

# State of Wisconsin

LEGISLATIVE REFERENCE BUREAU


## **RESEARCH APPENDIX -** **PLEASE DO NOT REMOVE FROM DRAFTING FILE**

Date Transfer Requested: 02/14/2008 (Per: ARG)




 Appendix A ... Part 12 of 23




 The 2007 drafting file for LRB-1109/2

has been transferred to the drafting file for

**2007 LRB-3866** (SB 483)

 This cover sheet, the final request sheet, and the final version of the 2007 draft were copied on yellow paper, and returned to the original 2007 drafting file.

 The attached 2007 draft was incorporated into the new 2007 draft listed above. For research purposes, this cover sheet and the complete drafting file were transferred, as a separate appendix, to the 2007 drafting file. If introduced this section will be scanned and added, as a separate appendix, to the electronic drafting file folder.

3. Section 305(a) expressly authorizes registration by "a person on whose behalf the offering is to be made." This would permit a nonissuer, cf. Section 102(18), or a broker-dealer to file a registration statement independent of the issuer.

4. This Act is intended, to the extent practicable, to be revenue neutral in its impact on existing state law, see Comment 3 to Section 608. Accordingly, Section 305(b) does not specify what fees states should provide. If a State prefers to have the fees in this section established by rule, replace the phrase "a fee of \$[ ]" in subsections (b) and (j) with the phrase "a fee established by the administrator by rule pursuant to the [state administrative procedure act]" and replace the phrase "\$[ ] of the fee" in subsection (b) with the phrase "an amount of the fee established by the administrator by rule". See Comment 3 to Section 410.

5. Section 305(c), which generally follows the 1956 Act and RUSA, does not require in Section 305(c)(3) disclosure of an order permitting the withdrawal of a registration statement. The administrator may, however, require disclosure of this information in a registration by qualification under Section 304(b)(18).

6. Section 305(c), like every other provision concerned with the content of the registration statement, must be read with Section 306(a)(1) which judges the accuracy and completeness of the registration statement as of its effective date unless an order denying effectiveness had been entered before the effective date. A registration statement must be kept current with changing developments until the effectiveness date, but a registration statement is not required to be amended after the effective date except to correct inaccuracies or deficiencies which existed as of the effective date. An administrator, however, separately may require under Section 305(i) or (j) periodic reports or amendments to keep reasonably current the information contained in the registration statement.

7. Under Section 305(d) incorporation by reference is permitted as a matter of administrative practice.

8. Section 305(e) is the substantive equivalent to provisions in the 1956 Act and RUSA. This subsection is designed to address nonissuer offerings where the seller cannot obtain certified financial statements and other normally required records. The phrase "without unreasonable effort or expense" originated in Section 10(a)(3) of the Securities Act of 1933. It is not meant to apply to expenses incidental to supplying required information required for registration in the case of a nonissuer distribution by a person in a control relationship with the issuer or otherwise having access to or contractual rights to obtain the required information. Section 305(e) applies only to registration by qualification under Section 304 and periodic reports for either registration by coordination or registration by qualification under Section 305(i).

9. Section 305(f), follows the 1956 Act and RUSA, and authorizes the administrator to require the impoundment of funds until the issuer receives a specified amount from the sale of the security in this State or elsewhere and to require the escrow of promotional stock until

specific conditions are met. This Section is limited to a security issued within the past five years or to be issued to a promoter for a consideration substantially different from the public offering price or to a person for a consideration other than cash. The typical distribution subject to Section 305(f) will be a relatively new promotional or speculative offering. Section 305(f) follows the 1956 Act and RUSA and provides that the administrator may not reject a depository solely because of its location in another state. Unlike the statute in *Schwaemmle Const. Co. v. Michigan Dep't of Commerce*, 360 N.W.2d 141 (Mich. 1984), Section 305(f) broadly provides that the administrator "may determine the conditions of any escrow or impoundment under this subsection." As in *Schwaemmle*, this power will operate only until the impounded funds or escrowed shares are released.

10. Section 305(g) follows the 1956 Act in authorizing the administrator to specify the form of a subscription or sale contract.

11. Section 305(h) generally follows the 1956 Act and RUSA. The term "nonissuer transaction" or "nonissuer distribution" is defined in Section 102(18). A sale by a nonissuer would have to be registered under Section 301 unless it is exempted or involves a federal covered security. Section 202(1) exempts "isolated nonissuer transactions." When a nonissuer transaction is not exempt under Section 202(1), it may still be exempted under other transaction exemptions.

If no exemption is available for a nonissuer distribution, and it does not involve a federal covered security, the security must be registered under Article 3. Under the first sentence of Section 305(h) each registration statement remains effective for at least one year and for any longer period the administrator may determine. However, no registration statement is effective while a stop order with respect to it is in effect under Section 306.

For the purposes of a nonissuer transaction, all outstanding securities of the same class as a registered security are considered to be registered as long as the registration statement remains effective. This means that during the effective period of a registration statement under this Act all outstanding securities of the same class can be traded by anyone, including nonissuers, as if they were registered.

Section 305(h) also provides that, unless the administrator determines otherwise, a registration statement cannot be withdrawn until one year after its effective date if any securities of the same class are outstanding. This is designed to protect sellers who would be unaware of a withdrawal from being subject to civil liability.

12. Section 305(j) follows RUSA and a procedure limited to investment companies in the 1956 Act in allowing posteffective date amendments. Under Section 305(j), when a posteffective amendment increases the number of securities to be offered or sold, an additional registration fee is required.

**SECTION 306. DENIAL, SUSPENSION, AND REVOCATION OF SECURITIES  
REGISTRATION.**

(a) [Stop orders.] The administrator may issue a stop order denying effectiveness to, or suspending or revoking the effectiveness of, a registration statement if the administrator finds that the order is in the public interest and that:

(1) the registration statement as of its effective date or before the effective date in the case of an order denying effectiveness, an amendment under Section 305(j) as of its effective date, or a report under Section 305(i), is incomplete in a material respect or contains a statement that, in the light of the circumstances under which it was made, was false or misleading with respect to a material fact;

(2) this [Act] or a rule adopted or order issued under this [Act] or a condition imposed under this [Act] has been willfully violated, in connection with the offering, by the person filing the registration statement; by the issuer, a partner, officer, or director of the issuer or a person having a similar status or performing a similar function; a promoter of the issuer; or a person directly or indirectly controlling or controlled by the issuer; but only if the person filing the registration statement is directly or indirectly controlled by or acting for the issuer; or by an underwriter;

(3) the security registered or sought to be registered is the subject of a permanent or temporary injunction of a court of competent jurisdiction or an administrative stop order or similar order issued under any federal, foreign, or state law other than this [Act] applicable to the offering, but the administrator may not institute a proceeding against an effective registration statement under this paragraph more than one year after the date of the order or injunction on

which it is based, and the administrator may not issue an order under this paragraph on the basis of an order or injunction issued under the securities act of another State unless the order or injunction was based on conduct that would constitute, as of the date of the order, a ground for a stop order under this section;

(4) the issuer's enterprise or method of business includes or would include activities that are unlawful where performed;

(5) with respect to a security sought to be registered under Section 303, there has been a failure to comply with the undertaking required by Section 303(b)(4);

(6) the applicant or registrant has not paid the filing fee, but the administrator shall void the order if the deficiency is corrected; or

(7) the offering:

(A) will work or tend to work a fraud upon purchasers or would so operate; [or]

(B) has been or would be made with unreasonable amounts of underwriters' and sellers' discounts, commissions, or other compensation, or promoters' profits or participations, or unreasonable amounts or kinds of options[; or

(C) is being made on terms that are unfair, unjust, or inequitable].

(b) **[Enforcement of subsection (a)(7).]** To the extent practicable, the administrator by rule adopted or order issued under this [Act] shall publish standards that provide notice of conduct that violates subsection (a)(7).

(c) **[Institution of stop order.]** The administrator may not institute a stop order proceeding against an effective registration statement on the basis of conduct or a transaction known to the administrator when the registration statement became effective unless the

proceeding is instituted within 30 days after the registration statement became effective.

(d) [**Summary process.**] The administrator may summarily revoke, deny, postpone, or suspend the effectiveness of a registration statement pending final determination of an administrative proceeding. Upon the issuance of the order, the administrator shall promptly notify each person specified in subsection (e) that the order has been issued, the reasons for the revocation, denial, postponement, or suspension, and that within 15 days after the receipt of a request in a record from the person the matter will be scheduled for a hearing. If a hearing is not requested and none is ordered by the administrator, within 30 days after the date of service of the order, the order becomes final. If a hearing is requested or ordered, the administrator, after notice of and opportunity for hearing for each person subject to the order, may modify or vacate the order or extend the order until final determination.

