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DEPARTMENT OF FINANCIAL INSTITUTIONS
SECURITIES DIVISION**

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Small Business Economic Impact Statement

Chapter 460-24A WAC
Investment Advisers

March 27, 2014

Introduction

This Small Business Economic Impact Statement (SBEIS) is written in support of proposed rule amendments drafted by the Department of Financial Institutions, Securities Division (“Securities Division”) to amend the rules in Chapter 460-24A WAC pertaining to investment advisers.

The investment adviser rules have not been amended since 2008. Since that time, there have been many changes in the financial industry and in the laws regulating investment advisers. For instance, as a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the number of investment advisers subject to state registration has increased. In addition, there have been numerous changes and updates to NASAA Model Rules, which are adopted by many states for use in the regulation of investment advisers. Many of the proposed amendments to the rules would make Washington’s rules consistent with current federal law and NASAA Model Rules. The Securities Division has also identified certain rules which could be improved to increase investor protection and to reduce the potential for fraud.

The Securities Division has involved its registered investment advisers and noticed filed investment advisers throughout the rulemaking process and has made changes to the proposed rule amendments in response their concerns. The Securities Division finds that the proposed rule amendments should be adopted in order to better protect clients of investment advisers in Washington.

Procedural Background

On March 19, 2010, the Washington Securities Division filed a CR-101 Preproposal Statement of Inquiry with the Code Reviser’s Office stating that it was considering possible updates, amendments, and additions to its investment adviser rules. The Securities Division subsequently prepared a draft of amendments to its investment adviser rules which was distributed to interested persons in a mailing on August 13, 2012. The Securities Division also conducted a

survey of state registered investment advisers and notice filed investment advisers to determine the costs associated with the rule amendments.

Since that time, the Securities Division has made certain changes to the draft amendments in response to feedback received from investment advisers registered or notice filed in the state of Washington. The Securities Division now intends to proceed with the rulemaking to amend WAC 460-24A by formally proposing the draft amendments in a CR-102 filing with the Code Reviser.

Summary of Proposed Rule Amendments

The proposed rule amendments would amend 27 rule sections under WAC 460-24A, create 7 new sections, and repeal 1 section.

The amendments would update various provisions of the investment adviser rules, including the rules regarding financial reporting requirements, custody, performance compensation arrangements, books and records, and unethical business practices. The amendments would add new rule sections addressing proxy voting, advisory contracts, and compliance procedures and practices, and would create exemptions from registration for certain private fund advisers and venture capital fund advisers. Many of these changes would make Washington's rules consistent with current federal law and NASAA Model Rules. Finally, the amendments would repeal WAC 460-24A-058, which defined when an application for investment adviser or investment adviser representative registration is considered filed. The Securities Division determined that this rule section was unnecessary. The proposed amendments are described in greater detail below:

Financial Reporting Requirements

The rulemaking would amend the financial reporting requirements in WAC 460-24A-060. The amendments would require investment advisers who have custody, or who require payment of advisory fees six months in advance and in excess of \$500 per client, to file an audited balance sheet with the Securities Division each year. Currently, a balance sheet must be filed but it does not need to be audited. In addition, the amendments would require advisers who have custody as defined in WAC 460-24A-005(1)(a)(iii) (management of a pooled investment vehicle) and who have indicated they will comply with the safekeeping requirements of WAC 460-24A-107(1)(b) by providing audited financial statements of the pooled investment vehicle to limited partners, to file the audited statements of the pooled investment vehicle with the Securities Division. Under the current rules, the annual audited financial statements are provided to investors to fulfill the safekeeping requirements but are not required to be filed with the Securities Division.

Custody

The amendments would make various changes and clarifications to the custody rules for investment advisers at WAC 460-24A-105, WAC 460-24A-106, and WAC 460-24A-107. Under the current WAC 460-24A-105, if the investment adviser sends account statements, rather than the qualified custodian, an independent CPA must verify client funds and securities by examination once per year. The amendments to WAC 460-24A-105 would provide that the

investment adviser enter into a written agreement with the CPA who will provide these services. The agreement must contain certain provisions specified in the amendments that are designed to protect against fraud. In addition, an investment adviser who acts as a qualified custodian must enter into an agreement with an independent CPA to conduct an examination to verify funds and securities.

The amendments will revise WAC 460-24A-106 to clarify that advisers who have the authority to directly deduct fees from client accounts must comply with the custody requirements in WAC 460-24A-105 as well as the additional safekeeping requirements specified in WAC 460-24A-106.

The amendments revise WAC 460-24A-107, which provides additional custody requirements for investment advisers that manage pooled investment vehicles. The amendments would require that if the additional custody requirements in WAC 460-24A-107(1) are met by engaging an independent party to authorize withdrawals, the investment adviser must enter into a written agreement with the independent party. The amendments specify that if the adviser uses an independent party to meet the requirements of WAC 460-24A-107(1)(a), the investment adviser is not required to comply with the net worth and bonding requirements for an investment adviser with custody. If the adviser meets the additional custody requirements of WAC 460-24A-107(1) by providing audited financial statements, the rule amendments specify to whom and when the audited financial statements must be delivered.

Finally, the amendments to WAC 460-24A-107 clarify that an investment adviser to a pooled investment vehicle must deliver account statements to each limited partner or beneficial owner of the pooled investment vehicle. The account statements must include the total amount of all additions and withdrawals to the fund, the opening and closing value at the end of the quarter, a listing of all long and short positions on the closing date of the statements, the total amount of additions to and withdrawals from the fund by the investor, and the total value of the investor's interest in the fund at the end of the quarter.

Performance Compensation Arrangements

The rulemaking will make several changes to WAC 460-24A-150, which addresses performance compensation arrangements. The amendments adopt the formula for permitted performance compensation arrangements and disclosure requirements found in the current NASAA Performance-Based Compensation Exemption for Investment Advisers Model Rule. In addition, the amendments add provisions to conform to the proposed revisions to the NASAA Performance-Based Compensation Exemption for Investment Advisers Model Rule. These provisions state that advisers who are *not* registered or required to be registered may enter into performance based compensation agreements. They also clarify that a beneficial owner of an equity interest in certain investment vehicles is a client for the purpose of the performance compensation rule. The rule amendments also adopt transition rules that allow performance based compensation arrangements that were permitted by the rule in place at the time the advisory contract was signed.

Books and Records

The rulemaking will amend WAC 460-24A-200, which specifies the books and records to be maintained by investment advisers. The amendments will add the following to the books and records that must be maintained:

- Written information about each security an adviser recommends a client buy or sell that is the basis for making any recommendation or providing any investment advice to such client;
- Records to be maintained following inadvertent custody of client securities or funds, pursuant to the NASAA Custody Requirements for Investment Advisers Model Rule; and
- A copy of a written business continuity plan which identifies procedures to be followed in the event of an emergency or significant business disruption and which is reasonably designed to enable the investment adviser to meet its fiduciary obligations to clients.

The amendments will require investment advisers who have custody to keep the following additional records:

- A copy of all documents executed by the client under which the adviser is authorized of permitted to withdraw a client's funds or securities maintained with a custodian upon the adviser's instruction to the custodian;
- A copy of each client's quarterly account statements as generated and delivered by the qualified custodian, plus any statements generated by the adviser and delivered to the client;
- Any special examination reports;
- Any findings by the independent CPA of any material discrepancies;
- Evidence of the client's designation of an independent representative, if applicable;
- For investment advisers who manage a pooled investment vehicle: current account statements, and specific records to demonstrate compliance with either WAC 460-24A-107(1)(a) or (b); and
- For investment advisers with custody under WAC 460-24A-109(3): a copy of the written statement and signed acknowledgment given to each beneficial owner explaining why the adviser is not complying with WAC 460-24A-105.

