



State of Washington

DEPARTMENT OF FINANCIAL INSTITUTIONS
DIVISION OF SECURITIES

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August 30, 2024

Concise Explanatory Statement

Pursuant to RCW 34.05.325(6)

This Concise Explanatory Statement is prepared regarding the proposed adoption of a new chapter of rules at Chapter 460-20C WAC pertaining to broker-dealers and salespersons of broker-dealers, and the proposed repeal of the existing broker-dealer and salesperson rules in Chapters 460-20B, 460-21B, and 460-22B WAC.

Agency reasons for adopting the rules. (RCW 34.05.325(6)(a)(i))

The reasons stated in the Form CR-102 filed on May 6, 2024 in connection with this rulemaking are hereby incorporated by reference.

Describe differences between the text of the proposed rules as published in the Washington State Register and the text of the rules as adopted, other than editing changes, stating the reasons for differences. (RCW 34.05.325(6)(a)(ii))

As discussed below in this Concise Explanatory Statement, the Securities Division revised the rules to delete the following proposed unethical practice for broker-dealers at WAC 460-20C-210(50):

Allowing an individual who is not registered as a salesperson in Washington to enter trades on behalf of retail customers of the broker-dealer who are located in Washington, unless an exemption from salesperson registration would apply;

In addition, the Securities Division revised the exam validity extension provisions at WAC 460-20C-040(2)(c) and (d) to add the clause “but were registered as a salesperson in at least one jurisdiction for at least one year immediately preceding the termination of the salesperson registration.” This language is consistent with the current eligibility requirements for participating in FINRA’s Maintaining Qualifications Program, which is a condition for exam validity extension under the rule. This addition clarifies the application of the rule.

Summary of comments received by DFI during the rulemaking process, and DFI's responses to the comments. (RCW 34.05.325(6)(a)(iii))

I. Written Comments

The Securities Division received four written comments on the proposed rules. The written comments were submitted by the Securities Industry and Financial Markets Association (SIFMA); the Financial Services Institute (FSI); John Cronin of LPL Financial; and attorney Dave Neuman of Israel & Neuman PC. These comments are discussed by subject matter below.

Comments Regarding the Proposed Unethical Practice for Broker-Dealers at WAC 460-20C-210(50)

The Securities Division received three comments regarding the proposed unethical practice for broker-dealers at WAC 460-20C-210(50). As proposed, WAC 460-20C-210(50) would have made it an unethical practice to “allow[] an individual who is not registered as a salesperson in Washington to enter trades on behalf of retail customers of the broker-dealers who are located in Washington, unless an exemption from salesperson registration would apply.”

In its comment letter, SIFMA requested that the Securities Division remove WAC 460-20C-210(50) from the proposed unethical practices rule. In addition, FSI and John Cronin submitted comments critiquing WAC 460-20C-210(50). The commenters stated that the provision is inconsistent with SEC and FINRA rules, and that no other state has a similar prohibition. John Cronin stated that WAC 460-20C-210(50) would create systemic challenges for many broker-dealer firms. FSI stated that it is not aware of any actual or potential harm caused by allowing a non-registered person to perform trade entry.

Both SIFMA and FSI asserted that the SEC's books and records rule for broker-dealers, Rule 17a-3 under the Securities Exchange Act of 1934, recognizes that a person other than a salesperson may enter a trade. According to the commenters, Rule 17a-3 requires a memorandum for each trade order. The trade memorandum must identify the associated person and must contain the “identity of any other person who entered or accepted the order on behalf of the customer.” SIFMA stated: “The concept of ‘any other person’ captures an unregistered associate who performs this function.”

In its comment letter, SIFMA further stated that FINRA Rule 1230(a) provides that a person is not required to register with FINRA if that person's functions are “solely and exclusively clerical or ministerial.” SIFMA cited past FINRA guidance stating that trade entry by administrative personnel at the direction and supervision of a registered person is ministerial or clerical in nature. In its comment letter, FSI represented: “It is common for broker-dealers to have non-registered employees perform the ministerial function of trade entry at the direction of a registered salesperson who is responsible for the trade.” Similarly, John Cronin of LPL Financial represented that the entry of orders by unregistered persons is a fairly common practice as it is considered clerical.

SIFMA stated that the broker-dealer industry has adopted policies and procedures to supervise trade entry by non-registered persons, and represented that broker-dealers and registered salesperson are liable for correcting any trade errors. SIFMA stated that the Securities Division currently has the authority to address order entry execution under existing SEC and FINRA rules.

