

Investment Adviser Recordkeeping Requirements

Investment advisers registered with the Securities and Exchange Commission (“SEC”) are required to maintain certain books and records pursuant to the Investment Advisers Act of 1940, as amended (the “Act”). This article is limited to a brief review of the SEC’s recordkeeping requirements and observations regarding recent inspection requests by the Office of Compliance Inspections and Examinations (“OCIE”) of the SEC of SEC-registered investment advisers’ e-mails. Most states have recordkeeping requirements that are substantially similar to the SEC’s requirements, but state-registered investment advisers are encouraged to check with each applicable jurisdiction to ensure compliance with that jurisdiction’s recordkeeping requirements.

Introduction



An SEC-registered investment adviser is generally required to keep certain records that are typical of business accounting records and certain records that the SEC believes are important based on the investment adviser’s fiduciary obligations to its clients. In addition, further books and records are required to be maintained if the investment adviser has custody of a client’s securities or funds or exercises proxy voting powers.

General Records



An SEC-registered investment adviser is required to keep the following business records and records related to the investment adviser’s fiduciary obligations:

- Journals and other records forming the basis of entries in any of the adviser’s ledgers.
- General ledger reflecting assets, liabilities, capital, reserves, income and expenses.
- Memoranda of each order placed by a portfolio manager on behalf of a client.
- Bank records, including check books, bank statements, canceled checks and cash reconciliations.
- Bills and statements relating to the adviser’s business.
- Trial balances, financial statements and internal audit working papers relating to the adviser’s business.
- Written communications, to and from clients.
- List of client accounts in which adviser has discretionary authority and instruments granting discretionary power (powers of attorney).
- Written agreements with clients.
- Copies of all advertising and other distributed materials.
- Personal transaction reports.
- Adviser’s Form ADV Part II or other disclosure statement provided for purposes of complying with the “Brochure Rule.”
- Solicitors’ disclosure statements and client acknowledgments.
- Accounts, books, working papers and other records substantiating prior performance claims.
- Written compliance policies and procedures (typically, a Compliance Manual).
- Records of sale and purchase transactions and access to a client’s current securities position.
- Corporate formation and governance documents.

Frequency

Generally, books and records are required to be kept on a “current” basis. With respect to primary business records, such as trade confirmations, invoices and logs, the records should be created concurrently with the transactions or as soon as practicable thereafter. Trade tickets are generally required to be completed and delivered to the client’s custodian

by the close of the trading day. For secondary business records, such as ledgers, the records may be created as frequently as the business may require. A small investment adviser with a limited number of clients may be able to post data to secondary records at longer intervals than a larger investment adviser with a greater number of clients. The SEC staff has generally taken the position that the meaning of "current", particularly with respect to secondary business records, depends on the circumstances of the adviser's business and the nature of the records being kept.

Records for Investment Advisers Who Have Custody



The records required of investment advisers who have custody of client assets include:

- Journals showing securities transactions.
- Separate client ledger.
- Copies of trade confirmations.
- Record for each security held by client showing amount and location.

Proxy Voting Records

The records required of investment advisers who vote proxies on behalf of their clients include:

- Copies of proxy voting policies.
- Copies of proxy statements received regarding client securities.
- Records of votes cast by the adviser on behalf of client.
- Copies of documents used in making a decision as to how to vote proxies.
- Copies of client correspondence requesting how the adviser voted proxies.

Timing

Records related to an investment adviser's corporate governance, such as articles of incorporation, code of regulations, stock certificates, and minute books, must be maintained continuously in the investment adviser's office until termination of the business and in an easily accessible place for three years after the termination. All other records must be

maintained by an investment adviser for five years (in the investment adviser's principal office for at least the first two years; they may be kept in an easily accessible place for the balance of the five years).