In addition, the rulemaking will revise the provisions regarding records retention and preservation in WAC 460-24A-200(7) in order to conform to the NASAA Investment Advisers Recordkeeping Model Rule.

Unethical Practices

The rulemaking will amend WAC 460-24A-220, which specifies certain practices as unethical business practices for investment advisers.

The unethical business practices rule currently states that it applies to investment advisers and federal covered advisers. The amendments add that the rule applies to investment adviser representative as well. The amendments clarify that advisers may not disclose any current or former client's financial information unless required by law or consented to by the client. The

amendments clarify that the adviser may not enter into an advisory contract that does not comply with the draft rule at WAC 460-24A-130.

In addition, the amendments specify that it is an unethical business practice for investment advisers, investment adviser representatives, and federal covered advisers to make in the solicitation of clients, any untrue statement of fact, or omitting to state a material fact necessary in order to make the statement made, in light of the circumstances in which it was made, not misleading.

Proxy Voting

The rulemaking will add a new section to the rules, WAC 460-24A-125, which will require investment advisers who exercise voting authority with respect to client securities to adopt policies and procedures that are designed to ensure that the adviser votes client securities in the best interest of the clients. Investment advisers who exercise voting authority must disclose to clients how they can obtain information on how their securities were voted.

Advisory Contracts

The rulemaking will add a new section to the rules, WAC 460-24A-130, which specifies the requirements for the investment advisory contract. The rule is based on the NASAA Model Rule on the Contents of the Investment Advisory Contract and incorporates existing advisory contract requirements currently found in the unethical practices provision at WAC 460-24A-220(16). The draft rule states it is unlawful under RCW 21.20.020 and RCW 21.20.030 to enter into an advisory contract unless it provides in writing:

- The services to be provided, the term of the contract, the investment advisory fee, the formula for computing the fee, the amount of prepaid fee to be returned in the event of termination or nonperformance of the contract, and whether and the extent to which the contract grants discretionary authority to the adviser and any limits on such authority;
- That no direct or indirect assignment or transfer the contract may be made without the written consent of the client;
- That the adviser shall not be compensated on the basis of a share of capital gains except as permitted under WAC 460-24A-150;
- That if the adviser is a partnership, it shall notify the client of any change to the membership of the partnership within a reasonable time after the change;
- That if the adviser has custody as a consequence of its authority to make withdrawals from client accounts to pay the adviser's advisory fees, that the contract gives the adviser the authority to deduct fees from the account held by the qualified custodian;
- The nature and extent to which the adviser is granted proxy voting authority with respect to client securities;
- The terms for termination of the contract;
- The nature and extent to which the adviser may electronically deliver documents including account statements and fee invoices, and the extent and manner in which the client may opt out of receiving documents electronically; and
- That the contract shall be governed by the laws of the state in which the client resides.

Compliance Procedures and Practices

The rulemaking would create a new section, WAC 460-24A-120, concerning compliance procedures and practices. The rule states that it is unlawful for an investment adviser who has more than one employee to provide investment advice unless the adviser adopts and implements written procedures reasonably designed to prevent violations of the Securities Act of Washington by the investment adviser and its supervised persons. The rule specifies that such policies must be reviewed for adequacy at least annually, and an individual must be designated as responsible for administering the policies and procedures.

Additional Provisions

In addition to the changes listed above, the rulemaking will:

- Create a new section at WAC 460-24A-071 which adds an exemption from investment adviser registration for advisers to qualified private funds (which does not apply to advisers of section 3(c)(1) funds);
- Create a new section at WAC 460-24A-072 which adds an exemption from investment adviser registration for venture capital fund advisers;
- Create a new section at WAC 460-24A-035 which clarifies who is a client and specifies how to count clients for the purposes of determining who needs to register as an investment adviser under RCW 21.20.040(3);
- Create a new section at WAC 460-24A-080 which provides for the termination of pending applications where the applicants have taken no action for 9 months;
- Update the examination and registration requirements at WAC 460-24A-050 to make them consistent with NASAA Model Rules;
- Update the brochure rule at WAC 460-24A-145 to make it consistent with the NASAA Model Rule;
- Repeal WAC 460-24A-058, which defined when an application was considered filed; and
- Make additional updates, amendments, and clarifications.

Need for Economic Impact Statement

RCW 19.85.030 provides that an agency shall prepare a small business economic impact statement if the rules it is proposing would impose more than minor costs on businesses in an industry. Minor costs are defined by RCW 19.85.020 as a cost per business that is less than three-tenths of one percent of annual revenue or income, or one hundred dollars, whatever is greater; or one percent of annual payroll. The Securities Division determined that a small business economic impact may be required for this rulemaking.

Survey of Investment Advisers

In order to gather the information to prepare a Small Business Economic Impact Statement, RCW 19.85.040 provides that an agency may survey a representative sample of affected businesses to assist in the accurate assessment of the costs of a proposed rule. To that end, the Securities Division prepared a Small Business Economic Impact Survey to survey its state

registered investment advisers and a representative sample of federal registered advisers that are notice filed in the state of Washington.

In general, investment advisers in Washington with assets under management of less than \$100 million must register with the state. Investment advisers with assets under management of \$100 million or more must register with the SEC and make a notice filing with the Securities Division if they do business in Washington. At the time of the survey, the Securities Division had 663 state registered investment advisers and 1527 federal registered notice filed advisers.

On August 13, 2012, the Securities Division sent a letter by e-mail to all state registered investment advisers (and applicants with a pending investment adviser application) and a random selection of approximately 50% of the federal registered investment advisers notice filed in Washington. If a state registered investment adviser did not have an email address on file, the Securities Division sent a hard copy of the letter by regular mail. The letter contained a link to an online survey designed to determine the economic impact of the proposed amendments to the rules under WAC 460-24A on small businesses. The letter explained the reasons for conducting the survey and requested that recipients complete the survey by following the link provided.

The online survey consisted of 36 questions. Each question in the survey focused on a proposed rule amendment and provided a background statement briefly explaining the amendment. The survey asked whether proposed changes to a rule section would cause increased costs. The survey then requested information on the additional costs of the professional services, equipment, supplies, labor, and administrative costs associated with each proposed rule change. Each question also allowed a free form response for survey takers to explain any additional costs. The survey also gathered data on the number of employees each investment adviser had, and questioned whether the rulemaking as a whole would cause a loss of revenue or the loss or addition of any jobs.

The initial survey period lasted from August 13, 2012 until September 7, 2012. The Securities Division received 314 unique responses. The Securities Division received responses or partial responses from 207 state registered investment advisers and 107 federal registered advisers notice filed in Washington. Of the respondents, 286 were small businesses as defined by RCW 19.85.020(3) of the Regulatory Fairness Act. All state registered investment advisers who responded to the survey are small businesses because they all have less than 50 employees.

The Securities Division prepared a Small Business Economic Impact Statement based on the initial survey results and filed a copy with the Code Reviser's Office. The Securities Division then received a comment suggesting that exempt reporting advisers should have been included in the survey pool. The Securities Division agreed that the three exempt reporting advisers doing business in Washington should be included in the survey. The Securities Division subsequently sent the online survey to these three advisers, all of whom are located out of state. The second survey period lasted from June 7, 2013 to June 28, 2013. The Securities Division received one response. The response was from an exempt reporting adviser that qualified as a small business for the purposes of the Regulatory Fairness Act. The response indicated that the proposed rule changes would not create additional costs, would not cause lost sales or revenues, and would not cause the elimination of any jobs.

