

NEW SECTION

WAC 460-24A-005 Definitions. For purposes of this chapter:

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

(a) "Custody" includes:

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

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

(iii) Any capacity (such as general partner of a limited partnership, managing member of a limited liability company or a comparable position for another type of pooled investment vehicle, or trustee of a trust) that gives an investment adviser or its supervised person legal ownership of or access to client funds or securities.

(b) Receipt of checks drawn by clients and made payable to unrelated third parties will not meet the definition of custody if forwarded to the third party within twenty-four hours of receipt and the adviser maintains a ledger or other listing of all securities or funds held or obtained inadvertently, including the following information:

(i) Issuer;

(ii) Type of security and series;

(iii) Date of issue;

(iv) For debt instruments, the denomination, interest rate, and maturity date;

(v) Certificate number, including alphabetical prefix or suffix;

(vi) Name in which registered;

(vii) Date given to the adviser;

(viii) Date sent to client or sender;

(ix) Form of delivery to client or sender, or copy of the form of delivery to client or sender; and

(x) Mail confirmation number, if applicable, or confirmation by client or sender of the fund's or security's return.

(2) "**Independent party**" means a person who:

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

(b) Does not control and is not controlled by and is not under common control with the investment adviser; and

(c) Does not have, and has not had within the past two years,

a material business relationship with the investment adviser.

(3) **"Independent representative"** means a person who:

(a) Acts as an agent for an advisory client, including in the case of a pooled investment vehicle, for limited partners of a limited partnership, members of a limited liability company, or other beneficial owners of another type of pooled investment vehicle and by law or contract is obliged to act in the best interest of the advisory client or the limited partners or members, or other beneficial owners;

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

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

(4) **"Qualified custodian"** means the following independent institutions or entities:

(a) A bank as defined in section 202(a)(2) of the Advisers Act, 15 U.S.C. 80b-2(a)(2), or a savings association as defined in section 3(b)(1) of the Federal Deposit Insurance Act, 12 U.S.C. 1813(b)(1), that has deposits insured by the Federal Deposit Insurance Corporation under the Federal Deposit Insurance Act, 12 U.S.C. 1811;

(b) A broker-dealer registered under section 15(b)(1) of the Securities Exchange Act of 1934, 15 U.S.C. 78o(b)(1), holding the client assets in customer accounts;

(c) A futures commission merchant registered under section 4f(a) of the Commodity Exchange Act, 7 U.S.C. 6f(a), holding the client assets in customer accounts, but only with respect to clients' funds and security futures, or other securities incidental to transactions in contracts for the purchase or sale of a commodity for future delivery and options thereon;

(d) A foreign financial institution that customarily holds financial assets for its customers, provided that the foreign financial institution keeps the advisory clients' assets in customer accounts segregated from its proprietary assets; and

(e) The transfer agent for an open-end company as defined in section 5(a)(1) of the Investment Company Act of 1940, 15 U.S.C. 80a-5(a)(1), only with respect to shares of the open-end company.

AMENDATORY SECTION (Amending WSR 01-16-125, filed 7/31/01, effective 10/24/01)

WAC 460-24A-105 Requirements for an investment adviser that has custody or possession of client funds or securities ((of clients)). If you are an investment adviser registered or required to be registered under RCW 21.20.040, it shall constitute an "act, practice, or course of business" which operates or would operate as a fraud within the meaning of RCW 21.20.020 for ((any investment adviser who has)) you to have custody ((or possession)) of ((any))

~~client funds or securities ((in which any client has any beneficial interest to do any act or take any action, directly or indirectly, with respect to any such funds or securities,)) unless:~~

~~(1) ((All such securities of each such client are segregated, marked to identify the particular client who has the beneficial interest therein, and held in safekeeping in someplace reasonably free from risk of destruction or other loss; and~~

~~(2) (a) All such funds of such clients are deposited in one or more bank accounts which contain only clients' funds,~~

~~(b) Such account or accounts are maintained in the name of the investment adviser as agent or trustee for such clients, and~~

~~(c) The investment adviser)) **You notify the director.** You notify the director promptly on Form ADV that you have or may have custody;~~