E-mail Inspections

The OCIE has recently started making routine inspections requests of SEC-registered investment advisers' emails. The securities laws and rules promulgated thereunder do not provide specific recordkeeping requirements with respect to an investment adviser's e-mails; however, there is broad authority regarding electronic recordkeeping obligations imposed on SEC-registered investment advisers that, when coupled with the recent emphasis of the OCIE staff during OCIE inspections, make it advisable for those advisers to consider formulating and adopting an e-mail retention policy.

Based on statements from the OCIE staff and the conduct of OCIE staff during inspections, some commentators suggest that the OCIE believes it is entitled to review all e-mails of an investment adviser. That proposition deserves closer analysis.



Section 204 of the Advisers Act imposes obligations on SEC-registered investment advisers to keep "records" as prescribed by the SEC by rule. SEC Rule 204-2 prescribes the various records to be kept as described above under "General Records." Section 3(a)(37) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), defines "records" broadly to include electronic records. If an e-mail falls in one of the categories of records an SEC-registered adviser must keep pursuant to Rule 204-2 of the Advisers Act (such as communications with clients), then the e-mail should be retained for the period specified by the rule. See, e.g. Put the Compliance Rule to Work: IA Compliance Best Practices Summit, Lori A. Richards, Director, OCIE, Washington, D.C. (Mar. 15, 2004). Section 204 also provides that all records (as defined in Section 3(a)(37)) of an SEC-registered investment

adviser are subject to examination by the staff of the SEC. Therefore, e-mails that a firm has retained may be subject to review by the staff on request, regardless of whether they fall into any category as a required record.

There are no formal SEC guidelines that recommend an e-mail retention policy, and representatives of the Investment Counsel Association of America and other groups are urging the SEC and the OCIE staff to provide clarification on the matter. In the meantime, an SEC-registered investment adviser may wish to note that NASD-registered broker-dealers that are also SEC-registered investment advisers are subject to NASD recordkeeping requirements, which expressly require the retention of e-mails. Using NASD Rule 3010(d)(2)-(3) and NASD Rule 3110, which require NASD members to comply with Rule 17a-4 of the Exchange Act, as guidelines, an e-mail retention policy might include the following:

- (1) Designating the investment adviser's Compliance Officer as the supervisor of the e-mail retention policy;
- (2) Establishing a consistent, systematic and routine means of retaining e-mails sent and received by the firm and its employees related to the required books and records in an original or electronic format;
- (3) Ensuring that archived e-mails are adequately protected;
- (4) Providing education and training programs for employees of the investment adviser; and
- (5) Conducting an annual review of the e-mail retention policy.

An e-mail retention policy should not be a "boilerplate" document. Each firm will need to evaluate its own circumstances and draft accordingly.

It is important to note that the OCIE has indicated a preference for e-mails to be in an electronically searchable format, although there is no current requirement that an investment adviser keep records in such a format.

An investment adviser may establish a document destruction policy for those records it is not required to maintain. E-mails should be covered by the same document destruction policy that applies to all of the firm's records. The document destruction policy that applies to e-mails should be regular, consistent and systematic (not on a totally discretionary basis). The policy should also emphasize that, upon receipt of a regulatory request or subpoena, any destruction activities should stop pending completion of the regulator's or court's inquiry.

Conclusion

Without OCIE staff guidance on the matter, it is difficult to anticipate what e-mail records should be retained by an SEC-registered investment adviser. For any e-mails not falling within Rule 204-2, it is helpful that an adviser have a set of guidelines for their deletion in order to minimize an appearance of selective deletion to "hide the ball." The SEC's recent adoption of the Compliance Rule makes the inclusion of an e-mail retention policy in the investment adviser's Compliance Manual more prudent, particularly considering the recent interest in e-mails posed by the OCIE staff.

For additional information concerning the investment adviser recordkeeping requirements or their possible application to your firm, please contact:

Glenn E. Morrical 216-696-3431
gmorrical@tuckerellis.com

Janice R. Gambaccini 216-696-4147
jgambaccini@tuckerellis.com

Craig T. Gretter 216-696-2879
cgretter@tuckerellis.com

David S. Lu 216-696-2879
dlu@tuckerellis.com

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