

STATE OF KANSAS
OFFICE OF THE SECURITIES COMMISSIONER
NOTICE OF PUBLIC HEARING ON ADMINISTRATIVE REGULATIONS

A public hearing will be conducted at 10:00 a.m., Tuesday, September 10, 2013, at the Office of the Securities Commissioner, 109 SW 9th St., Suite 600, Topeka, Kansas 66612, to consider amendments to K.A.R. 81-14-9 and the adoption of K.A.R. 81-14-11, on a permanent basis.

This 60-day notice of the public hearing shall constitute a public comment period for the purpose of receiving written public comments on the proposed amendment and adoption of regulations. All interested parties may submit written comments prior to the hearing to the attention of the Commissioner at the address above or by email to ksc@ksc.ks.gov. All interested parties will be given a reasonable opportunity to present their views orally regarding the adoption of the proposed regulations during the public hearing. In order to give all parties an opportunity to present their views, it may be necessary to request that each participant limit any oral presentation. Following the hearing, all written and oral comments submitted by interested parties will be considered by the Commissioner as a basis for making changes to the proposed regulations.

Any individual with a disability may request accommodation in order to participate in the public hearing and may request the proposed regulations and economic impact statements in an accessible format. Requests for accommodation to participate in the hearing should be made at least five working days in advance of the hearing by contacting Nichole Oathout, Legal Assistant, at (785) 296-5266 or the Kansas Relay Center at 1-800-766-3777. Handicapped parking is located on 9th Street or Kansas Avenue near the office building, and the hearing room is accessible to individuals with disabilities.

Summaries of the proposed regulations and their economic impacts follow. Copies of the full text of the proposed regulations and the economic impact statement may be obtained by writing to the Office of the Securities Commissioner at the address above or by email to ksc@ksc.ks.gov.

Amendments to K.A.R. 81-14-9 – Custody of client funds or securities; safekeeping; financial reporting; minimum net worth; bonding. The regulation currently specifies requirements for registered investment advisers that have custody of client funds or securities, or discretionary authority over client funds or securities, based on circumstances deemed to constitute custody or discretionary authority as defined in the regulation. The requirements were based on a model rule with provisions intended to protect clients' funds and securities. However, the Commissioner and staff have determined that several of the requirements do not effectively or significantly provide for such protection. Therefore, most of the amendments to the regulation are to delete requirements that are deemed unnecessary in relation to other protections that remain in K.A.R. 81-14-9 and other regulations.

The number of investment advisers currently registered in Kansas having custody of client funds or securities is relatively limited. For those investment advisers that do have custody, there are already sufficient safekeeping provisions within subsection (b) of K.A.R. 81-14-9 to provide for protection of client funds and securities. For example, one condition for investment advisers having custody is that a qualified custodian as defined in the regulation must independently maintain the funds and securities in a separate account for each client. That condition along with others pertaining to account statements involving independent persons or professionals are deemed to provide sufficient safeguards.

Special orders issued by the Commissioner on May 21, 2012 and November 7, 2012 as authorized under the Kansas Uniform Securities Act (KUSA) waived the following requirements for investment advisers registered or required to be registered under KUSA:

- 1) surety bond requirements specified under K.A.R. 81-14-9(e);
- 2) a notice of fee deduction required by K.A.R. 81-14-9(b)(1)(F);
- 3) an audited balance sheet required by K.A.R. 81-14-9(c)(1); and

4) minimum adjusted net worth required by K.A.R. 81-14-9(d).

The special orders described above continue in effect until automatically vacated by adoption of amendments to K.A.R. 81-14-9. The proposed amendments to K.A.R. 81-14-9 would permanently eliminate the requirements listed above by deletion of those provisions from the regulation.

Although economic impacts of the proposed amendments to K.A.R. 81-14-9 cannot be accurately estimated, it is expected that the primary impact will be reduced costs for registered investment advisers doing business in Kansas. There will be no material fiscal impacts on the operations of the Office of the Securities Commissioner of Kansas or any other government agencies. No adverse economic impact on the general public in Kansas is expected due to the proposed reduction in regulatory requirements for investment advisers registered in Kansas.

