the last entry was made on the document (or the document was disseminated), the first two years in their principal office.

If advisors keep some of their original books and records in a location that is not their principal office and place of business, they must note this and identify the alternative location on their Form ADV. Some advisors may choose to store an extra copy of their advisory records somewhere other than their principal office in case the records at the principal office are destroyed in a fire, flood, etc., although they are not required to do this.

Books and records relating to advertisements, including performance information used in marketing materials, must be maintained for five years from the end of the fiscal year during which the advisor last published or disseminated the materials.

Advisors must keep corporate documents in their principal office and must preserve them until at least three years after the firm has shut down.

Electronic media and records.

Advisors are expected to retain any emails if the content is of a type the advisor would be required to retain if the email were a paper document.

Regardless of the format in which they were created or received, records can be stored on micrographic media (microfilm, microfiche, or similar medium) or electronic storage media, i.e., advisors can scan paper records and retain them electronically.

The Act requires advisors storing records in micrographic or electronic media to:

- **Arrange and index** the records in a way that permits easy location, access, and retrieval of any particular record.

- **Provide the SEC promptly** (generally within 24 hours of a request):
    - A legible, true, and complete copy of the record in the medium and format in which it is stored;
    - A legible, true, and complete printout of the record; and
    - Means to access, view, and print the records.

- **Keep a duplicate copy of any electronic record.**

For electronically stored records, advisors must also establish policies and procedures to:

a. Safeguard records from loss, alteration, or destruction;
b. Limit access to the records to authorized personnel and regulators; and
c. Ensure that electronic copies of non-electronic originals are complete, true, and legible.

State record-keeping rules.

Most states impose the same or substantially similar recordkeeping requirements as the federal Books and Records Rule (Rule 204-2).

But some states may also have slightly different rules:

- Some states require registered advisors to maintain records that the SEC does not require advisors to keep, such as suitability records, litigation files, customer complaint files, and written supervisory procedures;

State record-keeping rules (con't)

- Some states require advisors to keep records for longer periods of time than the SEC does; and

- Some states require advisors to retain a larger universe of documents than the SEC.
    - For instance, the SEC requires advisors to maintain advertisements sent to 10 persons or more, while Virginia requires retention of advertisements sent to 2 or more persons, and New York that of advertisements sent to 5 or more persons.

Advisors registered and/or doing business in more than one state do not need to comply with multiple (and potentially conflicting) books and records regimes. Rather, advisors just need to meet the requirements of their home state. The Act prohibits laws or regulations that would require investment advisors to maintain any books or records in addition to those required by the state where they maintain their principal place of business if the advisor is licensed in that state and is in compliance with that state's books and records requirements.