~~(2) **A qualified custodian maintains your clients' funds and securities.**~~

~~(a) A qualified custodian maintains your clients' funds and securities:~~

~~(i) In a separate account for each client under that client's name; or~~

~~(ii) In accounts that contain only your clients' funds and securities, under either your name as agent or trustee for the clients or, in the case of a pooled investment vehicle that you manage, in the name of the pooled investment vehicle; and~~

~~(b) You maintain((s)) a separate record for each such account which shows the name and address of the ((bank)) qualified custodian where such account is maintained, the dates and amounts of deposits in and withdrawals from such account, and the exact amount of each client's beneficial interest in such account; ((and))~~

~~(3) ((Such investment adviser, immediately after accepting custody or possession of such funds or securities from any client, notifies such)) **You notify clients of the identity of the qualified custodian.** If you open an account with a qualified custodian on your client's behalf, either under the client's name, under your name as agent, or under the name of a pooled investment vehicle, you notify the client in writing of the ((place)) qualified custodian's name, address, and the manner in which ((such)) the funds ((and)) or securities ((will be)) are maintained, ((and thereafter, if and when there is any change in the place or manner in which such funds or securities are being maintained, gives each such client written notice thereof)) promptly when the account is opened and following any changes to this information; ((and))~~

~~(4) ((Such investment adviser sends to each client, not less frequently than once every three months, an itemized statement showing the funds and securities in the custody or possession of the investment adviser at the end of such period and all debits, credits and transactions in such client's account during such period; and~~

~~(5) All such)) **Either you or a qualified custodian sends account statements to your clients.** You or a qualified custodian sends your clients account statements subject to the following~~

requirements:

(a) Requirements if qualified custodian sends account statements. If you do not send account statements to your clients, you have a reasonable basis for believing that the qualified custodian sends an account statement, at least quarterly, to each of your clients for which the qualified custodian maintains funds or securities, identifying the amount of funds and of each security in the account at the end of the period and setting forth all transactions in the account during that period;

(b) Requirements if you send account statements. If the qualified custodian does not send account statements to your clients:

(i) You send account statements, at least quarterly, to each of your clients for whom you have custody of funds or securities, identifying the amount of funds and of each security of which you have custody at the end of the period and setting forth all transactions during that period;

(ii) An independent certified public accountant verifies all client funds and securities ((of clients are verified)) by actual examination at least once during each calendar year ((by an independent certified public accountant or public accountant)) at a time ((which shall be)) that is chosen by ((such)) the accountant without prior notice or announcement to ((the investment adviser. A certificate of such accountant stating that he has made an examination of such funds and securities, and describing the nature and extent of such examination shall be filed with the director promptly after each such examination)) you and that is irregular from year to year, and files a copy of the special examination report with the director within thirty days after the completion of the examination, stating that it has examined the funds and securities and describing the nature and extent of the examination; and

(iii) The independent certified public accountant, upon finding any material discrepancies during the course of the examination, notifies the director within one business day of the finding, by means of a facsimile transmission or electronic mail, followed by first class mail, directed to the attention of the director; and

(c) Account statements are sent to limited partners and members of limited liability companies that you advise. If you are a general partner of a limited partnership (or managing member of a limited liability company, or hold a comparable position for another type of pooled investment vehicle), the account statements required under this subsection are sent to each limited partner (or member or other beneficial owner); and

(5) A client may designate an independent representative to receive account statements. A client may designate an independent representative to receive, on his or her behalf, notices and account statements as required under subsections (3) and (4) of this section.

NEW SECTION

WAC 460-24A-106 Additional custody requirements for an investment adviser that directly deducts fees from client accounts.

(1) If you are an investment adviser registered or required to be registered under RCW 21.20.040 who has custody as defined in WAC 460-24A-005(1) solely because you have the authority to directly deduct fees from client accounts, you must comply with the safekeeping requirements in WAC 460-24A-105 and the following additional safeguards:

(a) **You must have your client's written authorization.** You must have written authorization from your client to deduct advisory fees from the account held with the qualified custodian.

(b) **You must provide notice to the qualified custodian and an itemized invoice to your client.** Each time a fee is directly deducted from your client's account, you must concurrently:

(i) Send the qualified custodian notice of the amount of the fee to be deducted from your client's account; and

(ii) Send your client an invoice itemizing the fee. Itemization includes the formula used to calculate the fee, the amount of assets under management the fee is based on, and the time period covered by the fee.