K.A.R. 81-14-11 – Kansas private adviser exemption. This is a new regulation proposed for adoption by the Commissioner which is intended to encourage more investment activity in Kansas by exempting certain investment advisers who manage a limited number of private investment funds or portfolios of individual Kansas investors from the registration and other regulatory requirements under KUSA. The adoption of K.A.R. 81-14-11 will make permanent the temporary exemptions that were implemented by special orders issued March 29, 2012 and July 19, 2011 for consistency with and extension of a similar exemption under former section 203(b)(3) of the federal Investment Advisers Act of 1940 that was repealed by the Dodd-Frank Act. Continuation of the exemption described further below will enable Kansas-based private investment advisers to operate without duplicative regulatory oversight or regulation deemed unnecessary by the Office of the Securities Commissioner of Kansas. Investment advisers that were previously exempt from federal registration with the Securities and Exchange Commission (SEC) and which now are required to either register or file a notice as an exempt reporting adviser with the SEC when they manage assets in excess of \$25 million can continue to be exempt from registration and other regulatory requirements in Kansas if they

comply with all requirements and conditions of proposed K.A.R. 81-14-11. Individual investment adviser representatives employed by exempt investment adviser firms can also be exempt from registration with the Office of the Securities Commissioner of Kansas if they meet conditions specified by the proposed K.A.R. 81-14-9.

The exemption provided by proposed K.A.R. 81-14-11 requires an investment adviser to: maintain its principal place of business in Kansas; provide investment advice solely to fewer than 15 clients; not hold out generally to the public as an investment adviser; not act as an investment adviser to any investment company registered under the federal Investment Company Act of 1940 (the 1940 act) or a company that has elected and not withdrawn its election to be a Business Development Company under the 1940 act; and not be, nor any of its advisory affiliates or investment adviser representatives, subject to a disqualification provision as described in SEC Rule 262.

The primary economic impact expected by adoption of K.A.R. 81-14-11 would be to enable the private investment advisers that claim and comply with the exemption provided by the regulation to avoid the significant costs of registration and other regulatory requirements for registered investment advisers and representatives under KUSA. There will be no material fiscal impacts on the operations of the Office of the Securities Commissioner of Kansas or any other government agencies. The amount of registration fees not received from exempt investment advisers and representatives at \$100 per firms and \$55 per individual each fiscal year cannot be estimated but is most likely immaterial in relation to total agency revenues. No material adverse economic impact on the general public in Kansas is expected due to the continued exemption of private advisers. No complaints by clients of Kansas-based private advisers or investment damages caused by exempt private advisers in Kansas have been reported to the Office of the Securities Commissioner in recent years. Persons claiming exemption under K.A.R. 81-14-11 as proposed would still be subject to anti-fraud provisions and penalties for violations under KUSA.

81-14-9. Custody of client funds or securities; safekeeping; financial reporting; ~~minimum net worth; bonding.~~ (a) Definitions. For the purposes of this regulation, the following definitions shall apply:

(1) ~~“Adjusted net worth” means the excess of total assets over total liabilities as determined in conformity with GAAP and adjusted by excluding the following assets and liabilities:~~

~~(A) Prepaid expenses, deferred charges, goodwill, franchise rights, organizational expenses, patents, copyrights, marketing rights, unamortized debt discounts and expenses, and all other assets of an intangible nature;~~

~~(B) advances or loans to a controlling person or employee of the investment adviser;~~

~~(C) homes, home furnishings, automobiles, and any other personal assets of a sole proprietor that would not be liquidated in the ordinary course of business; and~~

~~(D) liabilities of a sole proprietor that are secured by assets specified under paragraph (a)(1)(C), but not in excess of the value of the secured assets.~~

(2) “Custody” means holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them or the ability to appropriate them.

