CR 85-120

CERTIFICATE

STATE OF WISCONSIN)
OFFICE OF THE) ss.
COMMISSIONER OF SECURITIES)

TO ALL TO WHOM THESE PRESENT SHALL COME, GREETINGS:

I, Ulice Payne, Jr., Commissioner of the State of Wisconsin Office of the Commissioner of Securities and custodian of the official records of said agency, do hereby certify that the annexed rules relating to the operation of Chapters 551 and 553, Stats., with respect to securities and franchise registration exemptions; securities registration standards, requirements and procedures; securities broker-dealer and agency licensing requirements and procedures; and securities and franchise examination fees, were duly approved and adopted by this agency on December 2, 1985.

I further certify that said copy has been compared by me with the original on file in this agency and that the same is a true copy thereof, and of the whole of such original.

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed the official seal of the Office of the Commissioner of Securities in the City of Madison, this 2nd day of December, 1985.

(SEAL)

Ulice Payne Jr.

ULICE PAYNE, JR.
Commissioner of Securities
State of Wisconsin

1-1-86

ORDER OF THE OFFICE OF THE
COMMISSIONER OF SECURITIES
STATE OF WISCONSIN
ADOPTING, AMENDING AND REPEALING RULES

To repeal SEC 2.01(10) and 4.07(1)(c); to renumber SEC 2.01(11) and 4.07(1)(d) and (e); to amend SEC 2.01 (1)(a)3., 2.02(3)(b), 2.02(10)(f)4., 3.01(1), 3.03(5), 3.09(1)(b) and (c), 3.09(2)(intro.) and (2)(b), 3.16(2)(a), 3.18, 3.23(3), 3.27(1) and (2), 4.03(1)(r), 4.05(7), 4.07(1)(a), 7.01(2)(c) and (d), 7.01(5)(b), 31.01(2)(b), 32.02, 32.05(1)(b), 32.11, 35.01(1)(a) and (c) and 35.02(1)(b); to repeal and recreate SEC 4.07(1)(b) and 32.05(1)(c); and to create SEC 4.01(8), 4.04(10), 9.01(1)(b)14. and 32.05(1)(d), relating to securities and franchise registration exemptions; securities registration standards, requirements and procedures; securities broker-dealer and agent licensing requirements and procedures; and securities and franchise examination fees.

Pursuant to authority vested in the Office of the Commissioner of Securities by secs. 551.63(1) and (2), 551.23(3)(d), 551.23(18), 551.27(10), (11) and (12), 551.31(4), 551.32(7), 551.33(1) and (2), 551.52(3), 551.63(1), 553.25, 553.27(3), 553.53, 553.58(1) and 553.72(3), Wis. Stats., the Wisconsin Commissioner of Securities repeals, amends and adopts rules interpreting those sections as follows:

SECTION 1. SEC 2.01(1)(a)3. is amended to read:

SEC 2.01(1)(a)3. A notice of the proposed offering is filed with the commissioner prior to the offering, including a trust indenture meeting the requirements of s.SEC 3.24, an official statement or a prospectus meeting the requirements of s. SEC 3.23 that contains financial statements for the enterprise meeting the requirements of s. SEC 3.22(1)(p) and subject to the standards in s. SEC 3.06(2), and additional information as the commissioner may require, and the commissioner does not by order deny the exemption within 20 days of the date the notice is filed. ~~The financial statement requirement in this subdivision is not applicable if the revenue obligations being offered are the subject of an irrevocable letter of credit from a bank in favor of holders of the revenue obligations providing for payment of principal and interest on the revenue obligations, and the letter of credit is accompanied by an opinion of counsel stating that: a. i. payment of debt service will not constitute a preference under the U.S. bankruptcy code in the event of a filing of a petition in bankruptcy with respect to~~

~~the enterprise, or ii. the letter of credit will provide for reimbursement to holders of the revenue obligations in the event they are required by order of a U.S. bankruptcy court to disgorge as a preference any payment of a debt service, or a combination of i. and ii., and stating that b. the enforceability of the letter of credit would not be materially affected by the filing of a petition under the U.S. bankruptcy code with respect to the enterprise or any person obligated to reimburse the bank for payments made pursuant to the letter of credit.~~

ANALYSIS: This amendment deletes the last portion of the rule as unnecessary because the stricken language was included in amendments to sec. 551.22(1)(b), Wis. Stats., in 1983 Wisconsin Act 216. The statute change made the registration exemption under sec. 551.22(1), Wis. Stats., available on a self-executing basis for revenue bonds covered by sub. (b) if the requirements stated therein were met--the identical requirements in the stricken language of this rule. Thus, because both the statute and stricken language in the rule cover the same situation, and since the statutory exemption is "automatic", a filing subject to the stricken language of the rule need never take place.

SECTION 2. SEC 2.01(10) is repealed.

ANALYSIS: This rule is repealed because the September 30, 1984 "sunset"/expiration date for the rule specified therein has passed.

SECTION 3. SEC 2.01(11) is renumbered SEC 2.01(10).