The results of the initial survey are discussed below. The results from the exempt reporting advisers' survey were not included in the analysis because the response received indicated that there would be no economic impact on the adviser. The Securities Division determined that averaging a zero into the data would not affect the analysis of the economic impact.

REQUIRED ELEMENTS OF SMALL BUSINESS ECONOMIC IMPACT STATEMENT

A brief description of the reporting, record keeping, and other compliance requirements of the proposed rules and of the kinds of professional services that a small business is likely to need in order to comply with the requirements. An analysis of the costs of compliance for identified industries, including costs of equipment, supplies, and increased administrative costs.

The proposed rule amendments make a variety of changes to the existing investment adviser rules, some of which will create new recordkeeping, reporting, or compliance requirements for licensees. Registered investment advisers already maintain certain records required of investment advisers under WAC 460-24A-200. As they do currently, investment advisers registered in Washington will need to demonstrate compliance with the amended rules by providing required records during periodic examinations of the investment adviser by the Securities Division.

The rulemaking creates certain new recordkeeping and compliance requirements, including the following: revising and executing advisory contracts to meet the requirements of the new rule; drafting or revising compliance policies and procedures; drafting or revising agreements with independent CPAs and independent parties (if applicable) to meet the specification of the rules; developing proxy voting disclosures (if applicable); drafting business continuity plans; and drafting and maintaining written information on securities that the adviser recommends.

As a result of the rule amendments, investment advisers may incur expenses by the need to review existing procedures, documents, and agreements to ensure compliance with the new rules. Though not required to do so by the proposed rules, investment advisers may choose to hire professional services to assist them in complying with the new rules. Investment advisers may hire legal or other professional services to create or revise advisory agreements, compliance policies and procedures, proxy voting disclosures, account statements for pooled investment vehicles, and other documents and agreements used in the investment adviser's business. Investment advisers may also consult professional services for advice on establishing systems or methods to ensure compliance.

Certain advisers, such as those who have custody, will be required to use the services of an independent CPA in order to file an audited balance sheet for the investment adviser each year.

In addition, the proposed rulemaking may have an economic impact on investment advisers in the form of increased equipment, supplies, labor, and administrative costs. These costs may relate to postage and other mailing costs, copying expenses, computer or software expenses, and expenses associated with recordkeeping and record retention. The rulemaking may cause investment advisers to hire additional employees to ensure compliance

The Securities Division surveyed investment advisers to determine if the new requirements would add costs to their business, and if so, how much. The survey provided a summary of the rule changes by section, and asked first whether the proposed changes to each section would create any additional costs for the investment adviser. The following chart provides the responses from the survey question regarding whether compliance with the proposed changes to each rule section would create any additional costs.

Whether Rule Changes Will Create Additional Costs		
Rule Provision	Yes	No
WAC 460-24A-005	24%	76%
WAC 460-24A-010	4%	96%
Plain English Updates	11%	89%
WAC 460-24A-035	5%	95%
WAC 460-24A-040	2%	98%
WAC 460-24A-047	8%	93%
WAC 460-24A-050	11%	89%
WAC 460-24A-059	0%	100%
WAC 460-24A-060	13%	87%
WAC 460-24A-070	0%	100%
WAC 460-24A-071	1%	99%
WAC 460-24A-072	0%	100%
WAC 460-24A-080	4%	96%
WAC 460-24A-100	8%	92%
WAC 460-24A-105	9%	91%
WAC 460-24A-106	13%	87%
WAC 460-24A-107	4%	96%
WAC 460-24A-108	2%	98%
WAC 460-24A-109	0%	100%
WAC 460-24A-120	19%	81%
WAC 460-24A-125	10%	90%
WAC 460-24A-130	24%	76%
WAC 460-24A-140	1%	99%
WAC 460-24A-145	1%	99%
WAC 460-24A-150	1%	99%
WAC 460-24A-160	1%	99%
WAC 460-24A-170	2%	98%
WAC 460-24A-200	25%	75%
WAC 460-24A-205	6%	94%
WAC 460-24A-220	8%	92%
WAC 460-24A-058	0%	100%

Where the survey takers indicated that the rule changes in a particular section would create additional costs, the survey requested information regarding the amount of increased costs of professional services, equipment, supplies, labor, and administrative costs attributable to each section of the rules. Each survey taker provided information regarding its number of employees,

which allowed the Securities Division to calculate the average cost per employee for each investment adviser. These costs per employee were then averaged together.

The following chart provides the average cost increase per employee for each rule change for all survey respondents.

Average Cost Increase					
Rule Provision	Prof'l Services	Equipment	Supplies	Labor	Admin
WAC 460-24A-005	\$ 370.87	\$ 7.58	\$ 18.52	\$ 209.19	\$ 197.54
WAC 460-24A-010	\$ 15.21	\$ -	\$ 0.34	\$ 4.86	\$ 5.77
Plain English Updates	\$ 101.94	\$ 0.17	\$ 1.82	\$ 37.12	\$ 67.19
WAC 460-24A-035	\$ 25.25	\$ -	\$ 0.37	\$ 7.21	\$ 18.92
WAC 460-24A-040	\$ 0.98	\$ -	\$ 0.90	\$ 0.79	\$ 1.42
WAC 460-24A-047	\$ 25.89	\$ 0.18	\$ 0.26	\$ 8.90	\$ 15.01
WAC 460-24A-050	\$ 118.29	\$ -	\$ 0.42	\$ 9.23	\$ 103.62
WAC 460-24A-059	\$ 3.61	\$ -	\$ -	\$ 3.61	\$ -
WAC 460-24A-060	\$ 313.48	\$ 1.24	\$ 0.01	\$ 82.90	\$ 181.84
WAC 460-24A-070	\$ -	\$ -	\$ -	\$ -	\$ -
WAC 460-24A-071	\$ 129.74	\$ -	\$ 0.01	\$ 0.05	\$ 0.51
WAC 460-24A-072	\$ -	\$ -	\$ -	\$ -	\$ -
WAC 460-24A-080	\$ 29.56	\$ 0.09	\$ 0.10	\$ 16.03	\$ 9.64
WAC 460-24A-100	\$ 72.45	\$ -	\$ 0.57	\$ 40.32	\$ 34.32
WAC 460-24A-105	\$ 255.34	\$ 9.08	\$ 11.91	\$ 75.76	\$ 119.20
WAC 460-24A-106	\$ 361.52	\$ 8.55	\$ 31.40	\$ 134.33	\$ 188.08
WAC 460-24A-107	\$ 173.03	\$ 1.57	\$ 10.43	\$ 62.01	\$ 111.86
WAC 460-24A-108	\$ 15.79	\$ -	\$ -	\$ 7.80	\$ 6.14
WAC 460-24A-109	\$ -	\$ -	\$ -	\$ -	\$ -
WAC 460-24A-120	\$ 163.94	\$ 2.17	\$ 2.98	\$ 65.66	\$ 97.21
WAC 460-24A-125	\$ 106.69	\$ -	\$ 0.78	\$ 32.09	\$ 42.47
WAC 460-24A-130	\$ 120.78	\$ 0.97	\$ 3.86	\$ 83.43	\$ 58.96
WAC 460-24A-140	\$ 3.97	\$ -	\$ -	\$ 3.97	\$ -
WAC 460-24A-145	\$ 26.03	\$ 0.68	\$ 4.26	\$ 13.30	\$ 10.78
WAC 460-24A-150	\$ 7.85	\$ -	\$ -	\$ -	\$ 1.66
WAC 460-24A-160	\$ 4.94	\$ -	\$ 0.48	\$ 3.28	\$ 1.18
WAC 460-24A-170	\$ 16.80	\$ -	\$ -	\$ 12.00	\$ 6.40
WAC 460-24A-200	\$ 433.80	\$ 17.53	\$ 12.23	\$ 212.75	\$ 282.62
WAC 460-24A-205	\$ 43.59	\$ 0.30	\$ 1.97	\$ 11.13	\$ 19.40
WAC 460-24A-220	\$ 104.94	\$ -	\$ 0.34	\$ 59.42	\$ 59.58
WAC 460-24A-058	\$ 1.05	\$ -	\$ -	\$ 1.05	\$ -

The following chart provides the average cost increase per employee only for those investment advisers who indicated that a particular rule change would create additional costs.