(A) Each of the following circumstances shall be deemed to constitute custody:

(i) Possession of client funds or securities unless received inadvertently and returned to the sender promptly, but in any case within three business days of receiving the funds or securities;

(ii) any arrangement, including a general power of attorney, under which an investment adviser is authorized or permitted to withdraw client funds or securities maintained with a custodian upon the adviser’s instruction to the custodian; and

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(iii) any arrangement that gives an investment adviser or its supervised person legal ownership of or access to client funds or securities, which may include an arrangement in which the investment adviser or its supervised person is the trustee of a trust, the general partner of a limited partnership, the managing member of a limited liability company, or a comparable position for a pooled investment vehicle.

(B) Receipt of a check drawn by a client and made payable to an unrelated third party shall not meet the definition of custody if the investment adviser forwards the check to the third party within ~~24 hours~~ three business days of receipt and the adviser maintains the records required under K.A.R. 81-14-4(b)(22).

(3) ~~“Discretionary authority” shall not include the authority under which an investment adviser places trade orders with a broker-dealer pursuant to a third-party trading agreement if all of the following conditions are met:~~

~~(A) The investment adviser has executed a separate investment adviser contract exclusively with its client acknowledging that a third-party trading agreement will be executed to allow the investment adviser to effect securities transactions for the client in the client’s broker-dealer account.~~

~~(B) The investment adviser contract specifically states that the client does not grant discretionary authority to the investment adviser, and the investment adviser does not exercise discretion with respect to the account.~~

~~(C) A third-party trading agreement is executed between the client and a broker-dealer that specifically limits the investment adviser’s authority in the client’s broker-dealer account to the placement of trade orders and deduction of investment adviser fees.~~

(4)(2) “Independent party” means a person that meets the following conditions:

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(A) Is engaged by an investment adviser to act as a gatekeeper for the payment of fees, expenses, and capital withdrawals from a pooled investment;

(B) does not control, is not controlled by, and is not under common control with the investment adviser; and

(C) does not have, and has not had within the past two years, a material business relationship with the investment adviser.

~~(5)~~(3) "Independent representative" means a person who meets the following conditions:

(A) Acts as an agent for an advisory client, which may include a person who acts as an agent for limited partners of a pooled investment vehicle structured as a limited partnership, members of a pooled investment vehicle structured as a limited liability company, or other beneficial owners of another type of pooled investment vehicle;

(B) is obliged by law or contract to act in the best interest of the advisory client or the limited partners, members, or other beneficial owners;

(C) does not control, is not controlled by, and is not under common control with the investment adviser; and

(D) does not have, and has not had within the past two years, a material business relationship with the investment adviser.

~~(6)~~(4) "Qualified custodian" means any of the following independent institutions or entities:

(A) A bank or savings association that has deposits insured by the federal deposit insurance corporation;

(B) a broker-dealer registered under the act who holds client assets in customer accounts and complies with K.A.R. 81-3-7(d);

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(C) a futures commission merchant registered under section 6f of the commodity exchange act, 7 U.S.C. § 6f, who holds client assets in customer accounts, but only with respect to clients' funds and security futures, or other securities incidental to transactions in contracts for the purchase or sale of a commodity and options of the commodity for future delivery; and

(D) a foreign financial institution that customarily holds financial assets for its customers, if the foreign financial institution keeps the advisory clients' assets in customer accounts segregated from its proprietary assets.

(b) Safekeeping of client funds and securities.

(1) Requirements. An investment adviser registered or required to be registered under the act shall not have custody of client funds or securities unless the investment adviser meets each of the following conditions. "An act, practice, or course of business that operates or would operate as a fraud or deceit," as used in K.S.A. 17-12a502, and amendments thereto, shall include any violation of this subsection.

(A) Notice to administrator. The investment adviser shall notify the administrator promptly on form ADV that the investment adviser has or will have custody.

(B) Qualified custodian. A qualified custodian shall maintain the funds and securities in a separate account for each client under each client's name, or in accounts that contain only funds and securities of the investment adviser's clients under the name of the investment adviser as agent or trustee for each client.

(C) Notice to clients. If an investment adviser opens an account with a qualified custodian on behalf of its client, either under the client's name or under the investment adviser's name as agent, the investment adviser shall notify the client in writing of the qualified custodian's name, address, and the manner in which the funds or securities are maintained. The

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notice shall be given promptly when the account is opened and following any changes to the information.