ANALYSIS: The renumbering of this rule provision is necessary due to the repeal of section SEC 2.01(10), Wis. Adm. Code, in SECTION 2.

SECTION 4. SEC 2.02(3)(b) is amended to read:

SEC 2.02(3)(b) With respect to a security qualifying under s. 551.23(3)(d), Stats., the issuer or an applicant files with the commissioner prior to the offering a notice of the proposed sale, including: the prospectus used in the most recent offering of the securities proposed to be sold; a copy of the issuer's articles of incorporation and by-laws, or equivalents, as currently in effect; any information specified in ss. SEC 3.22 and 3.23, and not contained in the filed prospectus; the trust indenture, if any, under which the securities proposed to be sold are issued; the information concerning the public market for the security specified in s. SEC 3.02(1)(b); a balance sheet of the issuer as of the end of the last fiscal year of the issuer preceding the date of filing and statements of income and changes in financial position and analysis of surplus for such fiscal year meeting the requirements of s. SEC 7.06; an undertaking to file with the commissioner within 120 days (180 days with

respect to a corporation organized and operated not for private profit but exclusively for religious, educational, benevolent or charitable purpose) after the end of each fiscal year of the issuer comparable financial statements of the issuer for each such fiscal year; and an undertaking to furnish the commissioner with a written report within 30 days after the happening of any material event affecting the issuer or the securities proposed to be sold. The exemption, unless disallowed by order of the commissioner within 10 days, is effective so long as the information required to be furnished is kept current.

> ANALYSIS: This amendment adds to the information package required to be filed by an applicant for secondary trading authorization under the rule, the issuer's articles and by-laws (or equivalents if the issuer is not a corporation). The amendment corrects an inadvertent omission in the rule in that an issuer's articles of incorporation and by-laws are specified as part of the informational package required to be filed in applications for secondary trading authorization under this rule's companion provision in section SEC 2.02(3)(a), Wis. Adm. Code.

SECTION 5. SEC 2.02(10)(f)4. is amended to read:

SEC 2.02(10)(f)4. ~~Installment~~ Any provision of the plan providing for installment payments for shares issued upon

exercise ~~are~~ is not permitted except as authorized by a majority of the disinterested independent outside directors of the issuer;

> ANALYSIS: This SECTION is an amendment to one of the administrative rule requirements for issuance of an Order of Exemption for a stock option plan. The amendment provides an absolute waiver from the prohibition against installment payments for shares issued on exercise of options issued under a stock option plan if the installment payment provision of the plan is authorized by a majority of the disinterested independent outside members of the board of directors of the issuer. The waiver makes this rule consistent with the regulatory treatment provided under section SEC 3.16(1)(b)2.a., Wis. Adm. Code, that deals with an analogous situation in a registration filing context--the presence of loans to officers or controlling persons of an issuer. In that registration rule, a waiver from the general prohibition against loans to such persons is accorded if the loan transaction is authorized or subsequently ratified by a majority of the issuer's disinterested independent outside directors.

SECTION 6. SEC 3.01(1) is amended to read:

SEC 3.01 COMMISSIONS AND EXPENSES. (1) The aggregate amount of underwriters' and sellers' discounts, commissions and other compensation shall be reasonable, and except for issuers specified in sub. (2), is presumed reasonable if it

does not exceed 10% of the aggregate selling price of the securities or if, when added to the other expenses paid or payable in connection with the offering and sales of the securities, the total of commissions and other expenses does not exceed 15% of the aggregate selling price of the securities. ~~If~~ For corporate equity offerings of less than $5 million in aggregate proceeds, if the aggregate amount of underwriters' and sellers' discounts, commissions and other compensation does not exceed ~~10%~~ 12% of the aggregate selling price of the securities, the total of commissions and other offering expenses is not subject to limitation.

ANALYSIS: This amendment increases the presumed-reasonable sales compensation level to 12% from its current 10% level for offerings aggregating less than $5 million. The purpose of the amendment is to reduce the disadvantage that "small" securities offerings (determined for purposes of the rule as $5 million or less) are placed vis-a-vis large offerings. In large securities offerings, a maximum 10% broker-dealer sales compensation rate as applied to the offering proceeds is generally adequate in total dollar terms to compensate a broker-dealer for the risk and effort in underwriting/selling the offering. However, for offerings under $5 million, the maximum 10% rate does not provide sufficient compensation in total dollar terms.

As a result of comments received in two comment letters, this SECTION is revised to clarify the intent of the amendments that they apply only to corporate equity

offerings. This clarification is done by adding the language "corporate equity" before the language "offerings of" in line 6 of the public comment draft of the rule.

The purpose of the principal amendment in this SECTION increasing the presumed reasonable sales commission level--namely, to reduce the disadvantage that "small" securities offerings are placed vis-a-vis large offerings -- was derived from the remarks of various commentators on the regulatory impact certain securities law regulations have on small business capital formation. Those comments were reflected in the March, 1982 Report of the Wisconsin Commissioner of Securities Citizen's Advisory Committee on the Raising of Venture Capital in Wisconsin. Similar remarks have been made by other commentators.