(e) [**Procedural requirements for stop order.**] A stop order may not be issued under this section without:

- (1) appropriate notice to the applicant or registrant, the issuer, and the person on whose behalf the securities are to be or have been offered;
- (2) an opportunity for hearing; and
- (3) findings of fact and conclusions of law in a record [in accordance with the state administrative procedure act].

(f) [**Modification or vacation of stop order.**] The administrator may modify or vacate a stop order issued under this section if the administrator finds that the conditions that caused its issuance have changed or that it is necessary or appropriate in the public interest or for the protection of investors.

## Official Comments

**Prior Provisions:** 1956 Act Section 306; RUSA Section 306.

1. This Section generally follows the 1956 Act and RUSA and applies to both registration by coordination under Section 303 and registration by qualification under Section 304.

2. Section 306(a)(1) follows the 1956 Act and RUSA in testing in a suspension or revocation proceeding the completeness and accuracy of a registration statement as of the registration statement's effective date. A registration statement that becomes misleading because of a development that occurs after its effective date is not a ground for the issuance of a stop order under Section 306(a)(1). An administrator, however, may require periodic reports under Section 305(i) or a posteffective amendment under Section 305(j). With respect to periodic reports under Section 305(i), a misleading report would be the basis of a stop order under Section 306(a)(1) if it is materially inaccurate as of the date it was filed.

3. On the meaning of "willfully," see Comment 2 under Section 508.

4. A violation by an issuer has the same consequences whether the issuer has filed a registration statement or has had a broker-dealer file it. But this is not the case when the registration statement is filed by a broker-dealer acting independently.

5. The verb "is" at the beginning of Section 306(a)(3) means that a stop order or injunction that has expired or been vacated is not the ground for action under this paragraph.

6. Section 306(a)(4) applies to activity that is conducted in a State where that activity is illegal. It does not apply if the activity is not illegal under that State's law. This paragraph is not meant to apply to activity which is lawful where conducted but would be illegal if conducted in the State where the registration statement is filed.

7. Sections 306(a)(5) and (6) follow the 1956 Act and RUSA.

8. Sections 306(a)(7) and (b) address merit regulation. Sections 306(E) and (F) of the 1956 Act authorized a stop order when an "offering has worked or tended to work a fraud upon purchasers or would so operate" or "the offering has been or would be made with unreasonable amounts of underwriters' and sellers' discounts, commissions, or other compensation, or promoters' profits or participation, or unreasonable amounts or kinds of options." By 1985 a majority of states which had adopted the 1956 Act had adopted this approach to merit regulation rather than the earlier and broader "unfair, unjust or inequitable" standard that then applied in a minority of States.

RUSA Sections 306(a)(5) and (6) adopted provisions substantively identical to the 1956 Act and included in brackets an "unfair, unjust, or inequitable" alternative.

The National Securities Markets Improvement Act of 1996 subsequently preempted merit regulation of federal covered securities. See Section 102(7).

Sections 306(a)(7) and (b) take a different approach. Subject to the National Securities Markets Improvement Act of 1996, merit standards are retained but hortatory paragraph 306(b) encourages the administrator, to the extent practicable, to adopt, by rule or order, standards that provide notice to issuers of a state's merit standards. Notice will address one criticism of merit regulation. See generally 1 Louis Loss & Joel Seligman, *Securities Regulation* 111-124 (3d ed. rev. 1998). Statements of Policy of the North American Securities Administrator Association that have been adopted by a state would provide notice in compliance with Section 306(b). Similarly other state rules or orders could be adopted in the future to address new types of securities as they occur.

An order under Section 306(b) can be adopted after a securities registration statement has been filed. Under Section 306(b) an administrator, by rule or order, for example, could adopt a standard that would provide the basis for a stop order denying effectiveness to a development stage company that has no specific business purpose or plan or has indicated that its primary business plan is to engage in a merger or acquisition with an unidentified company, entity, or person. "Blank check offerings" are subject to Rule 419 adopted under the Securities Act of 1933. See Comment 3 to Section 202.

9. Section 306(c) follows the 1956 Act and RUSA and allows an administrator up to 30 days after a registration statement becomes effective to institute a stop order proceeding on the basis of a fact or transaction known when the registration statement became effective. This is to avoid the necessity of an administrator issuing a stop order prematurely.

10. Sections 306(d) and (e) assure each person subject to a stop order of notice, opportunity for a hearing, and findings of fact and conclusions of law contained in a record.

11. An administrator must consider the public interest when issuing a stop order and may under Section 306(f) consider the public interest when modifying or vacating a stop order. See, e.g., *TechnoMedical Lab., Inc. v. Utah Sec. Div.*, 744 P.2d 320, 324-325 (Utah Ct. App. 1987) (a state has a valid public interest in stopping the issuance of hundreds of thousands of public shares that did not comply with the disclosure requirements of securities registration); cf. stop orders under the Securities Act of 1933, see 1 Louis Loss & Joel Seligman, *Securities Regulation* 576-589 (3d ed. rev. 1998).

12. As of September 2002 46 jurisdictions had adopted a form of Section 306(a)(7)(A) ("will tend to work a fraud or would so operate"); 34 jurisdictions had adopted a form of Section 306(a)(7)(B) ("unreasonable amounts of underwriters' and sellers' discounts, commissions, or other compensation, or promoter profits or participations, or unreasonable amounts or kinds of options"); and 16 jurisdictions had adopted a form of bracketed Section 306(a)(7)(C) ("terms that are unfair, unjust, or inequitable").



**SECTION 307. WAIVER AND MODIFICATION.** The administrator may waive or modify, in whole or in part, any or all of the requirements of Sections 302, 303, and 304(b) or the requirement of any information or record in a registration statement or in a periodic report filed pursuant to Section 305(i).

**Official Comments**

**Prior Provision:** RUSA Section 303(h). Section 307 follows RUSA Section 303(h) and empowers the administrator to waive or modify any of the requirements of 302, 303, 304(b), or the requirement of any information or record in a registration statement. An example would be the expedited procedure several states have adopted to coordinate with shelf registration under Rule 415 of the Securities Act of 1933. In waiving or modifying requirements the administrator must make a finding satisfying the requirements of Section 605(b).

[ARTICLE] 4

**BROKER-DEALERS, AGENTS, INVESTMENT ADVISERS,  
INVESTMENT ADVISER REPRESENTATIVES, AND FEDERAL  
COVERED INVESTMENT ADVISERS**

**SECTION 401. BROKER-DEALER REGISTRATION REQUIREMENT AND  
EXEMPTIONS.**

(a) **[Registration requirement.]** It is unlawful for a person to transact business in this State as a broker-dealer unless the person is registered under this [Act] as a broker-dealer or is exempt from registration as a broker-dealer under subsection (b) or (d).

(b) **[Exemptions from registration.]** The following persons are exempt from the registration requirement of subsection (a):

(1) a broker-dealer without a place of business in this State if its only transactions effected in this State are with:

(A) the issuer of the securities involved in the transactions;

(B) a person registered as a broker-dealer under this [Act] or not required to be registered as a broker-dealer under this [Act];

(C) an institutional investor;

(D) a nonaffiliated federal covered investment adviser with investments under management in excess of \$100,000,000 acting for the account of others pursuant to discretionary authority in a signed record;

(E) a bona fide preexisting customer whose principal place of residence is not in this

State and the person is registered as a broker-dealer under the Securities Exchange Act of 1934 or not required to be registered under the Securities Exchange Act of 1934 and is registered under the securities act of the State in which the customer maintains a principal place of residence;

(F) a bona fide preexisting customer whose principal place of residence is in this State but was not present in this State when the customer relationship was established, if:

(i) the broker-dealer is registered under the Securities Exchange Act of 1934 or not required to be registered under the Securities Exchange Act of 1934 and is registered under the securities laws of the State in which the customer relationship was established and where the customer had maintained a principal place of residence; and

(ii) within 45 days after the customer's first transaction in this State, the person files an application for registration as a broker-dealer in this State and a further transaction is not effected more than 75 days after the date on which the application is filed, or, if earlier, the date on which the administrator notifies the person that the administrator has denied the application for registration or has stayed the pendency of the application for good cause;

(G) not more than three customers in this State during the previous 12 months, in addition to those customers specified in subparagraphs (A) through (F) and under subparagraph (H), if the broker-dealer is registered under the Securities Exchange Act of 1934 or not required to be registered under the Securities Exchange Act of 1934 and is registered under the securities act of the State in which the broker-dealer has its principal place of business; and

(H) any other person exempted by rule adopted or order issued under this [Act]; and

(2) a person that deals solely in United States government securities and is supervised as

a dealer in government securities by the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, or the Office of Thrift Supervision.