(D) Account statements. The investment adviser shall ensure that account statements are sent to each client for whom the adviser has custody of funds or securities.

(i) Statements sent by the qualified custodian. If a qualified custodian maintains accounts containing funds or securities, the qualified custodian may send account statements to clients if the investment adviser has a reasonable basis for believing that the qualified custodian sends an account statement at least quarterly to each of the adviser's clients for whom the custodian maintains funds or securities and that the account statement sets forth all transactions in the account during the period and identifies the amount of funds and amount of each security in the account at the end of the period.

(ii) Statements sent by the adviser. If account statements are not sent by the qualified custodian in accordance with paragraph (b)(1)(D)(i), the investment adviser shall send an account statement at least quarterly to each client for whom it has custody of funds or securities. The account statement shall set forth all transactions in the account during the period and identify the amount of funds and amount of each security of which it has custody at the end of the period.

At least once during each calendar year, an independent certified public accountant a CPA firm that is registered and authorized to provide attest services in compliance with requirements of the state where the investment adviser is domiciled shall verify all client funds and securities by actual examination be engaged by the investment adviser to attest to the accuracy, in all material respects, of the account statements sent to clients by the investment adviser based on a comparison with records of transactions and balances of funds and securities

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maintained by the qualified custodian. The attest engagement shall be performed in accordance with attestation standards established by the AICPA and contained in the "AICPA professional standards," as specified in K.A.R. 74-5-2. The CPA firm shall perform the attest engagement without prior notice or announcement to the adviser, on a date that changes from year to year as chosen by the accountant that changes from year to year CPA firm. The accountant CPA firm shall file a copy of the ~~auditor's~~ independent accountant's report and financial statements with the administrator within 30 days after the completion of the examination, along with a letter stating that the accountant has examined the funds and securities and describing the nature and extent of the examination attest engagement. The accountant CPA firm, upon finding any material discrepancies exceptions during the course of the examination engagement, shall notify the administrator of the finding within ~~one~~ two business day days by means of a facsimile transmission or electronic mail, followed by first-class mail, directed to the attention of the administrator.

(iii) Special rule for pooled investment vehicles. If the investment adviser is a general partner of a pooled investment vehicle structured as a limited partnership, is a managing member of a pooled investment vehicle structured as a limited liability company, or holds a comparable position for another type of pooled investment vehicle, the account statements required under this subsection shall be sent to each limited partner, member, or other beneficial owner or that person's independent representatives representative.

(E) Independent representatives. A client may designate an independent representative to receive, on the client's behalf, notices and account statements as required under paragraphs (b)(1)(C) and (b)(1)(D). Thereafter, the investment adviser shall send all notices and statements to the independent representative.

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(F) Direct fee deduction. Each investment adviser who has custody, as defined in paragraph ~~(a)(2)(A)(ii)~~ (a)(1)(A)(ii), by having fees directly deducted from client accounts held by a qualified custodian shall ~~comply with each of the following requirements:~~

~~(i) Written authorization. The investment adviser shall obtain prior written authorization from the client to deduct advisory fees from the account held with the qualified custodian.~~

~~(ii) Notice of fee deduction. Each time a fee is directly deducted from a client account, the investment adviser shall concurrently send the qualified custodian notice of the amount of the fee to be deducted from the client's account and send the client an invoice itemizing the fee. Itemization shall include the formula used to calculate the fee, the amount of assets under management on which the fee is based, and the time period covered by the fee.~~

~~(iii) Notice of safeguards. The investment adviser shall notify the administrator on form ADV that the investment adviser intends to use the safeguards specified in this subsection.~~

(G) Pooled investments. Each investment adviser who has custody, as defined in paragraph ~~(a)(2)(A)(iii)~~ (a)(1)(A)(iii), and who does not meet the exception provided under paragraph (b)(2)(C) shall comply with each of the following requirements:

(i) Engage an independent party. The investment adviser shall hire an independent party to review all fees, expenses, and capital withdrawals from the pooled accounts.

