January 8, 2019

Via Electronic Submission

Ms. Jill Vallely
Department of Financial Institutions
Securities Division
P.O. Box 9033
Olympia, WA 98507

Re: Notice of Proposed Rule Making; Amendments to Investment Adviser Rules in Chapter 460-24A WAC

Dear Ms. Vallely:

The Investment Adviser Association[1] (**IAA**) appreciates the opportunity to comment on the proposed amendments to investment adviser rules in Chapter 460-24A of the Washington Administrative Code (**WAC**). The proposed amendments are designed to "address changes in federal law and updates to NASAA Model Rules, and to implement necessary protections for the investing public who may use the services of investment advisers."[2] The IAA's members are exclusively investment adviser firms registered with the SEC under the Investment Advisers Act of 1940 (**Advisers Act**). We therefore have a strong interest in ensuring that the Securities Division, in compliance with the National Securities Markets Improvement Act of 1996 (**NSMIA**), does not attempt to extend any substantive regulation to SEC-registered advisers. As we discuss below, we are concerned that certain WAC rules and rule proposals that include substantive requirements are written to apply to SEC-registered advisers. We thus urge the Securities Division to amend these rules to recognize explicitly that they do not apply to federal covered advisers, consistent with NSMIA.

NSMIA Prohibits States from Directly or Indirectly Imposing Substantive Regulation on SEC-Registered Advisers

Congress enacted NSMIA to address its concerns about the overlap in regulation and duplication of regulatory resources. NSMIA sought to "moderniz[e] and rationaliz[e] aspects of the regulatory scheme, including the respective responsibilities of Federal and State

[1] The IAA is a not-for-profit association dedicated to advancing the interests of investment adviser firms registered with the Securities and Exchange Commission (**SEC**). The IAA's more than 650 member firms manage more than $25 trillion in assets for a wide variety of individual and institutional clients, including pension plans, trusts, mutual funds, private funds, endowments, foundations, and corporations. For more information please visit our website: www.investmentadviser.org.

[2] *Notice of Proposed Rule Making* (Form CR-102) at 1, *available at* https://dfi.wa.gov/sites/default/files/investment-adviser-rules-cr102.pdf.

governmental authorities over the securities markets,"[3] and to "eliminate[e] the costs and burdens of duplicative and unnecessary regulation."[4] Title III of NSMIA, the Investment Advisers Supervision Coordination Act (**Coordination Act**), broadly preempts state regulation of SEC-registered advisers.[5] States retain some limited authority over such advisers, only in that they may: (i) require the registration, licensing, or qualification – and related payment of state filing fees – of any individual investment adviser representative with a place of business in the state; (ii) require the filing of documents filed with the SEC, but only for notice purposes; and (iii) investigate and bring enforcement actions against SEC-registered advisers for fraud.[6] States may *not* adopt any regulations, interpretations, or guidance that would have the effect of substantively regulating SEC-registered advisers.

Nor may states indirectly regulate activities of SEC-registered advisers by deeming violations of state requirements related to business conduct to be fraudulent unless the conduct involved would be fraudulent even if the state requirements did not exist.[7] The SEC has explicitly asserted that states are precluded from "indirectly regulating the activities of [SEC]-registered advisers by applying state requirements that define 'dishonest' or 'unethical' business practices unless the prohibited practices would be fraudulent or deceptive absent the requirements."[8]

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[3] H.R. Rep. No. 104-622 at 16 (1996), available at https://www.congress.gov/congressional-report/104th-congress/house-report/622/1.

[4] The House Hearing report included references to testimony that indicated that there continues to be a substantial degree of duplication between federal and state securities regulation, and that this duplication tends to raise the cost of capital to American issuers of securities without providing commensurate protection to investors or our markets. Indeed, when President Clinton signed NSMIA into law, he stated that:

> This legislation will more efficiently divide responsibility for regulation between the Federal and State governments. The SEC will be charged with responsibility for . . . large investment advisors. States will have responsibility for . . . investment advisors with smaller portfolios, while retaining their authority to take enforcement actions against fraudulent conduct in all situations.

Statement by President Clinton on signing H.R. 3005, p. 1, October 11, 1996.

[5] *See SEC Rules Implementing Amendments to the Investment Advisers Act of 1940*, SEC Rel. IA-1633 (May 15, 1997) (**1997 Release**), at text accompanying n. 146, *available at* https://www.sec.gov/rules/final/ia-1633.txt.

[6] Advisers Act Section 203A(b).

[7] The Coordination Act includes a savings clause that explicitly preserves antifraud investigation and enforcement authority for states. The SEC has made clear its view that the very fact of the savings clause manifests Congress's intent that other authorities, including the authority to adopt any conduct regulations, are preempted. *See* 1997 Release.

[8] 1997 Release at text accompanying n. 152.

The State of Washington's rules regarding investment advisers are in Chapter 460-24A of the WAC, and they apply to investment advisers and investment adviser representatives registered or required to be registered in the State of Washington. Several substantive rules in Chapter 460-24A, however, are written to apply to "federal covered advisers" as well. Federal covered advisers are defined as investment advisers registered under Section 203 of the Advisers Act.[9] We believe that application of these rules to SEC-registered advisers is preempted by NSMIA.