(c) [**Limits on employment or association.**] It is unlawful for a broker-dealer, or for an issuer engaged in offering, offering to purchase, purchasing, or selling securities in this State, directly or indirectly, to employ or associate with an individual to engage in an activity related to securities transactions in this State if the registration of the individual is suspended or revoked or the individual is barred from employment or association with a broker-dealer, an issuer, an investment adviser, or a federal covered investment adviser by an order of the administrator under this [Act], the Securities and Exchange Commission, or a self-regulatory organization. A broker-dealer or issuer does not violate this subsection if the broker-dealer or issuer did not know and in the exercise of reasonable care could not have known, of the suspension, revocation, or bar. Upon request from a broker-dealer or issuer and for good cause, an order under this [Act] may modify or waive, in whole or in part, the application of the prohibitions of this subsection to the broker-dealer.

(d) [**Foreign transactions.**] A rule adopted or order issued under this [Act] may permit:

(1) a broker-dealer that is registered in Canada or other foreign jurisdiction and that does not have a place of business in this State to effect transactions in securities with or for, or attempt to effect the purchase or sale of any securities by:

(A) an individual from Canada or other foreign jurisdiction who is temporarily present in this State and with whom the broker-dealer had a bona fide customer relationship before the individual entered the United States;

(B) an individual from Canada or other foreign jurisdiction who is present in this State and whose transactions are in a self-directed tax advantaged retirement plan of which the individual is the holder or contributor in that foreign jurisdiction; or

(C) an individual who is present in this State, with whom the broker-dealer customer relationship arose while the individual was temporarily or permanently resident in Canada or the other foreign jurisdiction; and

(2) an agent who represents a broker-dealer that is exempt under this subsection to effect transactions in securities or attempt to effect the purchase or sale of securities in this State as permitted for a broker-dealer described in paragraph (1).

### Official Comments

**Prior Provisions:** 1956 Act Section 201; RUSA Sections 201-202.

1. "Broker-dealer" is defined in Section 102(4). The scope of the Section 401(a) reference "to transact business in this State" is specified in Section 610. "Transacts a business" has been held to mean "more than a trivial or *de minimis* business." *United States v. Schwartz*, 464 F.2d 499, 506 (2d Cir. 1972), *cert. denied*, 409 U.S. 1009 (1972).

2. Under Section 401(a) a person can be required to register as a securities broker-dealer only if the person transacts business in securities. See, e.g., *AMR Realty Co. v. State*, 373 A.2d 1002 (N.J. Supr. Ct. App. Div. 1977) (requirement that the transactions involve securities).

3. "Bona fide" is a much construed term particularly in the U.C.C. context. See, e.g., *MCC Proceeds, Inc. v. Advest, Inc.*, 743 N.Y.S.2d 1 (N.Y. A.D. 2002) (comparing bona fide to good faith standard).

4. Section 401(b)(1)(D) was added to provide relief in situations where a broker-dealer is accepting orders from a sophisticated financial professional who is making the investment decisions for its customers.

5. Under 401(b)(1)(E) and (F) preexisting customers must be bona fide. A principal place of residence, for example, normally would be the residence where the customer spends a majority of time. These exemptions were intended to facilitate ongoing broker-customer relationships with customers who have established a second or other residence for such purposes as a winter home (i.e. "snowbirds").

6. Section 401(c) prohibits a broker-dealer or issuer from employing or associating with an individual in a capacity for which that individual has been suspended by the administrator. Violation of this provision does not result in strict liability. In order for a broker-dealer or issuer to be liable, the broker-dealer or issuer must have known or should have known of the administrator's order to the individual suspended or barred. Cf. Comment 17 to Section 412.

7. Section 401(d) recognizes the increasingly transnational nature of securities brokerage and permits, if the administrator adopts a rule or order, transactions by a Canadian or a foreign broker-dealer with a person from Canada or other foreign jurisdiction who is resident in this State. This subsection is not self-executing and is effective only if the administrator adopts a rule or order.

8. To give effect to action taken by rule or order under Section 401(d), there must be a transaction registration exemption that will enable securities transactions to take place in customer accounts involving the broker-dealers and agents contemplated in Section 401(d). See Sections 202 and 203.

## **SECTION 402. AGENT REGISTRATION REQUIREMENT AND EXEMPTIONS.**

(a) **[Registration requirement.]** It is unlawful for an individual to transact business in this State as an agent unless the individual is registered under this [Act] as an agent or is exempt from registration as an agent under subsection (b).

(b) **[Exemptions from registration.]** The following individuals are exempt from the registration requirement of subsection (a):

(1) an individual who represents a broker-dealer in effecting transactions in this State limited to those described in Section 15(h)(2) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78(o)(2));

(2) an individual who represents a broker-dealer that is exempt under Section 401(b) or (d);

(3) an individual who represents an issuer with respect to an offer or sale of

the issuer's own securities or those of the issuer's parent or any of the issuer's subsidiaries, and who is not compensated in connection with the individual's participation by the payment of commissions or other remuneration based, directly or indirectly, on transactions in those securities;

(4) an individual who represents an issuer and who effects transactions in the issuer's securities exempted by Section 202, other than Section 202(11) and (14);

(5) an individual who represents an issuer that effects transactions solely in federal covered securities of the issuer, but an individual who effects transactions in a federal covered security under Section 18(b)(3) or 18(b)(4)(D) of the Securities Act of 1933 (15 U.S.C. Section 77r(b)(3) or 77r(b)(4)(D)) is not exempt if the individual is compensated in connection with the agent's participation by the payment of commissions or other remuneration based, directly or indirectly, on transactions in those securities;

(6) an individual who represents a broker-dealer registered in this State under Section 401(a) or exempt from registration under Section 401(b) in the offer and sale of securities for an account of a nonaffiliated federal covered investment adviser with investments under management in excess of \$100,000,000 acting for the account of others pursuant to discretionary authority in a signed record;

(7) an individual who represents an issuer in connection with the purchase of the issuer's own securities;

(8) an individual who represents an issuer and who restricts participation to performing clerical or ministerial acts; or

(9) any other individual exempted by rule adopted or order issued under this

[Act].

(c) **[Registration effective only while employed or associated.]** The registration of an agent is effective only while the agent is employed by or associated with a broker-dealer registered under this [Act] or an issuer that is offering, selling, or purchasing its securities in this State.

(d) **[Limit on employment or association.]** It is unlawful for a broker-dealer, or an issuer engaged in offering, selling, or purchasing securities in this State, to employ or associate with an agent who transacts business in this State on behalf of broker-dealers or issuers unless the agent is registered under subsection (a) or exempt from registration under subsection (b).

(e) **[Limit on affiliations.]** An individual may not act as an agent for more than one broker-dealer or one issuer at a time, unless the broker-dealer or the issuer for which the agent acts are affiliated by direct or indirect common control or are authorized by rule or order under this [Act].

### **Official Comments**

**Prior Provisions:** RUSA Sections 201-202.

1. "Agent" is defined in Section 102(2). The scope of the Section 402(a) reference to "transact business in this State" is specified in Section 610. An administrator may by rule or order take action under Section 401(d)(2) to address an agent.
2. An independent contractor must be either a broker-dealer or an agent if the individual transacts business as a broker-dealer or agent. There is no other status permitted under this Act for securities activities.
3. A broker-dealer in violation of Section 402(a) may be disciplined under Section 412 and be subject to a civil or administrative enforcement action under Section 603 or 604.
4. Under Sections 402(b)(3) and (5) an agent may be exempt if acting for an issuer and



receiving compensation (for example, as a corporate executive), as long as the compensation is not a commission or other remuneration based on transactions in the issuer's own securities. Such an agent could receive a salary with conventional benefits, including an annual bonus (related to his or her performance) as an executive, and still be within this exemption unless the agent is also being compensated directly or indirectly for participation in the specified securities transactions.

5. Section 402(b)(6) was added to provide relief in situations where an agent is accepting orders from a sophisticated financial professional who is making the investment decisions for its customers.

6. Ministerial or clerical acts in Section 402(b)(8) might include preparing routine written communications or responding to inquiries.

7. Section 402(e) limits agents to a single employment or affiliation unless a rule or order of the administrator authorizes multiple affiliations. In any event an agent must be registered, see Section 402(a), or exempt from registration, see Section 402(b). Registration is effective only while an agent is employed by or associated with a broker-dealer or an issuer. See Section 402(c).

### **SECTION 403. INVESTMENT ADVISER REGISTRATION REQUIREMENT AND EXEMPTIONS.**

(a) **[Registration requirement.]** It is unlawful for a person to transact business in this State as an investment adviser unless the person is registered under this [Act] as an investment adviser or is exempt from registration as an investment adviser under subsection (b).