(c) **You must notify the director that you will comply with these safekeeping requirements.** You must notify the director on Form ADV that you will comply with the safekeeping requirements set forth in this section.

(2) **Waiver of net worth and bonding requirements.** If you have custody as defined in WAC 460-24A-005(1) solely because you have the authority to have fees directly deducted from client accounts and you comply with the safekeeping requirements set forth in this section, you are not required to comply with the net worth and bonding requirements for an investment adviser that has custody set forth in WAC 460-24A-170.

NEW SECTION

WAC 460-24A-107 Custody requirements for an investment adviser that manages a pooled investment vehicle or trust.

(1) If you are an investment adviser registered or required to be registered under RCW 21.20.040 that has custody as defined in WAC 460-24A-005 (1)(a)(iii), you must either:

(a) **Comply with additional safekeeping requirements.** In addition to the safekeeping requirements set forth in WAC 460-24A-105, you must comply with the following safekeeping requirements:

(i) **You must engage an independent party to authorize withdrawals from the pooled account.** You must hire an independent party to review all fees, expenses, and capital withdrawals from the pooled account;

(ii) **You must send detailed invoices or receipts to the independent party.** You must send all invoices or receipts to the independent party, detailing the amount of the fee, expenses, or capital withdrawal and the method of calculation such that the independent party can:

(A) Determine that the payment is in accordance with the pooled investment vehicle standards (generally the partnership agreement or membership agreement); and

(B) Forward, to the qualified custodian, approval for payment of the invoice with a copy to the investment adviser; and

(iii) **You must notify the director that you will comply with these additional safekeeping requirements.** You must notify the director on Form ADV that you will comply with the safekeeping requirements in (a) of this subsection; or

(b) **You must provide audited financial statements of the pooled investment vehicle to all limited partners or members.** If you do not comply with the safekeeping requirements set forth in WAC 460-24A-105 and (a) of this subsection, you must comply with the following alternative safekeeping requirements:

(i) **The pooled investment vehicle must be subject to annual audits.** You must cause the financial statements of the limited partnership (or limited liability company, or another type of pooled investment vehicle) for which you are a general partner (or managing member or other comparable position) to be subject to audit, at least annually, by an independent certified public accountant to be conducted in accordance with generally accepted auditing standards;

(ii) **You must distribute audited financial statements for the pooled investment vehicle to all beneficial owners.** You must distribute audited financial statements prepared in accordance with generally accepted accounting principles for the limited partnership (or limited liability company, or another type of pooled investment vehicle) for which you are a general partner (or managing member or other comparable position) to all limited partners (or members or other beneficial owners) within one hundred twenty days of the end of its fiscal year; and

(iii) **You must notify the director that you will distribute audited financial statements of the pooled investment vehicle to all beneficial owners.** You must notify the director on Form ADV that you will comply with the safekeeping requirements in (b)(i) and (ii) of this subsection.

(2) **If you comply with the additional safekeeping requirements, you are not required to comply with the net worth and bonding requirements.** If you have custody solely as defined in WAC 460-24A-105 (1)(a)(iii) and you comply with the safekeeping requirements in WAC 460-24A-105 and subsection (1)(a) of this section, you are not required to comply with the net worth and bonding requirements for an investment adviser that has custody set forth in WAC 460-24A-170.

(3) **If you distribute audited financial statements of the pooled investment vehicle to all beneficial owners, you are not**

required to comply with the surprise examination requirements. You are not required to comply with WAC 460-24A-105 (4)(b)(ii) and (iii) with respect to the account of a limited partnership (or limited liability company, or another type of pooled investment vehicle) that is subject to audit if you comply with subsection (1)(b) of this section.

NEW SECTION

WAC 460-24A-108 Custody requirements for an investment adviser that acts as trustee and investment adviser to a trust. If you are an investment adviser registered or required to be registered under RCW 21.20.040 that acts as an investment adviser to a trust and the trust has retained you or one of your representatives, employees, directors, or owners as trustee, you must comply with the following requirements:

(1) **You must send invoices to the qualified custodian and a person connected to the trust at the same time.** You must send to the grantor of the trust, the attorney for the trust if it is a testamentary trust, the co-trustee (other than you or one of your representatives, employees, directors, or owners); or a defined beneficiary of the trust, at the same time that you send any invoice to the qualified custodian, an invoice showing the amount of the trustees' fee or investment management or advisory fee, the value of the assets on which the fees were based, and the specific manner in which the fees were calculated.