A state's substantive regulation of SEC-registered advisers is not saved by the fact that its rules track existing SEC rules because the state's rules cannot be enforced against SEC-registered advisers. As we discuss above, a key reason for the enactment of NSMIA was to eliminate duplicative regulation. Simply having such rules on the books imposes burdens on SEC-registered advisers that do business in that state to determine whether and how those rules might apply to them. In addition, maintaining such rules also imposes an ongoing obligation on the state to keep track of all related SEC developments to ensure that the states' rules remain fully consistent with the SEC's. As we discuss below, several of the WAC rules and proposed amendments that purport to apply to federal covered advisers are in fact not consistent with corresponding SEC rules.[10]

We believe that a better approach is that taken by the Securities Division in WAC Rule 24A-220 regarding Unethical Business Practices. Rule 24A-220 expressly recognizes the limitations on state regulation imposed by NSMIA by stating: "If you are a federal covered adviser, the provisions of this subsection apply to the extent that the conduct alleged is fraudulent, deceptive, *or as otherwise permitted by the National Securities Markets Improvement Act of 1996*" (emphasis added). There is no similar language in the substantive rules described below, however.[11] Because it would be inconsistent with NSMIA for these rules to apply to federal covered advisers, we urge the Securities Division to amend these rules to make it clear that they do not apply.

WAC Rules and Proposals that are Preempted Under NSMIA

The following are the WAC rules and proposals that we believe are preempted under NSMIA for SEC-registered advisers.

[9] Securities Act of Washington, Section 21.20.005(4).

[10] We note that the substance of the WAC rules would be less of a concern to us if it was clear that the rules were not intended to apply to SEC-registered advisers.

[11] While not described below, we note that WAC Rule 460-24A-110 regarding agency cross transactions applies to investment advisers and investment adviser representatives, but there is not an explicit exclusion for federal covered advisers. The Securities Division should make clear that this rule also does not apply to federal covered advisers.

WAC Rule 460-24A-100: Advertisements

The Securities Division proposes several amendments to this rule, including codifying language regarding performance advertising that is currently in interpretive statements previously issued by the Securities Division. In 2014, this rule was amended to purport to apply to federal covered advisers. We believe that this rule as currently written is preempted by NSMIA for SEC-registered advisers because it applies substantive provisions to those advisers. In addition, the proposed amendments to the rule would make it inconsistent with the SEC rule that regulates advertising, Advisers Act Rule 206(4)-1.

WAC Rule 460-24A-120: Compliance Procedures and Practices

This rule was added in 2014 and states that it applies to federal covered advisers. The rule requires advisers to have policies and procedures reasonably designed to prevent violations of the Securities Act of Washington and rules thereunder and the federal securities laws. For federal covered advisers, this rule conflicts with the SEC rule that applies to compliance procedures and practices, Advisers Act Rule 206(4)-7. Rule 206(4)-7 requires SEC-registered advisers to have policies and procedures reasonably designed to prevent violations of the Advisers Act and rules thereunder. The proposed amendments to WAC Rule 24A-120 would cause further deviations between that rule and Advisers Act Rule 206(4)-7. As with the Advertising Rule, this rule as currently written is preempted by NSMIA because it applies substantive provisions to SEC-registered advisers.

WAC Rule 460-24A-122: Material Nonpublic Information Policies and Procedures

The Securities Division proposes a new rule regarding material nonpublic information policies and procedures, and this rule as proposed states that it would apply to federal covered advisers. SEC-registered advisers are currently subject to Advisers Act Section 204A, which requires advisers to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material, nonpublic information. Rulemaking by states in this area is prohibited by NSMIA for SEC-registered advisers.

WAC Rule 460-24A-125: Proxy Voting

The Securities Division proposes to amend a rule that requires advisers, including on its face federal covered advisers, to have written policies and procedures reasonably designed to ensure that they vote client securities in the best interest of clients, among other requirements. SEC-registered advisers are currently subject to Advisers Act Rule 206(4)-6, which governs proxy voting. This is another substantive provision that is preempted by NSMIA for SEC-registered advisers.

WAC Rule 460-24A-126: Business Continuity and Succession Plan

This is a newly-proposed rule that would require Washington State-registered and federal covered advisers to establish, maintain, and enforce written procedures relating to a business

continuity and succession plan, review those procedures at least annually, and tailor them to the adviser's business model. Again, and for the same reasons as discussed above, this proposed rule is preempted under NSMIA for SEC-registered advisers.

As for the substance of the proposed rule, we note that the SEC proposed a rule regarding SEC-registered adviser business continuity and transition plans in 2016 but has since withdrawn the rulemaking from its regulatory agenda.

The Securities Division Should Make Clear that its Rules May Only Apply to Federal Covered Advisers Consistent with NSMIA

We urge the Securities Division to amend each of the rules and proposals described above to remove references to federal covered advisers. Alternatively, we request that the Securities Division include language in each of these rules specifying that the rule applies to federal covered advisers only to the extent permitted by NSMIA, or that it otherwise make explicit that it does not intend to apply its substantive rules to federal covered advisers. Failure to do so would contravene the broad preemption provided for under NSMIA.

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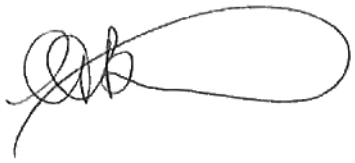
We appreciate your consideration of our comments on this important issue. Please contact the undersigned at (202) 293-4222 if we may provide any additional information or assistance in this regard.

Respectfully Submitted,



Gail C. Bernstein
General Counsel
Investment Adviser Association

cc: SEC Chairman Jay Clayton
SEC Commissioner Robert J. Jackson Jr.
SEC Commissioner Hester M. Peirce
SEC Commissioner Elad L. Roisman
Dalia Blass, Director, SEC Division of Investment Management