Average Additional Costs					
Rule Provision	Prof'l Services	Equipment	Supplies	Labor	Admin
WAC 460-24A-005	\$ 2,217.79	\$ 566.67	\$ 553.73	\$ 2,156.84	\$ 1,373.60
WAC 460-24A-010	\$ 742.54	\$ -	\$ 100.00	\$ 356.17	\$ 422.54
Plain English Updates	\$ 982.06	\$ 50.00	\$ 105.00	\$ 715.24	\$ 970.89
WAC 460-24A-035	\$ 654.24	\$ -	\$ 52.50	\$ 513.89	\$ 490.10
WAC 460-24A-040	\$ 92.92	\$ 0.20	\$ 85.07	\$ 75.07	\$ 100.94
WAC 460-24A-047	\$ 402.69	\$ 25.10	\$ 14.48	\$ 249.27	\$ 262.67
WAC 460-24A-050	\$ 1,478.63	\$ 0.24	\$ 16.46	\$ 317.15	\$ 1,676.25
WAC 460-24A-059	\$ 1,000.00	\$ -	\$ -	\$ 1,000.00	\$ -
WAC 460-24A-060	\$ 2,800.45	\$ 333.33	\$ 2.00	\$ 1,586.96	\$ 2,866.73
WAC 460-24A-070	\$ -	\$ -	\$ -	\$ -	\$ -
WAC 460-24A-071	\$ 17,644.23	\$ 0.40	\$ 2.00	\$ 14.00	\$ 68.69
WAC 460-24A-072	\$ -	\$ -	\$ -	\$ -	\$ -
WAC 460-24A-080	\$ 800.99	\$ 12.60	\$ 9.46	\$ 543.03	\$ 373.24
WAC 460-24A-100	\$ 963.52	\$ 0.20	\$ 25.43	\$ 975.02	\$ 652.07
WAC 460-24A-105	\$ 2,953.09	\$ 482.91	\$ 633.39	\$ 1,439.37	\$ 1,981.71
WAC 460-24A-106	\$ 2,870.22	\$ 447.93	\$ 913.97	\$ 1,599.80	\$ 2,053.22
WAC 460-24A-107	\$ 4,883.31	\$ 400.00	\$ 1,325.00	\$ 5,250.00	\$ 3,551.41
WAC 460-24A-108	\$ 679.18	\$ -	\$ -	\$ 671.05	\$ 527.78
WAC 460-24A-109	\$ -	\$ -	\$ -	\$ -	\$ -
WAC 460-24A-120	\$ 1,036.91	\$ 275.00	\$ 125.83	\$ 790.99	\$ 819.78
WAC 460-24A-125	\$ 1,437.48	\$ -	\$ 100.00	\$ 746.94	\$ 776.54
WAC 460-24A-130	\$ 601.48	\$ 120.83	\$ 137.13	\$ 741.93	\$ 458.82
WAC 460-24A-140	\$ 1,000.00	\$ -	\$ -	\$ 1,000.00	\$ -
WAC 460-24A-145	\$ 381.22	\$ 85.00	\$ 117.89	\$ 367.88	\$ 243.97
WAC 460-24A-150	\$ 656.97	\$ -	\$ -	\$ -	\$ 208.23
WAC 460-24A-160	\$ 413.21	\$ -	\$ 121.21	\$ 274.12	\$ 148.03
WAC 460-24A-170	\$ 840.00	\$ -	\$ -	\$ 1,000.00	\$ 533.33
WAC 460-24A-200	\$ 2,232.25	\$ 481.04	\$ 377.62	\$ 1,695.16	\$ 1,837.01
WAC 460-24A-205	\$ 904.39	\$ 75.00	\$ 163.62	\$ 346.47	\$ 536.77
WAC 460-24A-220	\$ 1,639.63	\$ -	\$ 42.50	\$ 1,485.53	\$ 1,354.14
WAC 460-24A-058	\$ 263.16	\$ -	\$ -	\$ 263.16	\$ -

Analysis of Increased Costs

The survey results indicated that certain rule changes would create greater costs than others. These were the changes to the definitions section, the Plain English updates, the financial reporting requirements and application requirements, the custody requirements, the compliance policies and procedures requirement, the proxy voting section, the advisory contracts section, and the books and records section. The survey results are described in further detail below.

WAC 460-24A-005 – Definitions

The Securities Division was surprised that 25% of survey respondents indicated that the changes to WAC 460-24A-005, the definitions section of the investment adviser rules, would lead to increased costs. The responses indicated an average cost per employee of \$370.87 for professional services, \$209.19 for labor, and \$197.54 for increased administrative costs.

The Securities Division added several definitions to WAC 460-24A-005, including definitions taken from NASAA Model Rules or from the Form ADV Glossary. The Securities Division proposed many of these definitions in order to create uniformity with other states. In the instance of definitions taken from the Form ADV Glossary, investment advisers were already subject to these definitions as all registered advisers must complete a Form ADV as part of their application.

The survey respondents commented upon the proposed revision of the definition of custody. The current definition allows funds to be returned within three business days without being deemed to have custody of the funds. However, the draft definition stated that an investment adviser has custody of funds if the adviser fails to return customer funds received inadvertently within one business day. Survey respondents indicated this change would cost them money and that returning funds within one business day might be difficult to accomplish.

The survey question regarding the Definitions section was the first substantive question of the survey. It appeared from the free form answer responses for this section that many of the respondents may have been providing comments related to other rule subsections, or all of the rule revisions collectively. For instance, comments in response to this question expressed that providing quarterly statements and updating written supervisory policies would increase costs. These provisions do not appear in definitions section. Therefore, it is not clear whether some survey respondents may have provided dollar figures in response to this question that were intended to apply to the rulemaking as a whole. It may be that some of the expenses reported in response to this survey question refer to costs associated with other sections of the rules.

Plain English Updates

In drafting amendments to the investment adviser rules, the Securities Division made an effort to revise the text of the rules to use “Plain English” style, which is a policy initiative in Washington State. For instance, constructions such as “an investment adviser must...” were replaced with “if you are an investment adviser, you must...” Such changes are intended to make the rules easier for laypersons to read and understand. Because the rulemaking will make substantive changes to multiple sections of the investment adviser rules, the Securities Division decided to make “Plain English” updates to several other sections at this time, namely: WAC 460-24A-020, WAC 460-24A-030, WAC 460-24A-045, WAC 460-24A-057, WAC 460-24A-110, and WAC 460-24A-210. These changes create uniformity in the chapter, but do not substantively change the rules.

