Assessment of Public Comment on Proposed Changes to 13 NYCRR 11

The below represents the substance of comments sent to the Department of Law (The "Department") in response to its proposal to amend 13 NYCRR 11 as summarized in the April 15, 2020 edition of the New York State Register (the "Part 11 Proposal"). The final rule adopting the Part 11 Proposal is referred to herein as the "Adopted Rule."

Below each comment the Department has responded.

1. Comment: A few commenters requested that the Department clarify that the registration requirements for investment advisers under Section 11.4 of the Part 11 Proposal do not apply to Federally Covered Investment Adviser ("FCIAs") or to those who otherwise are excluded or exempted under Section 11.13. The commenters also request clarification that an Investment Adviser Representative ("IAR") must register under Section 11.4 only where (1) the IAR represents an Investment Adviser who is required to register with the State of New York, and (2) the IAR represents a Federally Covered Investment Adviser ("FCIA") and has a place of business in the State of New York. The commenters noted that the Part 11 Proposal, as written, could be construed to apply in scenarios that would be preempted under Section 203A of the federal Investment Advisers Act of 1940 (15 U.S.C. 80b-3a) and 17 CFR § 275.203A-3 ("Rule 203A-3") thereunder.

   Response: The Department has clarified the Adopted Rule to address any risk of federal preemption in the application of New York's registration requirements. First, Section 11.13(a) is amended to clearly delineate that FCIAs are excluded from the definition of "investment adviser" consistent with the definition set forth in NY GBL § 359-eee and therefore are not subject to registration in New York. Section 11.13(b) will continue to provide separately for those who may be included in the definition of "investment adviser," but who are exempt from registration. Second, in Section 11.12, the proposed definition of "investment adviser representative" is modified to align explicitly with the requirements of Rule 203A-3 when applied to IARs for FCIAs.

2. Comment: A few commenters assert that the proposed definition of "investment adviser representative" in Section 11.12 of the Part 11 Proposal is overly broad because it includes "any natural person supervising an investment adviser representative," which unintentionally could subject every individual in a supervisory chain to registration in New York. Two commenters proposed a narrower definition to include only direct supervisors of those individuals who engage in the specific services that would constitute IAR services, rather than any supervisor. Similarly, another commenter urges that the Department amend Sections 11.4 and 11.6 of the Part 11 Proposal to prevent New York's registration requirements from being misapplied to "supervisors" and "principals" at FCIAs who are not themselves IARs due to potential preemption under federal law.

   Response: The Department has clarified the Adopted Rule to address any risk of federal preemption in the application of New York's registration requirements. The definition of

"investment adviser representative" has been modified to strike the language "[a]ny natural person supervising any investment adviser representative is deemed to be an investment adviser representative and is subject to the same examination and registration requirements…." To narrow registration to direct supervisors of IARs, the Department has amended Section 11.12 to define specifically the term "supervisor" as a "natural person who directly supervises one or more natural persons associated with an investment adviser in their capacity as investment adviser representatives." The term also incorporates the updated definition of "investment adviser" that is consistent with GBL § 359-eee to avoid preemption by federal law.

3. Comment: One commenter urged the Department to modify the proposed definition of "solicitor" under Section 11.12(j) from a person who introduces prospective investors to investment advisers "as part of their regular business" to one who does so "on a regular basis." The commenter believes the former phrase may cause confusion with respect to persons excluded from the definition of investment adviser due to their activity being "solely incidental" to their regular profession.

   Response: The Department does not believe clarification is necessary as the definition of Solicitor in 13 NYCRR 11.12 (j) of the Part 11 Proposal excludes those who fall under an enumerated exception under GBL § 359-eee(1)(a). GBL § 359-eee(1)(a)(2) and (3) carve out lawyers, accountants, engineers and teachers whose performance of investment advisory services are solely incidental to their practice and brokers or dealers whose conduct is similarly incidental and who receive no special compensation for such conduct. To the extent a person does not fall into any excluded category and otherwise meets the definition of solicitor, such person is required to register with New York.

   The commenter's proposed modification also would increase uncertainty as to what constitutes "a regular basis" triggering a duty to register. This includes likely questions over the frequency of solicitation activities, the number of investment advisers for whom a solicitor seeks investors, and a solicitors' ongoing efforts to have investment advisers engage them to locate prospective clients.