(ii) Review of fees. The investment adviser shall send all invoices or receipts to the independent party, detailing the amount of the fee, expenses, or capital withdrawal and the method of calculation so that the independent party can determine that the payment is in accordance with the agreement governing the pooled investment vehicle and so that the independent party can forward to the qualified custodian approval for payment of an invoice with a copy to the investment adviser.

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(iii) Notice of safeguards. The investment adviser shall notify the administrator on form ADV that the investment adviser intends to use the safeguards specified in this subsection.

(2) Exceptions.

(A) Shares of mutual funds. With respect to shares of a mutual fund that is an open-end company as defined in section 5(a)(1) of the investment company act of 1940, 15 U.S.C. 80a-5(a)(1), as adopted by reference in K.A.R. 81-2-1, any investment adviser may use the mutual fund's transfer agent in lieu of a qualified custodian for purposes of complying with paragraph (b)(1).

(B) Certain privately offered securities. An investment adviser shall not be required to comply with paragraph (b)(1) with respect to securities that meet the following conditions:

(i) Are acquired from the issuer in a transaction or chain of transactions not involving any public offering;

(ii) are uncertificated, with ownership of the securities recorded only on the books of the issuer or its transfer agent in the name of the client; and

(iii) are transferable only with the prior consent of the issuer or holders of the outstanding securities of the issuer.

(C) Limited partnerships subject to annual audit. An investment adviser shall not be required to comply with paragraph (b)(1) with respect to the account of a limited partnership, limited liability company, or other type of pooled investment vehicle that is subject to audit at least annually and that distributes its audited financial statements ~~prepared~~ presented in accordance conformity with GAAP to all limited partners, members, or other beneficial owners within 120 days after the end of its fiscal year. The investment adviser shall notify the

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administrator on form ADV that the investment adviser intends to distribute audited financial statements.

(D) Registered investment companies. An investment adviser shall not be required to comply with paragraph (b)(1) with respect to the account of an investment company registered under the investment company act of 1940, 15 U.S.C. 80a-1 et seq.

(E) Beneficial trusts. An investment adviser shall not be required to comply with the safekeeping requirements of paragraph (b)(1) if the investment adviser has custody solely because the investment adviser or an investment adviser representative is the trustee for a beneficial trust, if all of the following conditions are met for each trust:

(i) The beneficial owner of the trust is a parent, grandparent, spouse, sibling, child, or grandchild of the investment adviser representative, including "step" relationships.

(ii) The investment adviser provides a written statement to each beneficial owner of each account setting forth a description of the requirements of paragraph (b)(1) and the reasons why the investment adviser will not be complying with those requirements.

(iii) The investment adviser obtains from each beneficial owner a signed and dated statement acknowledging the receipt of the written statement.

(iv) The investment adviser maintains a copy of both documents described in paragraphs (b)(2)(E)(ii) and (iii) until the account is closed or the investment adviser or investment adviser representative is no longer trustee.

(F) Upon written request and for good cause shown, the requirement to use a qualified custodian may be waived by the administrator. As a condition of granting a waiver, the investment adviser may be required by the administrator to perform the duties of a qualified custodian as specified in paragraph (b)(1).

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(c) Financial reporting requirements for investment advisers.

~~(1) Balance sheet and auditor's report. Each registered investment adviser who has custody of client funds or securities, and each registered investment adviser who accepts the payment of advisory fees six months or more in advance and in excess of \$500 from any client, shall make prepare and maintain a balance sheet dated the last day of the investment adviser's fiscal year, as required by K.A.R. 81-14-4(b)(6), each month. The balance sheet shall be dated the last day of the month and shall be prepared within 10 business days after the end of the month. Each balance sheet shall meet both of the following requirements:~~

~~(A) The balance sheet shall be audited by an independent certified public accountant in accordance with generally accepted auditing standards.~~

~~(B) The balance sheet shall be accompanied by a report of the independent auditor containing an unqualified opinion that the balance sheet is a fair presentation of the investment adviser's financial position and is made in conformity with GAAP.~~