The Securities Division included a combined question in its survey regarding the Plain English changes made to WAC 460-24A-020, WAC 460-24A-030, WAC 460-24A-045, WAC 460-24A-057, WAC 460-24A-110, and WAC 460-24A-210. Surprisingly, 11% of the respondents

indicated that the Plain English changes would increase their costs. These costs included an average of \$101.94 per employee for professional services, \$37.12 for labor, and \$67.19 for increased administrative expenses.

Based on the free form answer for this survey question, it appears that several survey respondents did not understand the nature of the Plain English amendments. Several respondents appeared to conclude that the changes in the rules would require them to convert their own documents to Plain English style. They may have been primed to think this based on recent changes by the SEC requiring that Form ADV 2 be written in Plain English. However, the Securities Division has *not* proposed that investment advisers rewrite their documents in Plain English. The Securities Division was merely attempting to make the text of the investment adviser rules in WAC 460-24A easier to understand. As the Plain English changes require no action on the part of investment advisers or others, the Securities Division does not believe that making the Plain English changes to the investment adviser rules will create any additional costs for investment advisers.

WAC 460-24A-050: Application and Examination Requirements

The survey results indicated that approximately 11% of survey respondents believed that changes to the examination and application requirements in WAC 460-24A-050 would result in increased expenses. These expenses would include an average of \$118.29 per employee for professional services and \$103.62 per employee for increased administrative costs.

WAC 460-24A-050 lists the examination and application requirements for investment advisers. The requirements state that investment adviser must file the financial statements required by WAC 460-24A-060 with an application. Under WAC 460-24A-050 and WAC 460-24A-060, investment advisers with custody must submit an audited balance sheet as part of their initial application. Requiring an audited balance sheet provision means that investment adviser's with custody must hire the services of a CPA. This may increase costs.

In addition, the changes in the examination requirements may require a limited number of individuals who have never taken a licensing examination to take and receive a passing score. Such individuals may incur expenses for test preparation materials and examination fees.

Finally, the rule change specifies that investment advisers that manage pooled investment vehicles must submit certain additional documents with their applications. These documents include an account agreement with a qualified custodian, an engagement letter with a CPA, a private placement memorandum or other offering circular, a subscription agreement, and an operating agreement for the pooled investment agreement. The submission of these documents may increase costs in postage and copying; however, we note that an investment adviser who manages a pooled investment vehicle would already have these documents prepared. Furthermore, the Securities Division already requests these documents from investment adviser applicants who manage pooled investment vehicles and has for several years.

WAC 460-24A-060: Financial Reporting Requirements

The survey results indicated that approximately 13% of survey respondents believed that changes to WAC 460-24A-060 would result in increased expenses. These expenses would include an average of \$313.48 per employee for professional services, \$82.90 per employee in labor, and \$181.84 per employee for increased administrative expenses. Of the 13% who indicated that the changes would increase costs, those costs included an average per employee of \$2,800.45 for professional services, \$1,586.96 of labor and \$2,866.73 for increased administrative costs.

The cost increases under WAC 460-24A-060 relate to the requirement that investment advisers with custody submit an audited balance sheet. Currently, advisers submit a balance sheet but it does not need to be audited. As discussed above under the WAC 460-24A-050 heading, the new requirement will require investment advisers with custody to pay a CPA for audit services.

In addition, the changes to WAC 460-24A-060 will require the filing of audited financial statements for pooled investment vehicles by those investment advisers who choose to satisfy the custody requirements for pooled investment vehicles by provided audited financial statements for the pooled investment vehicle. There may be postage, copying, and other costs related to filing the statements with the Securities Division each year. Currently, investment advisers to pooled investment vehicles who choose to satisfy the custody requirements in WAC 460-24A-107 by providing audited financial statements provide these financial statements to investors but are not required to provide a copy to the Securities Division.

WAC 460-24A-105: Custody Requirements

The survey results indicated that approximately 9% of survey respondents believed that changes to the custody requirements at WAC 460-24A-105 would result in increased expenses. These expenses would include an average of \$255.34 per employee for professional services, \$75.76 per employee for labor, and \$119.20 per employee for increased administrative costs. For the 9% of survey respondents who indicated that the rule changes would create additional costs, the average costs per employee were \$2,953.09 for professional services, \$1,439.37 for labor, and \$1,981.71 for increased administrative costs.

The increase in costs would arise from the need for advisers who satisfy the custody rules by having regular audits to enter into agreements which contain certain provisions. Similarly, investment advisers who act as qualified custodians must comply with new provisions requiring an agreement with a CPA that meet the requirements specified in the rule. These provisions are adopted from the NASAA Model Custody Rule and will create uniformity with other states and with the SEC's custody rules. Furthermore, these provisions serve the goal of protecting client funds which is of utmost concern. However, the professional services, labor and administrative costs to amend or create compliant agreements may create additional costs for advisers.

WAC 460-24A-106: Additional Custody Requirements for Adviser Who Deduct Fees

According to the survey, 13% of respondents believed that changes to the additional custody requirements at WAC 460-24A-106 for advisers who directly deduct fees would increase costs.

The proposed change clarifies that WAC 460-24A-106 applies to all individuals who have custody under any of the three prongs of the custody definition in WAC 460-24A-005 *and* who deduct fees directly, not just those who have custody solely because they deduct fees directly. In the view of the Securities Division, the substance of the rule is not changed. However, survey takers responded differently. The survey found that there would be an average increase of \$361.52 in professional services, \$134.33 in labor, and \$188.08 in increased administrative costs.

WAC 460-24A-107: Additional Custody Provisions for Advisers to Pooled Funds

The survey revealed that updates to WAC 460-24A-107 would increase costs for 4% of survey respondents. Averaged over all respondents, the increased costs include \$173.03 per employee for professional services and \$111.86 for increased administrative costs. However, for the 4% of survey respondents who indicated an increased costs, these costs included \$4,883.31 per employee for administrative costs, \$400 per employee for equipment, \$1,325 per employee for supplies, \$5,250 per employee for labor, and \$3,551.41 per employee for increased administrative costs.

The proposed rule changes specify that the quarterly account statements required by WAC 460-24A-105 be sent to each beneficial owner of an interest in a pooled fund managed by the investment adviser. In addition, the rule amendments specify the information that the account statements must contain. The proposed rule changes provide some relief from the amount of information required by existing rules to be contained in account statements. However, the rule changes may require advisers who manage pooled investment vehicles to hire professional services to revise their account statements in order to comply with the rule changes if they do not already provide quarterly account statements that meet the requirements.

WAC 460-24A-120: Compliance Procedures and Policies

The survey results indicated that approximately 19% of survey respondents believed that the creation of the new rule provision at WAC 460-24A-120 requiring written compliance policies and procedures would result in increased expenses. The survey found that the average cost increases included \$163.94 per employee in professional services, and \$97.21 in increased administrative costs per employee. For the 19% of survey respondents who indicated that the new rule would create additional costs, there was an average increase of \$1,036.91 in professional services, \$790.99 in labor, and \$527.78 in increased administrative costs per employee.

The proposed rule is a new section modeled after federal Rule 206(4)-7. Investment advisers who do not have compliance policies and procedures reasonably designed to prevent violations of the Securities Act by their employees must adopt them, and must review them at least annually. Advisers may incur costs in professional fees in designing and updating their policies, and may incur expenses in training employees in the new policies and implementing annual review procedures, among other possible expenses.