(b) **[Exemptions from registration.]** The following persons are exempt from the registration requirement of subsection (a):

(1) a person without a place of business in this State that is registered under the securities act of the State in which the person has its principal place of business if its only clients in this State are:

(A) federal covered investment advisers, investment advisers registered under

this [Act], or broker-dealers registered under this [Act];

(B) institutional investors;

(C) bona fide preexisting clients whose principal places of residence are not in this State if the investment adviser is registered under the securities act of the State in which the clients maintain principal places of residence; or

(D) any other client exempted by rule adopted or order issued under this [Act];

(2) a person without a place of business in this State if the person has had, during the preceding 12 months, not more than five clients that are resident in this State in addition to those specified under paragraph (1); or

(3) any other person exempted by rule adopted or order issued under this [Act].

(c) **[Limits on employment or association.]** It is unlawful for an investment adviser, directly or indirectly, to employ or associate with an individual to engage in an activity related to investment advice in this State if the registration of the individual is suspended or revoked or the individual is barred from employment or association with an investment adviser, federal covered investment adviser, or broker-dealer by an order under this [Act], the Securities and Exchange Commission, or a self-regulatory organization, unless the investment adviser did not know, and in the exercise of reasonable care could not have known, of the suspension, revocation, or bar. Upon request from the investment adviser and for good cause, the administrator, by order, may waive, in whole or in part, the application of the prohibitions of this subsection to the investment adviser.

(d) **[Investment adviser representative registration required.]** It is unlawful for an investment adviser to employ or associate with an individual required to be registered under this

[Act] as an investment adviser representative who transacts business in this State on behalf of the investment adviser unless the individual is registered under Section 404(a) or is exempt from registration under Section 404(b).

### **Official Comments**

**Prior Provisions:** 1956 Act Section 201; RUSA Sections 203-204.

1. "Investment adviser" is defined in Section 102(15). The scope of the Section 403(a) reference to "transact business in this State" is specified in Section 610.

2. Excluded from the definition of investment adviser in Section 102(15)(C) is a broker-dealer who receives no special compensation for investment advisory services. Such a broker-dealer would not have to register as both a broker-dealer and investment adviser in this State. A broker-dealer that does receive special compensation, on the other hand, would also meet the statutory definition of investment adviser and would be required to register in both capacities.

3. Section 403(b)(2) is consistent with the National Securities Markets Improvement Act of 1996 which prohibits a State from regulating an investment adviser that does not have a place of business in this State and had fewer than six clients who were state residents during the preceding 12 months.

4. Section 403(c) prohibits an investment adviser from employing an individual who is prohibited from such employment or association by the administrator. Violation of this provision does not result in strict liability. To be liable the investment adviser must have known or should have known of the administrator's order to the individual suspended or barred.

### **SECTION 404. INVESTMENT ADVISER REPRESENTATIVE REGISTRATION REQUIREMENT AND EXEMPTIONS.**

(a) **[Registration requirement.]** It is unlawful for an individual to transact business in this State as an investment adviser representative unless the individual is registered under this [Act] as an investment adviser representative or is exempt from registration as an investment adviser under subsection (b).

(b) **[Exemptions from registration.]** The following individuals are exempt from the

registration requirement of subsection (a):

(1) an individual who is employed by or associated with an investment adviser that is exempt from registration under Section 403(b) or a federal covered investment adviser that is excluded from the notice filing requirements of Section 405; and

(2) any other individual exempted by rule adopted or order issued under this [Act].

(c) [**Registration effective only while employed or associated.**] The registration of an investment adviser representative is not effective while the investment adviser representative is not employed by or associated with an investment adviser registered under this [Act] or a federal covered investment adviser that has made or is required to make a notice filing under Section 405.

(d) [**Limit on affiliations.**] An individual may transact business as an investment adviser representative for more than one investment adviser or federal covered investment adviser unless a rule adopted or order issued under this [Act] prohibits or limits an individual from acting as an investment adviser representative for more than one investment adviser or federal covered investment adviser.

(e) [**Limits on employment or association.**] It is unlawful for an individual acting as an investment adviser representative, directly or indirectly, to conduct business in this State on behalf of an investment adviser or a federal covered investment adviser if the registration of the individual as an investment adviser representative is suspended or revoked or the individual is barred from employment or association with an investment adviser or a federal covered investment adviser by an order under this [Act], the Securities and Exchange Commission, or a self-regulatory organization. Upon request from a federal covered investment adviser and for

good cause, the administrator, by order issued, may waive, in whole or in part, the application of the requirements of this subsection to the federal covered investment adviser.

(f) **[Referral fees.]** An investment adviser registered under this [Act], a federal covered investment adviser that has filed a notice under Section 405, or a broker-dealer registered under this [Act] is not required to employ or associate with an individual as an investment adviser representative if the only compensation paid to the individual for a referral of investment advisory clients is paid to an investment adviser registered under this [Act], a federal covered investment adviser who has filed a notice under Section 405, or a broker-dealer registered under this [Act] with which the individual is employed or associated as an investment adviser representative.

### **Official Comments**

#### **No Prior Provision.**

1. "Investment adviser representative" is defined in Section 102(16). The scope of the Section 404(a) reference to "transacts business in this State" is specified in Section 610.

2. Neither the 1956 Act nor RUSA provided for the registration of investment adviser representatives. In recent years, however, the states increasingly have done so.

3. Under this Act a sole practitioner may register as an investment adviser. See Section 403. The Investment Adviser Registration Depository currently provides for entry of the legal name of the individual as the investment adviser and the entry of any name the individual is doing business under that is different from the individual's name. A sole practitioner is not required to register under Section 404 as an investment adviser representative, unless the administrator requires such registration.

4. Section 404(e) prohibits an investment adviser representative from association with a federal covered investment adviser when such association is prohibited by an order of the administrator. Unlike similar provisions in Sections 401 and 403, there is no culpability requirement that the investment adviser representative "knows or in the exercise of reasonable care should have known" of a suspension or bar because the order should be received by the investment adviser representative. As with Sections 401 and 403, the administrator may waive

this prohibition. Cf. Comment 17 to Section 412.

5. The administrator may adopt rules or orders under Section 404(f) in accordance with Section 605. The Securities and Exchange Commission has adopted a rule that addresses referral fees in Rule 206(4)-3 of the Investment Advisers Act of 1940.

6. For a state that intends to extend Section 404(f) to those broker-dealers and investment advisers who are not required to register and those federal covered investment advisers not required to file a notice, this subsection should read:

(f) **[Referral Fees.]** An investment adviser registered under this [Act], a federal covered investment adviser that has filed a notice under Section 405, or a broker-dealer registered under this [Act] is not required to employ or associate with an individual as an investment adviser representative if the only compensation paid to the individual for a referral of investment advisory clients is paid to an investment adviser registered under this [Act], or not required to register under this [Act], a federal covered investment who has filed a notice under Section 405 or is not required to file a notice under Section 405, or a broker-dealer registered under this [Act] or not required to register under this [Act] with which the individual is employed or associated as an investment adviser representative.

#### **SECTION 405. FEDERAL COVERED INVESTMENT ADVISER NOTICE FILING**

##### **REQUIREMENT.**

(a) **[Notice filing requirement.]** Except with respect to a federal covered investment adviser described in subsection (b), it is unlawful for a federal covered investment adviser to transact business in this State as a federal covered investment adviser unless the federal covered investment adviser complies with subsection (c).

(b) **[Notice filing requirement not required.]** The following federal covered investment advisers are not required to comply with subsection (c):

(1) a federal covered investment adviser without a place of business in this State if its only clients in this State are:

(A) federal covered investment advisers, investment advisers registered under

this [Act], and broker-dealers registered under this [Act];

(B) institutional investors;

(C) bona fide preexisting clients whose principal places of residence are not in this State; or

(D) other clients specified by rule adopted or order issued under this [Act];

(2) a federal covered investment adviser without a place of business in this State if the person has had, during the preceding 12 months, not more than five clients that are resident in this State in addition to those specified under paragraph (1); and

(3) any other person excluded by rule adopted or order issued under this [Act].

(c) **[Notice filing procedure.]** A person acting as a federal covered investment adviser, not excluded under subsection (b), shall file a notice, a consent to service of process complying with Section 611, and such records as have been filed with the Securities and Exchange Commission under the Investment Advisers Act of 1940 required by rule adopted or order issued under this [Act] and pay the fees specified in Section 410(e).

(d) **[Effectiveness of filing.]** The notice under subsection (c) becomes effective upon its filing.

### **Official Comments**

#### **No Prior Provision.**

1. "Federal covered investment adviser" is defined in Section 102(6). The scope of the Section 405(a) reference to "transacts business in this State" is specified in Section 610.