~~(2) Preparation and filing deadlines. The balance sheet and report required by this subsection shall be prepared within 90 days following the end of the investment adviser's fiscal year. The investment adviser shall file the balance sheet and report with the administrator, for any month specified by the administrator, within five days after a request by the administrator. Failure to file the balance sheet and report within five days after a request by the administrator shall constitute grounds for suspension of registration by emergency order under K.S.A. 17-12a412(f) and amendments thereto.~~

~~(3)(2) Exemptions. An investment adviser shall be exempt from the requirements of this subsection if either of the following conditions is met:~~

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~~(A) The investment adviser qualifies for an exception from the minimum adjusted net worth requirements of paragraph (d)(3).~~

~~(B) the investment adviser has its principal place of business in a state other than Kansas, is properly registered in that state, and satisfies the financial reporting requirements of that state.~~

~~(d) Adjusted net worth requirements.~~

~~(1) Positive net worth requirement for investment advisers. Each investment adviser that is registered or required to be registered under the act shall maintain at all times a positive adjusted net worth.~~

~~(2) Minimum adjusted net worth for advisers with discretionary authority. Each investment adviser that is registered or required to be registered under the act and that has discretionary authority over client funds or securities shall maintain at all times a minimum adjusted net worth of \$10,000, unless the investment adviser is subject to the greater requirements of paragraph (d)(3).~~

~~(3) Minimum adjusted net worth for advisers with custody. Each investment adviser that is registered or required to be registered under the act and that has custody of client funds or securities shall maintain at all times a minimum adjusted net worth of \$35,000, except the following advisers:~~

~~(A) Any investment adviser that has custody solely because the adviser meets the definition of custody in paragraph (a)(2)(A)(ii) by having fees directly deducted from client accounts and that complies with the safekeeping requirements in paragraphs (b)(1)(A) through (b)(1)(F) and the recordkeeping requirements of K.A.R. 81-14-4(c);~~

~~(B) any investment adviser that has custody solely because the adviser meets the definition of custody in paragraph (a)(2)(A)(iii) and that complies with the safekeeping~~

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requirements in paragraphs (b)(1)(A) through (b)(1)(E) and (b)(1)(G) and the recordkeeping requirements of K.A.R. 81-14-4(e); and

(C) any investment adviser that has custody solely because the adviser is trustee for a beneficial trust, if the trust meets the conditions in paragraph (b)(2)(E).

(4) Notification. Each investment adviser registered or required to be registered under the act shall, by the close of business on the next business day, notify the administrator if the investment adviser's adjusted net worth is less than the minimum required by this subsection. After transmitting the notice, each investment adviser shall, by the close of business on the next business day, file a report with the administrator of its financial condition, including the following:

(A) A trial balance of all ledger accounts;

(B) a statement of all client funds or securities that are not segregated;

(C) a computation of the aggregate amount of client ledger debit balances; and

(D) a statement indicating the number of client accounts.

(5) Appraisals. A current appraisal may be required by the administrator to be submitted in order to establish the worth of any asset.

(6) Exception for out-of-state advisers. If an investment adviser has its principal place of business in a state other than Kansas and is properly registered in that state, the investment adviser shall be required to maintain only the minimum capital required by the state in which the investment adviser maintains its principal place of business.

(e) Surety bond. Every investment adviser registered or required to be registered under the act that has custody or discretionary authority over client funds or securities shall be bonded for at least \$35,000. The bond shall be in a form acceptable to the administrator from a bonding

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~~company qualified to do business in Kansas, and the bond shall be subject to the claims of all clients of the investment adviser, regardless of each client's state of residence.~~

~~(1) Additional bond requirement. If an investment adviser does not meet the minimum adjusted net worth requirement of paragraphs (d)(2) and (d)(3), the investment adviser shall also be bonded for the amount of the net worth deficiency rounded up to the nearest \$5,000.~~

~~(2) Exemptions. Each investment adviser shall be exempt from the requirements of this subsection if the adviser meets at least one of the following requirements:~~

~~(A) Maintains a minimum adjusted net worth that exceeds the requirements of subsection (d) by at least \$35,000;~~

~~(B) qualifies for an exception from the minimum adjusted net worth requirements of paragraph (d)(3) and does not have discretionary authority; or~~