   In addition, the definition of "solicitor" in the Part 11 Proposal is consistent with the federal definition set forth in 17 CFR § 275.206(4)-3 ("Rule 206(4)-3"). Specifically, Rule 206(4)-3 defines a solicitor as "any person who, directly or indirectly, solicits any client for, or refers any client to, an investment adviser" and does not condition the definition by the regularity of the solicitor's business.

4. Comment: Two commenters requested that the Department modify the Part 11 Proposal to exclude from state registration requirements those solicitors whose sole activity for FCIAs is making referrals and who are not IARs. One commenter asserts that state registration requirements only would apply to third-party solicitors, and not to any solicitor who is a supervised person of an FCIA. The commenter further asserts that state registration of third-party solicitors is unnecessary because the current federal framework sufficiently protects investors.

   Response: The Department declines to incorporate the commenters' requested modifications. As a general matter, a solicitor who is a supervised person for an FCIA and operates from a place of

business within the state also is an IAR and subject to registration, so there is no additional solicitor requirement for that person. As to third-party solicitors engaged by either an FCIA or an investment adviser, or both, the Department believes it serves the public interest to require registration, disclosure and minimum examination requirements.

Further, FCIA oversight of third-party solicitors has not proven consistently adequate. The SEC's Office of Compliance Inspections and Examinations recently published a risk alert[1] in which it identified common deficiencies cited by the SEC staff regarding the use of third-party solicitors. These include inadequate provision of disclosure documents, failure to obtain required client acknowledgments, incomplete solicitation agreements, and insufficient bases for FCIAs to believe that solicitors had complied with the solicitation agreements. The Department therefore believes additional transparency and minimum competency requirements are appropriate.

5. Comment: A few commenters have urged the Department to expand the examination waivers to grandfather all individuals who were providing investment advisory services in New York on or before the effective date of the Part 11 Proposal. The commenters believe the waiver should apply to IARs both for New York-registered investment advisers and for FCIAs where the IAR's operate in the state. The commenters also propose applying the waiver with no minimum look-back period for prior experience or past registration.

   Response: The Department agrees that some expansion of the examination waiver is appropriate and has modified the Adopted Rule accordingly. In Section 11.7(a), the waiver for persons registered in jurisdictions outside of New York has been modified to cover individuals registered in any jurisdiction, including New York. The waiver still requires those persons to have been continuously registered in those jurisdictions for at least two years prior to the date of their registration filings in New York and with no lapse in registration exceeding two years. In addition, they must not be now, or in the preceding 10 years have been, subject to any regulatory or civil action, proceeding or arbitration requiring disclosure on Form U4.

   Section 11.7(b) separately provides a special waiver that exempts individuals who (i) acted as investment adviser representatives in the regular course of business, (ii) from a place of business in New York, and (iii) for a period of at least two years prior to the effective date of the Part 11 Proposal. Those seeking the waiver must not currently be, or in the last ten years been subject to, any regulatory or civil action, proceeding, arbitration, investigation or disciplinary event that would require disclosure on Form U4 or be the subject of a current investment-related investigation of which they are aware. The special waiver is not available to individuals (i) who submit applications for registration after August 31, 2021, (ii) whose investment advisory activities prior to December 2, 2020 – the date of publication in the State register – were limited to acting as a solicitor, or (iii) who ceased providing investment advisory services for two or more continuous years in the four-year period immediately preceding their registration application. All waivers are granted at the Department's discretion.

[1] *See* National Exam Program Risk Alert: Investment Adviser Compliance Issues Related to the Cash Solicitation Rule (October 31, 2018), https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20Cash%20Solicitation.pdf

Solicitors are excluded from special waiver eligibility because the limited scope of solicitor activities is an insufficient indicator of the experience necessary to merit waiving examination requirements during the implementation period. The deadline for requesting a special waiver is August 31, 2021, which allows nine months' notice from the date of publication of adoption of the proposal, to ensure timely receipt of registration applications and special waiver requests so that they do not arrive at the very end of the implementation period. All special waiver requests must be made on new Form NY-IASW.

Examination waivers granted before February 21, 2021 to IARs of State Registered Investment Advisers will continue to be honored, barring new information warranting a reevaluation or redetermination under 11.18.