2. Section 405(b)(2) is necessitated by the National Securities Markets Improvement Act of 1996 and is intended to coordinate this Act with the Investment Advisers Act of 1940.

3. Section 404(c) provides limits on those who can be employed by or associated with a federal covered investment adviser.

4. The succession provision of Section 407(a) is available to a federal covered investment adviser who has filed a notice under Section 405.

**SECTION 406. REGISTRATION BY BROKER-DEALER, AGENT, INVESTMENT ADVISER, AND INVESTMENT ADVISER REPRESENTATIVE.**

(a) [**Application for initial registration.**] A person shall register as a broker-dealer, agent, investment adviser, or investment adviser representative by filing an application and a consent to service of process complying with Section 611, and paying the fee specified in Section 410 and any reasonable fees charged by the designee of the administrator for processing the filing. The application must contain:

- (1) the information or record required for the filing of a uniform application; and
- (2) upon request by the administrator, any other financial or other information or record that the administrator determines is appropriate.

(b) [**Amendment.**] If the information or record contained in an application filed under subsection (a) is or becomes inaccurate or incomplete in a material respect, the registrant shall promptly file a correcting amendment.

(c) [**Effectiveness of registration.**] If an order is not in effect and a proceeding is not pending under Section 412, registration becomes effective at noon on the 45th day after a completed application is filed, unless the registration is denied. A rule adopted or order issued under this [Act] may set an earlier effective date or may defer the effective date until noon on the 45th day after the filing of any amendment completing the application.

(d) [**Registration renewal.**] A registration is effective until midnight on December 31 of



the year for which the application for registration is filed. Unless an order is in effect under Section 412, a registration may be automatically renewed each year by filing such records as are required by rule adopted or order issued under this [Act], by paying the fee specified in Section 410, and by paying costs charged by the designee of the administrator for processing the filings.

(e) **[Additional conditions or waivers.]** A rule adopted or order issued under this [Act] may impose such other conditions, not inconsistent with the National Securities Markets Improvement Act of 1996. An order issued under this [Act] may waive, in whole or in part, specific requirements in connection with registration as are in the public interest and for the protection of investors.

#### **Official Comments**

**Prior Provisions:** 1956 Act Section 202; RUSA Sections 205, 208.

1. Under Section 406(a), the administrator is authorized to accept standardized forms such as Form B-D for broker-dealers; Form U-4 for agents and investment adviser representatives; and Form ADV for investment advisers, which are filed today through such designees as the Web-CRD or the Investment Adviser Registration Depository (IARD). While this Act generally encourages uniformity, Sections 406(a) and (e) are intended to give the administrator authority to augment or waive disclosure requirements in appropriate cases.

2. Section 406(a) eliminates the listing of specified information delineated in Section 202 of the 1956 Act. As with RUSA Section 205, the intent is to facilitate coordination with widely used standardized forms.

3. Under this Act a single person may act both as an agent and investment adviser representative if the person satisfies applicable registration requirements to be both an agent and investment adviser representative.

#### **SECTION 407. SUCCESSION AND CHANGE IN REGISTRATION OF BROKER-DEALER OR INVESTMENT ADVISER.**

(a) **[Succession.]** A broker-dealer or investment adviser may succeed to the current

registration of another broker-dealer or investment adviser or a notice filing of a federal covered investment adviser, and a federal covered investment adviser may succeed to the current registration of an investment adviser or notice filing of another federal covered investment adviser, by filing as a successor an application for registration pursuant to Section 401 or 403 or a notice pursuant to Section 405 for the unexpired portion of the current registration or notice filing.

(b) [**Organizational change.**] A broker-dealer or investment adviser that changes its form of organization or State of incorporation or organization may continue its registration by filing an amendment to its registration if the change does not involve a material change in its financial condition or management. The amendment becomes effective when filed or on a date designated by the registrant in its filing. The new organization is a successor to the original registrant for the purposes of this [Act]. If there is a material change in financial condition or management, the broker-dealer or investment adviser shall file a new application for registration. A predecessor registered under this [Act] shall stop conducting its securities business other than winding down transactions and shall file for withdrawal of broker-dealer or investment adviser registration within 45 days after filing its amendment to effect succession.

(c) [**Name change.**] A broker-dealer or investment adviser that changes its name may continue its registration by filing an amendment to its registration. The amendment becomes effective when filed or on a date designated by the registrant.

(d) [**Change of control.**] A change of control of a broker-dealer or investment adviser may be made in accordance with a rule adopted or order issued under this [Act].

#### **Official Comments**

**Prior Provisions:** 1956 Act Section 202(c); RUSA 210.

1. Section 407 is intended to avoid unnecessary interruptions of business by specifying procedures for a successor broker-dealer or investment adviser; a broker-dealer or investment adviser to maintain its registration if it changes its form of organization or name; or, in accordance with a rule or order adopted under this Act, a change of control of a broker-dealer or investment adviser.

2. There is no filing fee under Section 407.

**SECTION 408. TERMINATION OF EMPLOYMENT OR ASSOCIATION OF AGENT AND INVESTMENT ADVISER REPRESENTATIVE AND TRANSFER OF EMPLOYMENT OR ASSOCIATION.**

(a) **[Notice of termination.]** If an agent registered under this [Act] terminates employment by or association with a broker-dealer or issuer, or if an investment adviser representative registered under this [Act] terminates employment by or association with an investment adviser or federal covered investment adviser, or if either registrant terminates activities that require registration as an agent or investment adviser representative, the broker-dealer, issuer, investment adviser, or federal covered investment adviser shall promptly file a notice of termination. If the registrant learns that the broker-dealer, issuer, investment adviser, or federal covered investment adviser has not filed the notice, the registrant may do so.

(b) **[Transfer of employment or association.]** If an agent registered under this [Act] terminates employment by or association with a broker-dealer registered under this [Act] and begins employment by or association with another broker-dealer registered under this [Act]; or if an investment adviser representative registered under this [Act] terminates employment by or association with an investment adviser registered under this [Act] or a federal covered

investment adviser that has filed a notice under Section 405 and begins employment by or association with another investment adviser registered under this [Act] or a federal covered investment adviser that has filed a notice under Section 405; then upon the filing by or on behalf of the registrant, within 30 days after the termination, of an application for registration that complies with the requirement of Section 406(a) and payment of the filing fee required under Section 410, the registration of the agent or investment adviser representative is:

(1) immediately effective as of the date of the completed filing, if the agent's Central Registration Depository record or successor record or the investment adviser representative's Investment Adviser Registration Depository record or successor record does not contain a new or amended disciplinary disclosure within the previous 12 months; or

(2) temporarily effective as of the date of the completed filing, if the agent's Central Registration Depository record or successor record or the investment adviser representative's Investment Adviser Registration Depository record or successor record contains a new or amended disciplinary disclosure within the preceding 12 months.

(c) **[Withdrawal of temporary registration.]** The administrator may withdraw a temporary registration if there are or were grounds for discipline as specified in Section 412 and the administrator does so within 30 days after the filing of the application. If the administrator does not withdraw the temporary registration within the 30 day period, registration becomes automatically effective on the 31st day after filing.

(d) **[Power to prevent registration.]** The administrator may prevent the effectiveness of a transfer of an agent or investment adviser representative under subsection (b)(1) or (2) based on the public interest and the protection of investors.

(e) [Termination of registration or application for registration.] If the administrator determines that a registrant or applicant for registration is no longer in existence or has ceased to act as a broker-dealer, agent, investment adviser, or investment adviser representative, or is the subject of an adjudication of incapacity or is subject to the control of a committee, conservator, or guardian, or cannot reasonably be located, a rule adopted or order issued under this [Act] may require the registration be canceled or terminated or the application denied. The administrator may reinstate a canceled or terminated registration, with or without hearing, and may make the registration retroactive.

#### Official Comments

**Prior Provision:** 1956 Act Section 204(d).

1. Under Sections 402(c) and 404(c) registration of an agent or investment adviser representative is effective only while the agent or investment adviser representative is employed by or associated with a broker-dealer, issuer, or investment adviser, as may be the case. Section 408(a) specifies a procedure to inform the administrator of a notice of termination.

2. To expedite transfer to a new broker-dealer or investment adviser, Section 408(b) provides a procedure by which agents or investment adviser representative registration will be effective immediately as of the date of new employment when there is no new or added disciplinary disclosure in the relevant Central Research Depository or Investment Adviser Registration Depository records. Both electronic systems are currently administered by the National Association of Securities Dealers. Section 408(d) is intended to ensure that the administrator has the authority to prevent immediate effectiveness in appropriate cases.