WAC 460-24A-125: Proxy Voting

The survey results indicated that 10% of survey respondents believed that the creation of the new rule provision at WAC 460-24A-125 regarding proxy voting would result in increased expenses. The average cost increase per employee for each survey respondent included \$106.69 per employee for professional services, \$32.09 per employee in labor, and \$43.47 per employee in increased administrative costs. Of the 10% who stated that the new rule would increase their costs, the average cost increase per employee was \$1,437.48 in professional services, \$100 in supplies, \$746.94 in labor, and \$776.54 in increased administrative costs.

The new rule will require investment advisers who exercise voting authority for their client's securities to adopt written policies and procedures to ensure that voting authority is exercised in the best interests of the adviser's client. In addition, advisers who exercise voting authority for their client's securities must provide disclosure information to clients as specified in the rule. Advisers who do not exercise voting authority will *not* be required to adopt policies or disclosure documents. However, those that do exercise voting authority may incur costs of developing policies, procedures, and disclosure documents. Advisers may choose to use the professional services of attorneys or consultants to complete these tasks.

WAC 460-24A-130: Contents of Advisory Contract

The survey results indicated that 24% of survey respondents believed that the creation of the new rule provision at WAC 460-24A-130 concerning the contents of the advisory contract would cause an increase in expenses. The average cost increase according to the survey results includes \$120.78 per employee in professional services. Advisers may choose to use the professional services of an attorney or consultant to ensure that their advisory contracts comply with the rule. However, many of the requirements for advisory contracts in proposed WAC 460-24A-130 represent existing requirements under RCW 21.20, or requirements under existing rules in WAC 460-24A-200 which are being moved to this new section.

WAC 460-24A-200: Books and Records

The survey results indicated that 25% of the survey respondents believed that the revisions to the books and records rule at WAC 460-24A-200 would increase costs. These expenses would include an average of \$433.80 per employee for professional services, \$212.75 per employee for labor, and \$282.62 per employee for increased administrative costs. Of the 25% of survey respondents who indicated the rule changes would increase their costs, the average increased costs per employee were \$2,232.25 for professional services, \$481.04 for equipment, \$377.62 for supplies, \$1,695.16 for labor, and \$1,837.01 for increased administrative costs.

The proposed changes to the books and records rule will increase the number of records that investment advisers must keep, which may increase costs. Adviser may incur expenses related to recordkeeping, such as costs for records retention and office supplies. Advisers may also incur expenses in developing new recordkeeping procedures and practices, such as the requirement to maintain written information regarding the securities recommended by the investment adviser.

There may also be expenses in developing a business continuity plan. However, it should be noted that many investment advisers already maintain the records being added to the rule.

Whether compliance with the proposed rule will cause businesses to lose sales or revenue.

The proposed rules may result in investment advisers losing sales or revenue. The Securities Division's survey revealed that 10% of respondents believed that compliance with the rule changes would result in lost sales or revenue. In contrast, 90% of respondents did not believe the rule changes would cause lost sales or revenue. The 10% who believed the changes would lead to lost sale or revenue estimated they would lose \$8,544 in revenue per employee.

The survey requested a free form answer on what specific provision in the proposed rules would cause the lost sales or revenue. Most of the answers did not address what would cause lost sales or revenue, but instead focused on the increased costs the rule amendments would create. However, at least two survey respondents mentioned that increased time spent on compliance matters would leave less time for working with clients, and might cause an investment adviser to engage fewer clients. Additionally, revenue may be lost if advisers limit the type of services they provide because of the cost of compliance.

An estimate of the number of jobs that will be created or lost as a result of compliance with the proposed rule

The Securities Division surveyed its state registered investment advisers and federal notice filed investment advisers to determine whether the proposed rulemaking could result in the addition or elimination any jobs.

Approximately 3% of survey takers anticipated that the rulemaking would cause them to eliminate jobs. These 3% estimated that they would eliminate between 1 to 4 jobs. Approximately 97% of survey takers did not anticipate that they would need to eliminate any jobs.

Approximately 4% of respondents indicated that the rule changes would cause them to add jobs. These 4% estimated between they would add between .5 to 2 jobs. Approximately 96% of survey takers did not anticipate adding any jobs.

Based on the survey results, the Securities Division estimates that the average investment adviser will neither add nor eliminate any jobs as a result of the rule amendments.

A comparison of compliance costs for the small business segment and the large business segment of the affected industries, and whether the impact on small business is disproportionate.

RCW 19.85.040 requires that the Securities Division determine whether compliance with the proposed rules will have a disproportionate impact on small businesses by comparing the cost of compliance for small business with the costs of compliance for the ten percent of businesses that are the largest businesses required to comply with the proposed rules.

The Securities Division categorized each survey response based on whether it came from a small business or whether it represented the ten percent of businesses that were the largest businesses that responded. The two categories were then compared to each other. The survey results tended to show that the increased costs per employee of small businesses were disproportionately greater than the increased costs per employee of the largest businesses.

The results may be impacted by the fact that all state registered investment advisers who responded to the survey qualified as small businesses. Many of these businesses have only one employee. The largest ten percent of businesses included federal notice filed investment advisers. The largest advisers, having more employees and typically offering more complicated products and services, may already have compliance policies and procedures, proxy voting disclosures, business continuity plans, and advisory contracts that meet the requirements of the proposed rule amendments. Consequently, they may see less of an increase in the costs for professional services, labor, and administrative costs than smaller advisers.

In order to determine whether the regulatory difference between state and federal notice filed advisers was the cause of the disproportionate expenses, the Securities Division also compared the increased costs of all state registered investment advisers (all small businesses) with the costs of the largest 10% of state registered advisers. However, the results still showed that costs per employee of small businesses were disproportionately greater than the increased costs per employee of the largest businesses. This may be because the largest state advisers have more employees and therefore more internal systems, and may have been in business longer than the smallest businesses. In any event, all advisers, large and small, provide investment advice to members of the public. It is imperative that investment advisers be well regulated in order to increase confidence in the markets and to protect the public from financial fraud.

The following chart compares the average cost increase associated with the proposed changes to the rule provision for both the largest 10% of businesses required to comply and small businesses. Small businesses are defined as 50 or fewer employees. The largest 10% of business were likewise determined by the number of employees.

Average Cost Increase – Comparison of Small Business and Largest 10% of Businesses					
Rule Provision	Prof'l Services	Equipment	Supplies	Labor	Admin
WAC 460-24A-005					
Small Businesses	\$ 397.41	\$ 8.12	\$ 19.84	\$ 224.19	\$ 211.65
Largest 10%	\$ 0.37	\$ -	\$ 0.10	\$ -	\$ 0.05
WAC 460-24A-010					
Small Businesses	\$ 16.75	\$ -	\$ 0.38	\$ 5.35	\$ 6.38
Largest 10%	\$ 0.52	\$ -	\$ -	\$ 0.26	\$ -
Plain English Updates					
Small Businesses	\$ 112.45	\$ 0.19	\$ 2.00	\$ 40.95	\$ 3.71
Largest 10%	\$ -	\$ -	\$ -	\$ -	\$ -