The Securities Division has taken the comments received into consideration. In contrast to FINRA Rule 1230(a), the definition of a salesperson under RCW 21.20.005(15) of the Securities Act of Washington does not explicitly exclude persons who solely and exclusively perform clerical or ministerial functions. Rather, the Securities Act defines a salesperson as “any individual other than a broker-dealer who represents a broker-dealer or issuer in effecting or attempting to effect sales of securities.” Pursuant to RCW 21.20.040(1), unless an exemption from registration applies, a person who meets the definition of a salesperson must register in Washington. Accordingly, the question is whether a person is acting as a representative of the broker-dealer, and whether a person is engaging in effecting transactions.

The Securities Division agrees that the performance of trade entry by unregistered persons when done at the direction and supervision of a registered salesperson may not represent the unregistered person acting as a salesperson. However, based on field examinations, the Securities Division has observed that in certain circumstances, unregistered staff who enter trade orders do not appear to be acting under the direction and supervision of a registered salesperson. This may involve a failure of the broker-dealer to supervise the activities of the unregistered person or to adequately document a registered person’s authorization of the transaction. If not acting pursuant to reasonable direction and supervision of a registered salesperson, an unregistered person who enters trades may be representing a broker-dealer in effecting or attempting to effect sales of securities. Such person would therefore meet the definition of a salesperson under RCW 21.20.005(15). We acknowledge that WAC 460-20C-210(50) as drafted does not capture this nuance, and consequently is too broad. For this reason, the Securities Division deleted the proposed unethical practice regarding trade entry from the final rules. The Securities Division may enforce other provisions of the Securities Act of Washington and the rules adopted thereunder to address our concerns regarding registration, supervision, and books and records with respect to the activities of unregistered persons.

In the future, the Securities Division may elect to issue an interpretive statement or other guidance describing the circumstances in which a non-registered person who enters orders may in fact be acting as an unregistered salesperson in Washington. The format of an interpretive statement would allow the Securities Division the opportunity to explain our concerns with certain trade entry practices, and to suggest potential compliance solutions.

Comment in Support of the Adoption of WAC 460-20C-210(4) and WAC 460-20C-220(9)

FSI submitted a comment in support of the adoption of the unethical practice for broker-dealers at WAC 460-20C-210(4) and the unethical practice for salespersons at WAC 460-20C-220(9). These provisions would make it an unethical practice to fail to comply with Regulation Best Interest. As the comment supported the proposed rules, we made no changes in response.

Comment in Support of the Rulemaking

The Securities Division received a comment letter in support of the proposed rules from attorney Dave Neuman of Israel & Neuman PLC. Neuman specifically praised the proposed rules that would make it an unethical practice for a broker-dealer or salesperson to fail to pay an arbitration award, judgment, or regulatory fine. He expressed the hope that the Securities Division will enact similar unethical practices with respect to its registered investment advisers and investment adviser representatives. In addition, Neumann recommended that the Securities Division consider “requiring a certain level of insurance for those in the securities industry” as an investor protection, and cited the existence of a statutory insurance requirement for investment advisers in Oregon.

As the comment letter supported the proposed rules, we made no changes in response. The Securities Division will consider the suggestions with respect to the investment adviser rules for potential future rulemakings, but note that this rulemaking pertains to the broker-dealer rules.

II. Oral Comments.

The Securities Division held a public hearing on the proposed rules at 10:30 a.m. on June 25, 2024 at the Department of Financial Institutions office at 150 Israel Rd. SW, Tumwater, WA 98501.

No members of the public attended the hearing. The Securities Division received no oral comments or written testimony at the hearing.

CONCLUSION

The final rules are the product of an open and deliberative process with stakeholder input.

On December 20, 2023, the Securities Division emailed a link to the initial draft of the rules to all Washington-registered broker-dealers in connection with a small business economic impact survey. The survey period lasted until February 1, 2024. At the same time, the Securities Division posted the draft rules on the Securities Division’s website. As described in the Small Business Economic Impact Statement filed with the Form CR-102, the Securities Division made changes to the initial draft based on the feedback received in the survey.

On May 6, 2024, the Securities Division filed the proposed rules on Form CR-102 with the Code Reviser. The Securities Division distributed a link to the Form CR-102 and the proposed rules to its interested persons list via GovDelivery. The Securities Division also emailed a link to the Form CR-102 and proposed rules to all broker-dealers registered in Washington. In addition, the Securities Division posted the proposed rules on the Securities Division’s website. The Securities Division accepted written comments on the rulemaking until June 25, 2024. The Securities Division held a public hearing on the proposed rules on June 26, 2024. As described in this Concise Explanatory Statement, the Securities Division considered the written comments received on the proposed rules and revised the rules in the response.