



STATE OF MAINE
DEPARTMENT OF PROFESSIONAL
AND FINANCIAL REGULATION

OFFICE OF SECURITIES
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AUGUSTA, ME
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JOHN ELIAS BALDACI
GOVERNOR

Michael J. Colleran
Securities Administrator

MEMORANDUM

TO: Maine Licensed Investment Advisers
FROM: Michael J. Colleran, Securities Administrator
DATE: September 21, 2005
RE: Investment Adviser Examinations – Common Deficiencies

Over the past two years, the State of Maine Office of Securities has been systematically conducting on-site examinations of all of the Maine licensed Investment Advisers located in this state. Having completed 35 exams to date, we would like to apprise all of our licensees of the most common problems and deficiencies noted by our examiners. It is our hope that sharing this information will encourage you to re-examine your business practices, re-familiarize yourself with the applicable law and our IA rule (Rule Chapter 515), and help you avoid common compliance deficiencies.

1. Licensing

We have found that many Investment Advisers are not updating their Form ADV annually or when there is a “material” change. Further, they are not offering their Form ADV, Part II (or brochure) to their clients annually or are failing to document that offering. Many IAs also fail to file their most current Form ADV, Part II, with the Office of Securities. As you know, the Form ADV, Part II is not yet available to update electronically via the IARD, and thus it must be filed in paper form.

Since the licensing requirement for IA representatives has gone into effect, several IAs and IARs have been the subject of consent agreements because of failures to license IARs.

As a reminder, IAs who are sole proprietors must apply for IAR licensure by filing a Form U-4; they will not be charged another licensing fee for their representative license. Additionally, please take note of the fingerprint requirement in Rule Chapter 515 for IARs who have not previously been fingerprinted by a securities regulatory agency. Fingerprint cards are available from Christian Van Dyck in our office by calling (207) 624-8560.

2. Books and Records

We have discovered that many Investment Advisers are not paying enough attention to record security issues. In many instances, examiners have noted that computers were not password protected, passwords were not changed on a regular basis, and computer files were not



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backed up. With respect to paper records, filing cabinets were not locked or kept in a secure location, and files were kept in common areas or in plain view.

Many IAs had either no client correspondence/communication files or those files were difficult to locate or not kept in a discrete paper or electronic file.

Several IAs have been cited for not having a complaint/litigation file or an advertising file. These are required to be maintained, even if the IA has had no complaints or advertisements.

3. IA Contracts

We have learned that a surprising number of IAs have no written advisory contacts/agreements with their clients as required by the IA rule. Others have written contracts with some clients, but no written contracts with clients who are close friends or family members. Written contracts are required for all IA clients.

Examiners also have found many contracts with inaccurate or missing fee schedules, or with fees that are inconsistent with Form ADV disclosures. Other common problems include the use of improper liability disclaimer clauses, missing non-assignment clauses, and the failure of one or both parties to execute the contract.

4. Investment Activities

Examiners have found multiple examples of IAs who have inadequate or, in some cases, no suitability information or “client profiles” on file. While many Maine licensed IAs are small operations with clients who are well known to the IA, IAs nevertheless are obligated to collect and maintain information in order to assess and document the risk tolerance and suitability of investments for each client.

5. Privacy

We have found several IAs who either did not have a privacy policy or failed to document annual delivery of their privacy policy to their clients.

6. Custody

Finally, we caution IAs to be wary of having custody of client funds, for example by accepting “trustee” status or a general power of attorney. Having custody of client funds entails additional books and records, minimum net worth, and accounting requirements under the IA rule. If you have custody of client funds, you must comply with these additional requirements.

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Our goal in the on-site examination process is to increase licensee awareness and compliance. If you have any questions or concerns about our examinations or about the common deficiencies cited in this letter, please do not hesitate to contact me or my staff.