Small Business Economic Impact Statement

WAC 460-24A-035					
Small Businesses	\$ 27.68	\$ -	\$ 0.40	\$ 7.91	\$ 20.73
Largest 10%	\$ -	\$ -	\$ -	\$ -	\$ -
WAC 460-24A-040					
Small Businesses	\$ 1.08	\$ -	\$ 0.99	\$ 0.87	\$ 0.79
Largest 10%	\$ -	\$ -	\$ -	\$ -	\$ 6.90
WAC 460-24A-047					
Small Businesses	\$ 28.65	\$ 0.20	\$ 0.29	\$ 9.85	\$ 16.60
Largest 10%	\$ -	\$ -	\$ -	\$ -	\$ 0.10
WAC 460-24A-050					
Small Businesses	\$ 128.14		\$ 0.41	\$ 9.97	\$ 112.44
Largest 10%	\$ 4.28		\$ 0.43	\$ 0.61	\$ 1.83
WAC 460-24A-059					
Small Businesses	\$ 3.97	\$ -	\$ -	\$ 3.97	\$ -
Largest 10%	\$ -	\$ -	\$ -	\$ -	\$ -
WAC 460-24A-060					
Small Businesses	\$ 338.76	\$ 1.34	\$ 0.01	\$ 89.59	\$ 196.51
Largest 10%	\$ -	\$ -	\$ -	\$ -	\$ -
WAC 460-24A-070					
Small Businesses	\$ -	\$ -	\$ -	\$ -	\$ -
Largest 10%	\$ -	\$ -	\$ -	\$ -	\$ -
WAC 460-24A-071					
Small Businesses	\$ 143.45		\$ 0.01	\$ 0.06	\$ 0.56
Largest 10%	\$ -	\$ -	\$ -	\$ -	\$ -
WAC 460-24A-072					
Small Businesses	\$ -	\$ -	\$ -	\$ -	\$ -
Largest 10%	\$ -	\$ -	\$ -	\$ -	\$ -
WAC 460-24A-080					
Small Businesses	\$ 29.94	\$ 0.10	\$ 0.10	\$ 16.38	\$ 9.33
Largest 10%	\$ 20.86	\$ -	\$ 0.11	\$ 10.03	\$ 10.71
WAC 460-24A-100					
Small Businesses	\$ 79.83	\$ -	\$ 0.61	\$ 44.50	\$ 37.77
Largest 10%	\$ 1.18	\$ -	\$ 0.24	\$ -	\$ 0.94
WAC 460-24A-105					
Small Businesses	\$ 281.56	\$ 10.02	\$ 13.14	\$ 83.61	\$ 131.30
Largest 10%	\$ 2.38	\$ -	\$ -	\$ -	\$ 2.36
WAC 460-24A-106					
Small Businesses	\$ 397.62	\$ 9.41	\$ 34.56	\$ 147.88	\$ 206.70
Largest 10%	\$ 3.21	\$ -	\$ -	\$ -	\$ 3.21
WAC 460-24A-107					
Small Businesses	\$ 189.00	\$ 1.72	\$ 11.42	\$ 67.89	\$ 122.19
Largest 10%	\$ 4.26	\$ -	\$ -	\$ -	\$ 2.65
WAC 460-24A-108					
Small Businesses	\$ 17.49	\$ -	\$ -	\$ 8.64	\$ 6.80
Largest 10%	\$ -	\$ -	\$ -	\$ -	\$ -
WAC 460-24A-109					

Small Business Economic Impact Statement

Small Businesses	\$ -	\$ -	\$ -	\$ -	\$ -
Largest 10%	\$ -	\$ -	\$ -	\$ -	\$ -
WAC 460-24A-120					
Small Businesses	\$ 181.57	\$ 2.41	\$ 3.31	\$ 72.85	\$ 107.59
Largest 10%	\$ 2.95	\$ -	\$ -	\$ -	\$ 2.36
WAC 460-24A-125					
Small Businesses	\$ 117.96		\$ 0.87	\$ 35.57	\$ 46.79
Largest 10%	\$ 2.36	\$ -	\$ -	\$ -	\$ 2.36
WAC 460-24A-130					
Small Businesses	\$ 133.91	\$ 1.08	\$ 4.29	\$ 92.66	\$ 65.28
Largest 10%	\$ 2.90	\$ -	\$ -	\$ 0.68	\$ 2.18
WAC 460-24A-140					
Small Businesses	\$ 4.35	\$ -	\$ -	\$ 4.35	\$ -
Largest 10%	\$ -	\$ -	\$ -	\$ -	\$ -
WAC 460-24A-145					
Small Businesses	\$ 28.39	\$ 0.75	\$ 4.69	\$ 14.65	\$ 11.59
Largest 10%	\$ 2.45	\$ -	\$ -	\$ -	\$ 2.45
WAC 460-24A-150					
Small Businesses	\$ 8.47	\$ -	\$ -	\$ -	\$ 1.69
Largest 10%	\$ 1.84	\$ -	\$ -	\$ -	\$ 1.22
WAC 460-24A-160					
Small Businesses	\$ 2.99	\$ -	\$ 0.53	\$ 2.39	\$ 0.07
Largest 10%	\$ -	\$ 21.61	\$ -	\$ 10.80	\$ 10.80
WAC 460-24A-170					
Small Businesses	\$ 18.58	\$ -	\$ -	\$ 13.27	\$ 7.08
Largest 10%	\$ -	\$ -	\$ -	\$ -	\$ -
WAC 460-24A-200					
Small Businesses	\$ 478.34	\$ 19.33	\$ 13.49	\$ 234.60	\$ 311.64
Largest 10%	\$ -	\$ -	\$ -	\$ -	\$ -
WAC 460-24A-205					
Small Businesses	\$ 47.88	\$ 0.33	\$ 2.11	\$ 12.18	\$ 21.26
Largest 10%	\$ 3.05	\$ -	\$ 0.61	\$ 1.22	\$ 1.83
WAC 460-24A-220					
Small Businesses	\$ 115.57	\$ -	\$ 0.37	\$ 65.44	\$ 65.62
Largest 10%	\$ -	\$ -	\$ -	\$ -	\$ -
WAC 460-24A-058					
Small Businesses	\$ 1.16	\$ -	\$ -	\$ 1.16	\$ -
Largest 10%	\$ -	\$ -	\$ -	\$ -	\$ -

Comparison of lost sales or revenue

The largest 10% of businesses indicated in their survey responses that they would lose an average of \$8.33 per employee in lost revenue, with only one larger business expecting to lose revenue. Small businesses estimated that they would lose an average of \$876.41 in revenue per employee, with 22 small businesses reporting that they expected to lose revenue because of the rule changes.

Comparison of addition or elimination of jobs

Approximately 4% of respondents indicated that the rule changes would cause them to add jobs. These represented 9 small businesses plus one business that was in the 10% of the largest businesses. Approximately 3% of respondents indicated that the rule changes would cause them to eliminate jobs. These responses represented 8 small businesses. None of the 10% of the largest business indicated that jobs would be eliminated because of the rule changes.

Steps taken by the Department under RCW 19.85.030(2) to reduce the costs of the proposed rule on small businesses, or reasonable justification for not doing so, addressing the specified mitigation steps.

Investor Protection Purpose

In drafting the rule amendments, the Securities Division attempted to balance the business concerns of registered investment advisers with the Securities Division's mission to protect the investing public and to promote confidence in the capital markets. While the proposed rule changes may increase costs to licensees, the Securities Division believes the costs will be outweighed by the increased protection for investors. In addition, certain changes to the rules are being made in order to conform with changes to federal law and to create uniformity with other states by adopting provisions from updated NASAA Model Rules.

As a result of feedback received from affected businesses, the Securities Division made certain modifications to its initial draft of the rule amendments in order to reduce the cost of compliance for small businesses. These changes are detailed below. The Securities Division does not believe that it can reduce costs further and still accomplish the investor protection purpose of the rulemaking.