6. Comment: A few commenters suggested that the Department expand the Part 11 Proposal's waivers for persons required to take and successfully pass the required examinations. One commenter believes the examination waiver for IARs registered in other jurisdictions should not have a two-year lookback requirement. Another commenter suggested the examination waiver should apply to anyone who at any time previously passed the Series 65 or a combination of the Series 7 and 66, and should not be limited to those who passed the examinations within two years prior to their respective applications for registration. Other commenters suggested that the waiver should apply to any person who currently provides investment advisory services in New York and who holds Series 7 and Series 63 certifications, or who previously held a Series 65 or 66 certification that lapsed due to non-registration or non-payment of fees.

   Response: The Department maintains that applicants registered in other jurisdictions must show continuous registration for two years prior to submitting their applications in New York and requesting a waiver. However, the waiver provision is slightly modified to apply to those registered as an investment adviser representative in any U.S. jurisdiction in order to allow that same waiver to apply to New York registered investment adviser representatives in the future. The Department also maintains the two-year continuous registration requirement for waiver applicants. This requirement serves as an indicator that individuals obtaining the waiver are sufficiently experienced in the area of investment advisory services. This timeframe also is consistent with FINRA's expiration period and retesting requirement for individuals who pass the Series 7 and other licensing examinations, but who have gone two continuous years without employment with a FINRA-member. The Department declines to otherwise extend the waiver provisions related to prior investment adviser representative registration.

   Separately, the Part 11 Proposal preserves the examination waiver for individuals who hold certain professional designations in good standing. The Department declines to expand the waiver to include other examinations or certifications.

7. Comment: One commenter requests clarification of the requirement under Section 11.7 of the Part 11 Proposal that individuals seeking a waiver from registration not have faced any regulatory action or arbitrations refers to Form U4 disclosable disciplinary incidents.

Response: Applicants seeking an examination waiver under Section 11.7 must not be subject, at the time of application or in the preceding 10 years, to regulatory or civil actions, proceedings or arbitrations that would require disclosure on Form U4.

8. Comment: A few commenters have requested that the Department extend the compliance period for satisfying the new requirements under the Part 11 Proposal, particularly with respect to the examination requirements, from 60 days to one year. The commenters have cited difficulties caused by the 2020 COVID-19 pandemic and its impact on the State of New York as the hardest obstacle to overcome in terms of complying with the new requirements.

   Response: The Department agrees that extensions to the compliance periods for the new requirements under the Part 11 Proposal are appropriate and has created an approximately yearlong implementation period (11.4(i)) and extended compliance period (11.6(b)), as well as a special exam waiver (11.7(b)) to effect those extensions in the Adopted Rule. The implementation period begins on the date of publication in the state register and ends on December 2, 2021. Individuals who provided investment advisory services prior to the effective date may continue their investment advisory activity so long as their applications are not denied and they have not failed to correct any deficiency. The extended compliance period also gives those individuals until December 2, 2021 to pass the required examinations. Those persons who are eligible and who seek the protection of these extensions must submit their registration applications by August 31, 2021.

   Thus, the Department expects that all industry participants subject to the new registration and exam requirements will be able to continue their current business activity for approximately one year before an approved registration is required. The Department encourages investment adviser representatives to submit their Form U4 filings and schedule any required exams as soon as possible on or after the effective date to ensure sufficient time for review and processing.

9. Comment: A few commenters have requested that the Department lower the registration fees set forth in the Part 11 Proposal. The commenters are concerned that New York's $200 initial and annual registration fee for both investment advisers and IARs is excessive compared to other states and could create a barrier to entry.

   Response: The Department has maintained the $200 initial and annual registration fee for both investment advisers and IARs as it is derived from GBL § 359-eee (7). The Department believes that the $200 registration fee will not cause any barrier to entry across the investment adviser industry, which receives fees based on trillions of dollars in assets under management each year. Notably, the Adopted Rule contains registration fee relief for sole proprietorships under 11.4(h).

10. Comment: Two commenters have requested the Department more explicitly clarify under Section 11.18 in the Part 11 Proposal the circumstances under which the Attorney General would deny, suspend, revoke or condition the registration of an investment adviser, IAR, principal or solicitor.

    Response: The Department is promulgating guidance that will be available on its website following publication of this assessment.

11. Comment: One commenter requested that the Department update the name the "Investment Council Association of America" to its current name, the "Investment Adviser Association," as the association awarding the Chartered Investment Counselor designation in Section 11.7 of the Part 11 Proposal.

    Response: The Department has modified the language in Section 11.7 in the Adopted Rule accordingly.