**SECTION 409. WITHDRAWAL OF REGISTRATION OF BROKER-DEALER,  
AGENT, INVESTMENT ADVISER, AND INVESTMENT ADVISER**

**REPRESENTATIVE.** Withdrawal of registration by a broker-dealer, agent, investment adviser, or investment adviser representative becomes effective 60 days after the filing of the application to withdraw or within any shorter period as provided by rule adopted or order issued under this [Act] unless a revocation or suspension proceeding is pending when the application is filed. If a proceeding is pending, withdrawal becomes effective when and upon such conditions as required by rule adopted or order issued under this [Act]. The administrator may institute a revocation or suspension proceeding under Section 412 within one year after the withdrawal became effective automatically and issue a revocation or suspension order as of the last date on which registration was effective if a proceeding is not pending.

**Official Comments**

**Prior Provisions:** 1956 Act Section 204(e); RUSA Section 214

1. This section generally follows the 1956 Act Section 204(e) and RUSA Section 214. This section does not affect any applicant's privilege of withdrawal of an application from registration before the registration becomes effective. It is simply designed to prevent withdrawal of an effective registration under fire. The last sentence preserves the ability of the administrator to initiate an action under Section 412 when the administrator does not know of a reason to object to withdrawal until after withdrawal has become effective.

2. Ordinarily today a registrant will file a standardized form such as Form U-5, BD-W or ADV-W to withdraw registration.

**SECTION 410. FILING FEES.**

(a) [**Broker-dealers.**] A person shall pay a fee of \$[ ] when initially filing an application for registration as a broker-dealer and a fee of \$[ ] when filing a renewal of

registration as a broker-dealer. If the filing results in a denial or withdrawal, the administrator shall retain \$[ ] of the fee.

(b) [**Agents.**] The fee for an individual is \$[ ] when filing an application for registration as an agent, a fee of \$[ ] when filing a renewal of registration as an agent, and a fee of \$[ ] when filing for a change of registration as an agent. If the filing results in a denial or withdrawal, the administrator shall retain \$[ ] of the fee.

(c) [**Investment advisers.**] A person shall pay a fee of \$[ ] when filing an application for registration as an investment adviser and a fee of \$[ ] when filing a renewal of registration as an investment adviser. If the filing results in a denial or withdrawal, the administrator shall retain \$[ ] of the fee.

(d) [**Investment adviser representatives.**] The fee for an individual is \$[ ] when filing an application for registration as an investment adviser representative, a fee of \$[ ] when filing a renewal of registration as an investment adviser representative, and a fee of \$[ ] when filing a change of registration as an investment adviser representative. If the filing results in a denial or withdrawal, the administrator shall retain \$[ ] of the fee.

(e) [**Federal covered investment advisers.**] A federal covered investment adviser required to file a notice under Section 405 shall pay an initial fee of \$[ ] and an annual notice fee of \$[ ].

(f) [**Payment.**] A person required to pay a filing or notice fee under this section may transmit the fee through or to a designee as a rule or order provides under this [Act].

(g) [**Dual agent/investment adviser representative.**] An investment adviser representative who is registered as an agent under Section 402 and who represents a person that

is both registered as a broker-dealer under Section 401 and registered as an investment adviser under Section 403 or required as a federal covered investment adviser to make a notice filing under Section 405 is not required to pay an initial or annual registration fee for registration as an investment adviser representative.]

### Official Comments

**Prior Provisions:** 1956 Act Section 202(b); RUSA Section 206.

1. Each state should determine the appropriate fee for each type of registration and for each type of renewal, denial, or withdrawal of a registration.
2. Similarly each state should determine whether it wishes to remove the brackets from Section 410(g) and charge a single fee for dually registered agents and investment adviser representatives.
3. If a State prefers to have the fees in this section established by rule, amend this section to read as follows, inserting the appropriate reference to the State's administrative procedure act:

#### **[SECTION 410. FILING FEES.**

(a) **[Fee established by administrator.]** The administrator shall establish fees by rule pursuant to the [state administrative procedure act] for:

(1) an initial filing of an application as a broker-dealer and renewal of an application by a broker-dealer for registration, but, if the filing results in a denial or withdrawal, the administrator shall retain an amount of the fee established by the administrator;

(2) an application for registration as an agent and renewal of registration as an agent, but, if the filing results in a denial or withdrawal, the administrator shall retain an amount of the fee established by the administrator;

(3) an application for registration as an investment adviser and renewal of registration as an investment adviser, but, if the filing results in a denial or withdrawal, the administrator shall retain an amount of the fee established by the administrator.

(4) an application for registration as an investment adviser representative, a renewal of registration as an investment adviser representative, and a change of registration as an investment adviser representative, but, if the filing results in a denial or withdrawal, the administrator shall retain an amount of the fee established by the administrator; and

(5) an initial fee and annual notice fee for a federal covered investment adviser required to file a notice under Section 405.

(b) **[Payment.]** A person required to pay a filing or notice fee under this section may transmit the fee through or to a designee as a rule or order provides under this [Act].



**[(c) [Dual agent/investment adviser representative.]** An investment adviser representative who is registered as an agent under Section 402 and who represents a person that is both registered as a broker-dealer under Section 401 and registered as an investment adviser under Section 403 or required as a federal covered investment adviser to make a notice filing under Section 405 is not required to pay an initial or annual registration fee for registration as an investment adviser representative.]

#### **SECTION 411. POSTREGISTRATION REQUIREMENTS.**

(a) **[Financial requirements.]** Subject to Section 15(h) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78o(h)) or Section 222 of the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-22), a rule adopted or order issued under this [Act] may establish minimum financial requirements for broker-dealers registered or required to be registered under this [Act] and investment advisers registered or required to be registered under this [Act].

(b) **[Financial reports.]** Subject to Section 15(h) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78o(h)) or Section 222(b) of the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-22), a broker-dealer registered or required to be registered under this [Act] and an investment adviser registered or required to be registered under this [Act] shall file such financial reports as are required by a rule adopted or order issued under this [Act]. If the information contained in a record filed under this subsection is or becomes inaccurate or incomplete in a material respect, the registrant shall promptly file a correcting amendment.

(c) **[Recordkeeping.]** Subject to Section 15(h) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78o(h)) or Section 222 of the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-22):

(1) a broker-dealer registered or required to be registered under this [Act] and an investment adviser registered or required to be registered under this [Act] shall make and

maintain the accounts, correspondence, memoranda, papers, books, and other records required by rule adopted or order issued under this [Act];

(2) broker-dealer records required to be maintained under paragraph (1) may be maintained in any form of data storage acceptable under Section 17(a) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78q(a)) if they are readily accessible to the administrator; and

(3) investment adviser records required to be maintained under paragraph (1) may be maintained in any form of data storage required by rule adopted or order issued under this [Act].

(d) **[Audits or inspections.]** The records of a broker-dealer registered or required to be registered under this [Act] and of an investment adviser registered or required to be registered under this [Act] are subject to such reasonable periodic, special, or other audits or inspections by a representative of the administrator, within or without this State, as the administrator considers necessary or appropriate in the public interest and for the protection of investors. An audit or inspection may be made at any time and without prior notice. The administrator may copy, and remove for audit or inspection copies of, all records the administrator reasonably considers necessary or appropriate to conduct the audit or inspection. The administrator may assess a reasonable charge for conducting an audit or inspection under this subsection.

(e) **[Custody and discretionary authority bond or insurance.]** Subject to Section 15(h) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78o(h)) or Section 222 of the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-22), a rule adopted or order issued under this [Act] may require a broker-dealer or investment adviser that has custody of or discretionary authority over funds or securities of a customer or client to obtain insurance or

post a bond or other satisfactory form of security in an amount not to exceed \$[\_\_\_\_]. The administrator may determine the requirements of the insurance, bond, or other satisfactory form of security. Insurance or a bond or other satisfactory form of security may not be required of a broker-dealer registered under this [Act] whose net capital exceeds, or of an investment adviser registered under this [Act] whose minimum financial requirements exceed, the amounts required by rule or order under this [Act]. The insurance, bond, or other satisfactory form of security must permit an action by a person to enforce any liability on the insurance, bond, or other satisfactory form of security if instituted within the time limitations in Section 509(j)(2).

(f) **[Requirements for custody.]** Subject to Section 15(h) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78o(h)) or Section 222 of the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-22), an agent may not have custody of funds or securities of a customer except under the supervision of a broker-dealer and an investment adviser representative may not have custody of funds or securities of a client except under the supervision of an investment adviser or a federal covered investment adviser. A rule adopted or order issued under this [Act] may prohibit, limit, or impose conditions on a broker-dealer regarding custody of funds or securities of a customer and on an investment adviser regarding custody of securities or funds of a client.