Reducing, modifying, or eliminating substantive regulatory requirements

The Securities Division received several comments in its economic impact survey which indicated that the change in the definition of custody, which shortened the amount of time an adviser could hold inadvertently received funds, would be burdensome and increase costs. As a result of the survey, the Securities Division changed the custody definition at WAC 460-24A-005 to allow for the return of inadvertently received funds within three business days rather than one. The Securities Division also changed the existing rule to allow advisers to forward checks drawn by clients and made payable to third parties within three business days of receipt (rather than the current twenty-four hours). These changes will provide relief to advisers who were concerned that one business day was not sufficient time to identify client funds and either forward them to third parties or return them as appropriate to avoid being deemed to have custody.

The Securities Division also received several comments suggesting that the requirement for compliance policies and procedures in new section WAC 460-24A-120 was burdensome and unnecessary for advisers who are solo practitioners. In response, the Securities Division made

amendments to the draft rule to specify that the requirement to implement compliance policies and procedures applies only to advisers who have more than one employee.

In addition, the Securities Division made changes to the financial reporting requirements in WAC 460-24A-060, the compliance policies and procedures requirement in WAC 460-24A-120, the proxy voting provisions in WAC 460-24A-125, the advisory contract requirements in WAC 460-24A-130, and the performance compensation provisions in WAC 460-24A-150 to clarify that the rules apply only to investment advisers who are registered or required to be registered under the Securities Act. Thus, certain investment advisers who are exempt from registration, such as private fund advisers under new section WAC 460-24A-071 and venture capital fund advisers under new section WAC 460-24A-072, will not be required to comply with these provisions.

To further simplify its rules and to reduce expenses for investment advisers, the Securities Division removed three new subsections that had been added as unethical business practices in WAC 460-24A-220. The Securities Division had added as unethical business practices providing investment advice without having implemented compliance policies and procedures in violation of WAC 460-24A-120; exercising voting authority with respect to client securities in violation of WAC 460-24A-125; and failing to keep a written business continuity plan as unethical business practices. After reviewing survey results which indicated that these additions to the unethical practices rule section may increase expenses, the Securities Division decided to remove these three additions to WAC 460-24A-220 because they are not necessary additions. However, it is important to note that violation of one of rules specified above may still constitute an unethical business practice even if it is not specifically listed in WAC 460-24A-220.

Simplifying, reducing or eliminating record keeping and reporting requirements

The Securities Division received several comments regarding the proposed changes to WAC 460-24A-060. The draft amendments to WAC 460-24A-060 require that investment advisers with custody of client funds file an annual audited balance sheet. The costs of obtaining an audited balance sheet each year may be significant to a small business owner. However, requiring an audited balance sheet will provide increased protections for the clients whose funds are in the custody of an investment adviser.

To balance these concerns, the Securities Division decided to relax the audited balance sheet requirement for certain advisers. The Securities Division revised WAC 460-24A-106 to state that advisers who have custody as defined in WAC 460-24A-005(1) solely because they deduct fees are not required to file an audited balance sheet provided the adviser otherwise meets the requirements of WAC 460-24A-105, WAC 460-24A-060(3), and WAC 460-24A-106(1). This change will reduce the costs of obtaining an audited balance sheet for advisers who have custody solely because they deduct fees.

In addition, the Securities Division revised WAC 460-24A-107 to state that advisers who have custody as defined in WAC 460-24A-005(1)(a)(iii) because they manage a pooled investment vehicle, and who provide audited financial statements of the pooled investment vehicle to clients pursuant to WAC 460-24A-107(1)(b), are not required to file an audited balance sheet for the

investment adviser provided they otherwise comply with WAC 460-24A-105, WAC 460-24A-060(3), and WAC 460-24A-107(1)(b) & (2). This change will reduce the cost obtaining an audited balance sheet for advisers to pooled funds where the pooled funds are subject to annual audits.

Delaying compliance timetables

Investments advisers will be allowed adequate time to adjust to the rule changes through processes already in place. Through the exam and deficiency letter process, the Securities Division will allow reasonable time for investment advisers to fix any deficiencies related to the new rules that the exam staff identify during examinations of investment advisers that occur in the period immediately following enactment of the rules. The Securities Division will also continue to provide technical assistance visits to newly registered investment advisers to provide feedback on recordkeeping and other compliance matters.

Other mitigation techniques

The Securities Division will develop a Frequently Asked Questions (“FAQ”) publication for distribution when the amended rules are adopted. The Securities Division intends to provide guidance through the FAQ to explain what is required for compliance with the rule amendments. The Securities Division has determined that in many cases, the nature of the compliance envisioned by the Securities Division is less burdensome than that imagined by the investment advisers taking the small business economic impact survey.

The Securities Division intends to address the following topics in the FAQ:

- The Securities Division will clarify that none of the rule changes requires that investment advisers revise their contracts or other documents in “Plain English” style. The Securities Division merely revised the text of its rules in “Plain English” so that they would be easier to understand.
- The Securities Division will provide guidance on the annual review of compliance policies and procedures required by WAC 460-24A-120. The text of this rule provision is adopted from federal Rule 206(4)-7. The purpose of the review is to ensure that policies are reasonably up to date, for the protection of both the investment adviser and its clients. The review need not be done by outside professional services, but may be conducted by the investment adviser on an as-needed basis when there are changes to the rules and laws affecting investment advisers.
- The Securities Division will clarify that the proxy voting and electronic delivery provisions required for advisory contracts by WAC 460-24A-130 must be added *only if* the adviser intends to exercise voting authority over client securities or if the adviser intends to deliver documents by electronic means. Advisers not engaging in these activities do not need to add these provisions to their advisory contracts.

- The Securities Division will provide guidance on the business continuity plan required under WAC 460-24A-200(1)(y). The business continuity plan should provide instructions in the event of an emergency or the incapacitation of the investment adviser. For instance, the plan should describe what will happen to client funds over which the investment adviser has custody or exercises discretion. The plan need not be more than one page in length and should not require the use of professional services to prepare.
- The Securities Division will provide guidance regarding the type of written information regarding securities that the adviser should maintain to comply with WAC 460-24A-200(1)(s). The type of written information will be different depending on the nature of the security recommended. For instance, a publicly traded security for which research information is widely available would require less documentation than an obscure privately offered security. For a privately offered security, the adviser generally must conduct and document more extensive research and analysis in order to determine the suitability of the security for a client. This requirement for written documentation protects both investors and the investment adviser.

In addition to the assistance provided in the anticipated FAQ, the Securities Division may conduct informational sessions for investment advisers to provide an overview of the rule changes.

How the Department will involve small business in rule development

Since the beginning of the rulemaking process in 2010, the Securities Division has involved its registered investment advisers and interested persons in the rulemaking process.

On March 19, 2010, the Securities Division filed a Preproposal Statement of Inquiry (CR-101) concerning the possible amendment of the investment adviser rules. The Securities Division distributed the CR-101 notice to its interested persons list for securities registration matters and to all state registered advisers. This group of recipients included many small businesses and those that advise small businesses.

The CR-101 notice invited interested persons to participate in the rulemaking process by submitting comments to the Securities Division. The Securities Division took the feedback received into account when preparing the initial draft of the rule amendments. Once a draft was prepared, it was distributed to the interested persons list on August 13, 2012.

The Securities Division next prepared a survey to determine the economic impact of the proposed rulemaking on investment advisers. The survey, along with a copy of the draft rule amendments, was sent to all state registered investment advisers and a representative sample of federal notice filed investment advisers. Based on the results received, the Securities Division made changes to its proposed draft as detailed above. The Securities Division will continue to seek the feedback of interested parties as the rulemaking process continues.

A list of the industries that will be required to comply with the rule

Investment advisers doing business in Washington will be required to comply with the amended rules.