(2) **You must have an agreement with a qualified custodian that contains certain terms.** You must enter into a written agreement with a qualified custodian that complies with the following requirements:

(a) **The agreement must restrict payments to you or persons related to you.** The agreement must specify that the qualified custodian will neither deliver trust securities nor transmit any funds to you or one of your representatives, employees, directors, or owners, except that the qualified custodian may pay trustees' fees to the trustee and investment management or advisory fees to you, provided that:

(i) The grantor of the trust or attorneys for the trust, if it is a testamentary trust, the co-trustee (other than you or one of your representatives, employees, directors, or owners), or a defined beneficiary of the trust has authorized the qualified custodian in writing to pay those fees;

(ii) The statements for those fees show the amount of the fees for the trustee and, in the case of statements for investment management or advisory fees, show the value of the trust assets on which the fee is based and the manner in which the fee was calculated; and

(iii) The qualified custodian agrees to send to the grantor of

the trust, the attorneys for a testamentary trust, the co-trustee (other than you or one of your representatives, employees, directors, or owners); or a defined beneficiary of the trust, at least quarterly, a statement of all disbursements from the account of the trust, including the amount of investment management fees paid to you and the amount of trustees' fees paid to the trustee.

(b) **The agreement must restrict the transfer of funds or securities.** Except as otherwise set forth in subsection (1)(b)(i) of this section, the agreement must specify that the qualified custodian may transfer funds or securities, or both, of the trust only upon the direction of the trustee (who may be you or one of your representatives, employees, directors, or owners), who you have duly accepted as an authorized signatory. The grantor of the trust or attorneys for the trust, if it is a testamentary trust, the co-trustee (other than you or one of your representatives, employees, directors, or owners), or a defined beneficiary of the trust, must designate the authorized signatory for management of the trust. The agreement must further specify that the direction to transfer funds or securities, or both, can only be made to the following:

(i) To a trust company, bank trust department or brokerage firm independent from you for the account of the trust to which the assets relate;

(ii) To the named grantors or to the named beneficiaries of the trust;

(iii) To a third person independent from you in payment of the fees or charges of the third person including, but not limited to:

(A) Attorney's, accountant's, or qualified custodian's fees for the trust; and

(B) Taxes, interest, maintenance, or other expenses, if there is property other than securities or cash owned by the trust;

(iv) To third persons independent from you for any other purpose legitimately associated with the management of the trust; or

(v) To a broker-dealer in the normal course of portfolio purchases and sales, provided that the transfer is made on payment against delivery basis or payment against trust receipt.

(3) **You must notify the director that you will comply with these safekeeping requirements.** You must notify the director on Form ADV that you will comply with the safekeeping requirements set forth in this section.

(4) **You are not required to comply with the net worth and bonding requirements if you comply with these safekeeping requirements.** If you have custody solely as defined in WAC 460-24A-005 (1)(a)(iii) because you are the trustee of a trust and you comply with the safekeeping requirements in WAC 460-24A-105 and this section, you are not required to comply with the net worth and bonding requirements for an investment adviser that has custody set forth in WAC 460-24A-170.

NEW SECTION

WAC 460-24A-109 Exceptions from custody requirements.

Exceptions from the custody requirements for investment advisers that are registered or required to be registered under RCW 21.20.040 are available in the following circumstances:

(1) (a) **You are not required to comply with the custody requirements for certain privately offered securities.** You are not required to comply with WAC 460-24A-105 through 460-24A-108 with respect to securities that are:

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

(ii) Uncertificated, and ownership thereof is recorded only on books of the issuer or its transfer agent in the name of the client; and

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

(b) Notwithstanding (a) of this subsection, the provisions of this subsection (1) are available with respect to securities held for the account of a limited partnership (or limited liability company, or other type of pooled investment vehicle) only if you comply with the requirements in WAC 460-24A-107 (1) (b).