(g) **[Investment adviser brochure rule.]** With respect to an investment adviser registered or required to be registered under this [Act], a rule adopted or order issued under this [Act] may require that information or other record be furnished or disseminated to clients or prospective clients in this State as necessary or appropriate in the public interest and for the protection of investors and advisory clients.

(h) [Continuing education.] A rule adopted or order issued under this [Act] may require an individual registered under Section 402 or 404 to participate in a continuing education program approved by the Securities and Exchange Commission and administered by a self-regulatory organization or, in the absence of such a program, a rule adopted or order issued under this [Act] may require continuing education for an individual registered under Section 404.

### Official Comments

**Prior Provisions:** 1956 Act Sections 102(c), 202(d) and (e) and 203; RUSA Sections 209, 211 and 215.

1. Sections 411(a) through (c) and (e) through (f) implicitly refer to “capital, custody, margin, financial responsibility, making and keeping records, bonding, or financial or operational reporting requirements.” Under the National Securities Markets Improvement Act of 1996, States may not impose such requirements on covered broker-dealers and investment advisers greater than those specified in Section 15(h) of the Securities Exchange Act of 1934 and Section 222 of the Investment Advisors Act of 1940.

2. Minimum financial requirements must be maintained during the entire time a person is registered and not merely at the time of the registration. See, e.g., *National Grange Mut. Ins. Co. v. Prioleau*, 236 S.E.2d 808 (S.C. 1977) (continuing bond requirement); *Ridgeway, McLeod & Assoc.*, 281 A.2d 390 (N.J. Super. Ct. App. Div. 1971) (continuing minimum capital requirement).

3. The duty in Section 411(b) to correct or update information is limited to material information which a reasonable investor would continue to consider important in deciding whether to purchase or sell securities. Cf. *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 444-450 (1970); Securities Act Release No. 6084, 17 SEC Dock. 1048, 1054 (1979) (“persons are continuing to rely on all or any material portion of the statements”).

4. Section 411(c)(1) authorizes the administrator to require all records to be preserved for the period the administrator prescribes by rule or order.

5. Rule 17a-4 is the current rule under Section 17(a) of the Securities Exchange Act referred to in Section 411(c)(2) that addresses acceptable forms of data storage.

6. The administrator’s power to copy and examine records in Section 411(d) is subject to all applicable privileges. See, e.g., 10 Louis Loss & Joel Seligman, *Securities Regulation* 4921-

4925 n.69 (3d ed. rev. 1996). The power in Section 411(d) to conduct audits or inspections is distinguishable from the administrator's enforcement powers under Section 602. No subpoena is necessary under Section 411(d). Failure to submit to a reasonable audit or inspection is a violation of this Act which may result in an action by the administrator under Section 412(d)(8), a criminal prosecution under Section 508, or an injunction under Section 603. An unreasonable audit, inspection or demand for information or documents would be subject to challenge in an appropriate court.

7. Section 411(f) broadens 1956 Act Section 102(c) and RUSA Section 215 to apply to agents as well as investment adviser representatives. Subject to Section 15(h) of the Securities Exchange Act of 1934 and Section 222 of the Investment Adviser Act of 1940, the administrator is given broad authority to prohibit, limit, or condition custody arrangements.

8. Section 411(g) parallels Rule 204-3, adopted under the Investment Advisers Act of 1940, popularly known as the brochure rule, which authorizes the SEC to require dissemination to investment adviser clients of specified information about the investment adviser and investment advice.

## **SECTION 412. DENIAL, REVOCATION, SUSPENSION, WITHDRAWAL, RESTRICTION, CONDITION, OR LIMITATION OF REGISTRATION.**

(a) **[Disciplinary conditions-applicants.]** If the administrator finds that the order is in the public interest and subsection (d) authorizes the action, an order issued under this [Act] may deny an application, or may condition or limit registration: (1) of an applicant to be a broker-dealer, agent, investment adviser, or investment adviser representative, and (2) if the applicant is a broker-dealer or investment adviser, of any partner, officer, director, person having a similar status or performing similar functions, or person directly or indirectly controlling the broker-dealer or investment adviser.

(b) **[Disciplinary conditions – registrants.]** If the administrator finds that the order is in the public interest and subsection (d) authorizes the action an order issued under this [Act] may revoke, suspend, condition, or limit the registration of a registrant and if the registrant is a

broker-dealer or investment adviser, any partner, officer, or director, any person having a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer or investment adviser. However, the administrator

(1) may not institute a revocation or suspension proceeding under this subsection based on an order issued by another State that is reported to the administrator or designee later than one year after the date of the order on which it is based; and

(2) under subsection (d)(5)(A) and (B), may not issue an order on the basis of an order under the state securities act of another State unless the other order was based on conduct for which subsection (d) would authorize the action had the conduct occurred in this State.

(c) **[Disciplinary penalties – registrants.]** If the administrator finds that the order is in the public interest and subsection (d)(1) through (6), (8), (9), (10), or (12) and (13) authorizes the action, an order under this [Act] may censure, impose a bar, or impose a civil penalty in an amount not to exceed a maximum of \$[ ] for a single violation or \$[ ] for several violations on a registrant and if the registrant is a broker-dealer or investment adviser, any partner, officer, or director, any person having similar functions or any person directly or indirectly controlling the broker-dealer or investment adviser.

(d) **[Grounds for discipline.]** A person may be disciplined under subsections (a) through (c) if the person:

(1) has filed an application for registration in this State under this [Act] or the predecessor act within the previous 10 years, which, as of the effective date of registration or as of any date after filing in the case of an order denying effectiveness, was incomplete in any material respect or contained a statement that, in light of the circumstances under which it was

made, was false or misleading with respect to a material fact;

(2) willfully violated or willfully failed to comply with this [Act] or the predecessor act or a rule adopted or order issued under this [Act] or the predecessor act within the previous 10 years;

(3) has been convicted of a felony or within the previous 10 years has been convicted of a misdemeanor involving a security, a commodity future or option contract, or an aspect of a business involving securities, commodities, investments, franchises, insurance, banking, or finance;

(4) is enjoined or restrained by a court of competent jurisdiction in an action instituted by the administrator under this [Act] or the predecessor act, a State, the Securities and Exchange Commission, or the United States from engaging in or continuing an act, practice, or course of business involving an aspect of a business involving securities, commodities, investments, franchises, insurance, banking, or finance;

(5) is the subject of an order, issued after notice and opportunity for hearing by:

(A) the securities, depository institution, insurance, or other financial services regulator of a State or by the Securities and Exchange Commission or other federal agency denying, revoking, barring, or suspending registration as a broker-dealer, agent, investment adviser, federal covered investment adviser, or investment adviser representative;

(B) the securities regulator of a State or by the Securities and Exchange Commission against a broker-dealer, agent, investment adviser, investment adviser representative, or federal covered investment adviser;

(C) the Securities and Exchange Commission or by a self-regulatory organization

suspending or expelling the registrant from membership in the self-regulatory organization;

(D) a court adjudicating a United States Postal Service fraud order;

(E) the insurance regulator of a State denying, suspending, or revoking the registration of an insurance agent; or

(F) a depository institution regulator suspending or barring a person from the depository institution business;

(6) is the subject of an adjudication or determination, after notice and opportunity for hearing, by the Securities and Exchange Commission, the Commodity Futures Trading Commission; the Federal Trade Commission; a federal depository institution regulator, or a depository institution, insurance, or other financial services regulator of a State that the person willfully violated the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, the Investment Company Act of 1940, or the Commodity Exchange Act, the securities or commodities law of a State, or a federal or state law under which a business involving investments, franchises, insurance, banking, or finance is regulated;

(7) is insolvent, either because the person's liabilities exceed the person's assets or because the person cannot meet the person's obligations as they mature, but the administrator may not enter an order against an applicant or registrant under this paragraph without a finding of insolvency as to the applicant or registrant;

(8) refuses to allow or otherwise impedes the administrator from conducting an audit or inspection under Section 411(d) or refuses access to a registrant's office to conduct an audit or inspection under Section 411(d);

(9) has failed to reasonably supervise an agent, investment adviser representative, or



other individual, if the agent, investment adviser representative, or other individual was subject to the person's supervision and committed a violation of this [Act] or the predecessor act or a rule adopted or order issued under this [Act] or the predecessor act within the previous 10 years;

(10) has not paid the proper filing fee within 30 days after having been notified by the administrator of a deficiency, but the administrator shall vacate an order under this paragraph when the deficiency is corrected;

(11) after notice and opportunity for a hearing, has been found within the previous 10 years:

(A) by a court of competent jurisdiction to have willfully violated the laws of a foreign jurisdiction under which the business of securities, commodities, investment, franchises, insurance, banking, or finance is regulated;

(B) to have been the subject of an order of a securities regulator of a foreign jurisdiction denying, revoking, or suspending the right to engage in the business of securities as a broker-dealer, agent, investment adviser, investment adviser representative, or similar person; or

(C) to have been suspended or expelled from membership by or participation in a securities exchange or securities association operating under the securities laws of a foreign jurisdiction;

(12) is the subject of a cease and desist order issued by the Securities and Exchange Commission or issued under the securities, commodities, investment, franchise, banking, finance, or insurance laws of a State;

(13) has engaged in dishonest or unethical practices in the securities, commodities, investment, franchise, banking, finance, or insurance business within the previous 10 years; or

(14) is not qualified on the basis of factors such as training, experience, and knowledge of the securities business. However, in the case of an application by an agent for a broker-dealer that is a member of a self-regulatory organization or by an individual for registration as an investment adviser representative, a denial order may not be based on this paragraph if the individual has successfully completed all examinations required by subsection (e). The administrator may require an applicant for registration under Section 402 or 404 who has not been registered in a State within the two years preceding the filing of an application in this State to successfully complete an examination.