~~(C) has its principal place of business in a state other than Kansas, is properly registered in that state, and satisfies the bonding requirements of that state. (Authorized by K.S.A. 17-12a502(b) and 17-12a605(a); implementing K.S.A. 17-12a411 and 17-12a502(a)(2); effective Aug. 18, 2006; amended Aug. 15, 2008; amended P-_____.)~~

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81-14-11. Kansas private adviser exemption. (a) Exemption from registration. An investment adviser shall be exempt from the registration requirements of K.S.A. 17-12a403, and amendments thereto, if both of the following requirements are met:

(1) The investment adviser shall meet each of the following conditions:

(A) Maintain its principal place of business in Kansas;

(B) provide investment advice solely to fewer than 15 clients;

(C) not hold itself out generally to the public as an investment adviser; and

(D) not act as an investment adviser to any investment company registered under the investment company act of 1940, 15 U.S.C. § 80a-1 et seq., or a company that has elected and has not withdrawn its election to be a business development company pursuant to section 54 of the investment company act of 1940, 15 U.S.C. § 80a-54.

(2) Neither the investment adviser nor any of its advisory affiliates or associated investment adviser representatives shall be subject to a disqualification provision as described in rule 262 of SEC regulation A, 17 C.F.R. § 230.262, as adopted by reference in K.A.R. 81-2-1.

(b) Exemption from notice filing requirement. Each investment adviser that qualifies for exemption under subsection (a) and manages assets in excess of \$25 million and, therefore, is either required to register with the SEC or qualified to file with the SEC as an exempt reporting adviser shall be exempt from the notice filing requirements of K.S.A. 17-12a405, and amendments thereto.

(c) Exemption for investment adviser representatives. An investment adviser representative shall be exempt from the registration requirements of K.S.A. 17-12a404, and amendments thereto, if the individual meets the following requirements:

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(1) Is employed by or associated with an investment adviser that meets the exemption requirements under subsection (a);

(2) is not subject to a disqualification as described in rule 262 of SEC regulation A, 17 C.F.R. § 230.262; and

(3) does not otherwise act as an investment adviser representative.

(d) Transition. Each investment adviser or investment adviser representative who becomes ineligible for the exemption specified in this regulation shall comply with the registration or notice filing requirements under the act within 90 days after the date of ineligibility. (Authorized by K.S.A. 17-12a605(a); implementing K.S.A. 17-12a403(b)(3), 17-12a404(b)(2), and 17-12a405(b)(3); effective P-_____.)

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OFFICE OF THE SECURITIES COMMISSIONER OF KANSAS

ECONOMIC IMPACT STATEMENT

Amendment of K.A.R. 81-14-9 and Adoption of K.A.R. 81-14-11

Summary of proposed amendment and adoption of regulations:

K.A.R. 81-14-9 currently specifies requirements for registered investment advisers that have custody of client funds or securities, or discretionary authority over client funds or securities, based on circumstances deemed to constitute custody or discretionary authority as defined in the regulation. The Commissioner and staff have determined that several of the requirements do not effectively or significantly provide for such protection. The number of investment advisers currently registered in Kansas having custody of client funds or securities is limited. For those investment advisers, there are sufficient safekeeping provisions within subsection (b) of K.A.R. 81-14-9 to provide for protection of client funds and securities. Therefore, most of the amendments to the regulation are to delete requirements that are deemed unnecessary in relation to other protections that remain in K.A.R. 81-14-9 and other regulations.

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- 1) surety bond requirements specified under K.A.R. 81-14-9(e);
- 2) a notice of fee deduction required by K.A.R. 81-14-9(b)(1)(F);
- 3) an audited balance sheet required by K.A.R. 81-14-9(c)(1); and
- 4) minimum adjusted net worth required by K.A.R. 81-14-9(d).

The waivers by special order will remain in effect until amendments to K.A.R. 81-14-9 are adopted. The proposed amendments to K.A.R. 81-14-9 would permanently eliminate the requirements listed above by deletion of those provisions from the regulation.