(2) **You are not required to comply with the custody requirements with respect to the account of a registered investment company.** You are not required to comply with WAC 460-24A-105 through 460-24A-108 with respect to the account of an investment company registered under the Investment Company Act of 1940, 15 U.S.C. 80a-1 to 80a-64.

(3) **You are not required to comply with the custody requirements with respect to a trust for the benefit of your relative.** You are not required to comply with the safekeeping requirements of WAC 460-24A-105 through 460-24A-108 or the net worth and bonding requirements for an investment adviser that has custody set forth in WAC 460-24A-170 if you have custody solely because you or one of your representatives, employees, directors, or owners is a trustee for a beneficial trust, if all of the following conditions are met for each trust:

(a) The beneficial owner of the trust is your parent, a grandparent, a spouse, a sibling, a child, or a grandchild. These relationships shall include "step" relationships.

(b) For each account under (a) of this subsection, you comply with the following:

(i) You provide a written statement to each beneficial owner of the account setting forth a description of the requirements of WAC 460-24A-105 through 460-24A-108 and WAC 460-24A-170 and the reasons why you will not be complying with those requirements;

(ii) You obtain from each beneficial owner a signed and dated statement acknowledging the receipt of the written statement required under (b) (i) of this subsection; and

(iii) You maintain a copy of both documents described in (b) (i) and (ii) of this subsection until the account is closed or you are no longer trustee.

AMENDATORY SECTION (Amending WSR 01-16-125, filed 7/31/01, effective 10/24/01)

WAC 460-24A-170 Minimum financial requirements for investment advisers. (1) An investment adviser registered or required to be registered under RCW 21.20.040, who has custody of client funds or securities, shall maintain at all times a minimum net worth of \$35,000 unless provided otherwise in this chapter. An investment adviser registered or required to be registered under RCW 21.20.040, who has discretionary authority over client funds or securities, but does not have custody of client funds or securities, shall maintain at all times a minimum net worth of \$10,000.

(2) An investment adviser registered or required to be registered under RCW 21.20.040 who has custody or discretion of client funds or securities, but does not meet the minimum net worth requirements in subsection (1) of this section shall be bonded in the amount of the net worth deficiency rounded up to the nearest \$5,000. Any bond required by this section shall be in the form determined by the director, issued by a company qualified to do business in this state, and shall be subject to the claim of all clients of the investment adviser regardless of the client's state of residence.

(3) An investment adviser registered or required to be registered under RCW 21.20.040, who accepts prepayment of more than \$500 per client and six or more months in advance, shall maintain at all times a positive net worth.

(4) Unless otherwise exempted, as a condition of the right to transact business in this state, every investment adviser registered or required to be registered under RCW 21.20.040 shall, by the close of business on the next business day, notify the director if the investment adviser's net worth is less than the minimum required. After transmitting such notice, each investment adviser shall file, by the close of business on the next business day, a report with the director of its financial condition, including the following:

(a) A trial balance of all ledger accounts;

(b) A statement of all client funds or securities which are not segregated;

(c) A computation of the aggregate amount of client ledger debit balances; and

(d) A statement as to the number of client accounts.

(5) For purposes of this section, the term "net worth" shall mean an excess of assets over liabilities, as determined by generally accepted accounting principles, but shall not include as assets: Prepaid expenses (except as to items properly classified as assets under generally accepted accounting principles), deferred

charges, goodwill, franchise rights, organizational expenses, patents, copyrights, marketing rights, unamortized debt discount and expense, all other assets of intangible nature, home furnishings, automobile(s), and any other personal items not readily marketable in the case of an individual; advances or loans to stockholders and officers in the case of a corporation; and advances or loans to partners in the case of a partnership.

~~(6) ((For purposes of this section, a person will be deemed to have custody if said person directly or indirectly holds client funds or securities, has any authority to obtain possession of them, or has the ability to appropriate them. An adviser shall not be deemed to have constructive custody of a client's cash or securities, if such possession is for the sole purpose of immediately forwarding such cash or securities to a third party at the request of the client.~~

~~(7))~~ The director may require that a current appraisal be submitted in order to establish the worth of any asset.

~~((8))~~ (7) Every investment adviser that has its principal place of business in a state other than this state shall maintain only such minimum net worth as required by the state in which the investment adviser maintains its principal place of business, provided the investment adviser is licensed in that state and is in compliance with that state's minimum capital requirements.