(e) **[Examinations.]** A rule adopted or order issued under this [Act] may require that an examination, including an examination developed or approved by an organization of securities regulators, be successfully completed by a class of individuals or all individuals. An order issued under this [Act] may waive, in whole or in part, an examination as to an individual and a rule adopted under this [Act] may waive, in whole or in part, an examination as to a class of individuals if the administrator determines that the examination is not necessary or appropriate in the public interest and for the protection of investors.

(f) **[Summary process.]** The administrator may suspend or deny an application summarily; restrict, condition, limit, or suspend a registration; or censure, bar, or impose a civil penalty on a registrant before final determination of an administrative proceeding. Upon the issuance of an order, the administrator shall promptly notify each person subject to the order that the order has been issued, the reasons for the action, and that within 15 days after the receipt of a request in a record from the person the matter will be scheduled for a hearing. If a hearing is not requested and none is ordered by the administrator within 30 days after the date of service of the

order, the order becomes final by operation of law. If a hearing is requested or ordered, the administrator, after notice of and opportunity for hearing to each person subject to the order, may modify or vacate the order or extend the order until final determination.

(g) [**Procedural requirements.**] An order issued may not be issued under this section, except under subsection (f), without:

- (1) appropriate notice to the applicant or registrant;
- (2) opportunity for hearing; and
- (3) findings of fact and conclusions of law in a record [in accordance with the state administrative procedure act].

(h) [**Control person liability.**] A person that controls, directly or indirectly, a person not in compliance with this section may be disciplined by order of the administrator under subsections (a) through (c) to the same extent as the noncomplying person, unless the controlling person did not know, and in the exercise of reasonable care could not have known, of the existence of conduct that is a ground for discipline under this section.

(i) [**Limit on investigation or proceeding.**] The administrator may not institute a proceeding under subsection(a), (b), or (c) based solely on material facts actually known by the administrator unless an investigation or the proceeding is instituted within one year after the administrator actually acquires knowledge of the material facts.

#### **Official Comments**

**Prior Provisions:** 1956 Act Section 204; RUSA Sections 207, 212-213.

1. Section 412 generally follows Section 204 of the 1956 Act and Sections 207 and 212-213 of RUSA, but has been modified to reflect subsequent developments that have broadened the scope and remedies of counterpart federal and state statutes.

2. Section 412 authorizes the administrator to seek a sanction based on the seriousness of the misconduct. Under Section 412 the administrator must prove that the denial, revocation, suspension, cancellation, withdrawal, restriction, condition, or limitation both is (1) in the public interest and (2) involves one of the enumerated grounds in Section 412(d). See, e.g., *Mayflower Sec. Co., Inc. v. Bureau of Sec.*, 312 A.2d 497 (N.J. 1973). The "public interest" is a much litigated concept that has come to have settled meanings. See generally 6 L. Loss & J. Seligman, *Securities Regulation* 3103.5-3103.18 (3d ed. rev. 2002) (under federal securities laws). The public interest will not require imposition of a sanction for every minor or technical violation of subsection (d).

3. The term "foreign" means a jurisdiction outside of the United States, not a different state within the United States.

4. Section 412(a) through (c) authorizes the administrator to proceed against an entire firm, regardless of whether the administrator proceeds against any individual, when an individual partner, officer, or director or person occupying a similar status or performing similar functions, or a controlling person is disciplined under subsection (d), but only if proceeding against the entire firm is in the public interest. The discipline of such an individual may not automatically be used against a broker-dealer or investment adviser. When, however, there is a failure to reasonably supervise, see Section 412(d)(9) or control person liability, see Section 412(h), the administrator is empowered to proceed against a firm in an appropriate case. In Section 412, "any partner, officer, or director, any person occupying a similar status or performing similar function." can include a branch manager, assistant branch manager, or other supervisor.

5. In Section 412(d)(1) the completeness and accuracy of an effective application for registration is tested as of the appropriate effective date. An application that becomes incomplete or inaccurate after its effective date is not a ground for discipline under paragraph (d)(1). In an appropriate case, an action might be available under paragraph (d)(2) and Section 406(b). On the other hand, in a proceeding to deny effectiveness to a pending application for registration, the completeness and accuracy of the application is not limited to the effective date and can be judged on any date after filing.

6. The term "willfully" in Section 412(d)(2) and (11)(A) is discussed in Comment 2 to Section 508.

7. There is no time limit or statute of limitations on felony convictions in Section 412(d)(3) as a ground for disciplinary action.

8. The present tense of the verb "is" in Sections 412(d)(4) through (6) and (12) means that an injunction, order, adjudication, or determination that has expired or been vacated is no longer a ground for discipline.

9. In Sections 412(d)(5) and (6) the administrator is not required to prove the

validity of the ground which led to the earlier disciplinary order.

10. Under Section 412(d)(7) the administrator may not proceed against a broker-dealer or investment adviser firm on the basis of the insolvency of a partner, officer, director, controlling person or other person specified in subsection (b), unless it is a sole proprietorship.

11. Section 412(d)(8) can be violated by a refusal to cooperate with an administrator's reasonable audit or inspection, including by withholding or concealing records, refusing to furnish required records, or refusing the administrator reasonable access to any office or location within an office to conduct an audit or inspection under this Act. However, a request by a person subject to an audit or inspection for a reasonable delay to obtain assistance of counsel does not constitute a violation of Section 412(d)(8).

12. The term "failed to supervise reasonably" in Section 412(d)(9) includes not having reasonable supervisory procedures in place as well as a proper system of supervision and internal control. Cf. *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564 (9th Cir. 1990), *cert. denied*, 499 U.S. 976 (1991). Section 15(b)(4)(E) of the Securities Exchange Act of 1934 similarly addresses "failure to supervise reasonably." See 6 Louis Loss & Joel Seligman, *Securities Regulation* 3097-3101 (3d ed. rev. 2002).

13. The term "dishonest and unethical practices" in Section 412(d)(13) has been held not to be unconstitutionally vague. See, e.g., *Brewster v. Maryland Sec. Comm'n*, 548 A.2d 157, 160 (M.D. Ct. Spec. App. 1988) ("a broad statutory standard is not vague if it has a meaningful referent in business practice, custom or usage"); *Johnson-Bowles Co. v. Division of Sec.*, 829 P.2d 101, 114 (Utah Ct. App. 1992) (such legislative language bespeaks a legislative intent to delegate the interpretation of what constitutes "dishonest and unethical practices" in the securities industry to the administrator). Ministerial or clerical violations of a statute or rule, if immaterial and occurring without intent or recklessness, typically would not constitute dishonest or unethical practices.

14. Under the counterparts to Section 412(d)(14) and (e) applicants to become agents of broker-dealers typically take standardized tests administered by the National Association of Securities Dealers, Inc.

15. Sections 412(f) and (g) amplify the earlier procedures found in Section 204(f) of the 1956 Act and are intended to facilitate summary disciplinary proceedings, when these are appropriate.

16. Section 412(i) parallels the language of Section 204 of the 1956 Act and Section 212(b) of RUSA with some significant changes. The time period in which the administrator can act has been extended to one year from 30 days in the 1956 Act and 90 days in RUSA. The limitation on instituting a proceeding can also be tolled by instituting a formal investigation.

The addition of the word "solely" is intended to make it clear that an administrator may consider the prior history of an applicant or registrant even if that prior history had been known to the administrator for more than one year if there are additional material facts which are actually known to the administrator within the last year.

17. "Actually known" in Section 412(i) is used to signify that the mere filing of material facts in the Central Registration Depository or Investment Advisory Registration Depository systems does not constitute actual knowledge, unless that information was received by the administrator, or, but for a decision by the administrator, would have been received by the administrator.