K.A.R. 81-14-11 is a new regulation proposed for adoption by the Commissioner which is intended to encourage more investment activity in Kansas by exempting certain investment advisers who manage a limited number of private investment funds or portfolios of individual Kansas investors from the registration and other regulatory requirements under KUSA. The adoption of K.A.R. 81-14-11 will make permanent the temporary exemptions that were implemented by special orders issued

March 29, 2012 and July 19, 2011 for consistency with and extension of a similar exemption under former section 203(b)(3) of the federal Investment Advisers Act of 1940 that was repealed by the Dodd-Frank Act. Continuation of the exemption authorized by special order will enable Kansas-based private investment advisers to operate without duplicative regulatory oversight or regulation deemed unnecessary by the Office of the Securities Commissioner of Kansas. Investment advisers that were previously exempt from federal registration with the Securities and Exchange Commission (SEC) and which now are required to either register or file a notice as an exempt reporting adviser with the SEC when they manage assets in excess of \$25 million can continue to be exempt from registration and other regulatory requirements in Kansas if they comply with all requirements and conditions of proposed K.A.R. 81-14-11. Individual investment adviser representatives employed by exempt investment adviser firms can also be exempt from registration with the Office of the Securities Commissioner of Kansas if they meet conditions specified by the proposed K.A.R. 81-14-11.

The exemption provided by proposed K.A.R. 81-14-11 requires an investment adviser to: maintain its principal place of business in Kansas; provide investment advice solely to fewer than 15 clients; not hold out generally to the public as an investment adviser; not act as an investment adviser to any investment company registered under the federal Investment Company Act of 1940 (the 1940 act) or a company that has elected and not withdrawn its election to be a Business Development Company under the 1940 act; and not be, nor any of its advisory affiliates or investment adviser representatives, subject to a disqualification provision as described in SEC Rule 262 under federal Regulation A.

Federal mandate considerations and comparison with similar federal law:

The proposed amendments to K.A.R. 81-14-9 and adoption of new K.A.R. 81-14-11 are not mandated by federal law as a requirement for participating in or implementing a federally subsidized or assisted program, and the proposed amendment and adoption do not exceed requirements of applicable federal law. In fact, the exemption provided by proposed K.A.R. 81-14-11 enables reduced requirements for private advisers based in Kansas as compared to federal securities laws.

Anticipated economic impacts:

Although economic impacts of the proposed amendments to K.A.R. 81-14-9 cannot be accurately estimated, it is expected that the primary impact will be reduced costs for registered investment advisers doing business in Kansas. There will be no material fiscal impacts on the operations of the Office of the Securities Commissioner of Kansas or any other Kansas agencies. No

adverse economic impact on the general public in Kansas is expected due to the proposed reduction in regulatory requirements for investment advisers registered in Kansas.

The primary economic impact expected by adoption of K.A.R. 81-14-11 would be to enable the private investment advisers that claim and comply with the exemption provided by the regulation to avoid the significant costs of registration and other regulatory requirements for registered investment advisers and representatives under KUSA. There will be no material fiscal impacts on the operations of the Office of the Securities Commissioner of Kansas or any other Kansas agencies. The amount of registration fees not received by the Office of the Securities Commissioner from exempt investment advisers and representatives at \$100 per firm and \$55 per individual each fiscal year cannot be estimated but is most likely immaterial in relation to total agency revenues. No material adverse economic impact on the general public in Kansas is expected due to the continued exemption of private advisers. The exemption may attract private advisers to locate in Kansas and possibly enhance economic benefits for private clients in Kansas communities, however, it is not possible to estimate the amount of such potential benefits.

Less costly or less intrusive alternatives:

Less costly or less intrusive alternatives are not deemed applicable because the proposed amendment and adoption actually reduce costs and requirements for investment advisers in Kansas that are subject to the provisions of the regulations. If the proposed amendment and new regulation are not adopted, and if the special orders currently in effect that provide waivers and an exemption from registration requirements would be vacated, the costs and requirements for compliance by affected investment advisers would increase.

Impact on cities, counties, or school districts:

The regulations have no impact on the revenues, functions, or responsibilities of cities, counties or school districts.