The context in which those comments regarding "reducing the disadvantage faced by small offerings" have been raised, however, is incident to discussions of the impact of securities registration requirements on corporate equity offerings. This was exemplified by the 1982 Citizens Advisory Committee Report language which, on page four thereof, referred to corporate equity offerings in discussing the impact of administrative rule limitations on commissions and offering expenses. Also, the commissions and offering expenses rule provision was just one of several rule provisions discussed in the 1982 Advisory Committee Report--the others included options and warrants, promotional stock and promoters investment--all of which comments based their applicability on corporate equity offerings. Additionally, common stock offerings by corporations is the context in which the majority of small businesses

raise capital and is thus the context in which facilitating capital formation by such entities is sought to be furthered. No comments have ever been raised that the commissions and offering expenses limitation in the context of limited partnership offerings or corporate debt offerings is too restrictive. Thus, application of the proposed rule revision in s. SEC 3.01(1) to other types of securities offerings--such as corporate debt offerings or limited partnership offerings--would be unintended, unnecessary and inappropriate.

Also, it is to be noted that s. SEC 3.01(1) is not intended to be applicable in the context of limited partnership offerings because those offerings are subject to separate and distinct regulatory guidelines that include coverage of commissions and offering expenses (see for example SEC 3.11 regarding real estate limited partnerships, SEC 3.12 regarding oil and gas limited partnerships, SEC 3.13 regarding cattle feeding limited partnerships, SEC 3.18 regarding commodity pool limited partnerships and SEC 3.19 regarding equipment leasing limited partnerships.)

SECTION 7. SEC 3.03(5) is amended to read:

SEC 3.03(5) All options and warrants except those issued to financing institutions shall be issued at not less than <u>85% of</u> fair market value on the date of issuance, and the exercise price shall not be subject to change by the issuer except in accordance with anti-dilution provisions in effect on the date of issuance.

ANALYSIS: The amendment updates this options-and-warrants registration rule to reflect general corporate industry practice over the last several years in the structuring for tax reasons of stock option plans as so-called "non-statutory" options rather than "incentive stock options" within the meaning of section 422A of the Internal Revenue Code. The federal tax treatment of incentive stock options (which require under Section 422A for a 100% of fair market value exercise price) is less favorable to a corporation/employer than is a non-statutory option (which generally provides for an 85% of fair market value exercise price), because the corporation/employer is not entitled to a tax deduction with respect to the grant or exercise of an incentive stock option, nor with respect to any disposition of such shares after certain holding periods. Consequently, issuers in registration applications are increasingly using the non-statutory option plans that provide for an 85% of fair market value exercise price. The amendment will bring the rule into conformance with current practice and make Wisconsin's options and warrants registration rule consistent with the registration rules of most other states on this issue.

SECTION 8. SEC 3.09(1)(b) and (c) are amended to read:

SEC 3.09(1)(b) 1. No investment company, other than an investment company that invests more than 80% of its assets in debt securities, may purchase any securities of the classes specified in this subsection, if by reason thereof

the value of its aggregate investment in those classes of securities will exceed: 10% of its total assets in securities of issuers which the company is restricted from selling to the public without registration under the securities act of 1933; 10% of its total assets in the securities of one or more real estate investment trusts or in one or more investment companies; 5% of its total assets in securities of unseasoned issuers, including their predecessors, which have been in operation for less than 3 years, and equity securities of issuers which are not readily marketable; ~~or~~ .2. An investment company may not invest in options, financial futures or stock index futures, other than hedging positions or positions that are covered by cash or securities, if as a result thereof, more than 5% of its ~~total~~ assets ~~in--puts,--calls,---straddles,---spreads,---and---any combination-thereof~~ would be so invested.

(c) No investment company may invest any part of its total assets in real estate or interests in real estate, excluding readily marketable securities; commodities--~~or~~, other than precious metals not to exceed 10% of the investment company's total assets; commodity futures contracts or options thereon other than as permitted by investment companies qualifying for an exemption from the

definition of commodity pool operator under 17 CFR 4.5 (c)(2)(i); or interests in commodity pools or oil, gas or other mineral exploration or development programs.

ANALYSIS: The SECTION makes several amendments particularized below to these two rules that limit an investment company from investing more than a specified percentage of its assets in certain listed categories of securities. The amendments update the rules to reflect new developments in industry practice and the emergence of new securities products that have become available for purchase in the marketplace by investment companies since this rule was last amended in 1980. (1) Paragraph (b) is divided into two sections, (b)1. and (b)2., to provide that the exclusionary language added for an investment company that invests more than 80% of its assets in debt securities applies only to sub. 1.; (2) Language is added excluding applicability of the investment restrictions in (b)1 for any investment company that invests more than 80% of its assets in debt securities. Where an investment company has more than 80% of its assets invested in debt securities, the asset investment limitations in (b)1. have a de minimis impact since collectively such investments cannot exceed 20% of the total assets of the investment company; (3) Language is added permitting an investment company subject to the rule to invest a maximum of 10% of its assets in one or more real estate investment trusts or investment companies. The amendment recognizes current industry practice that involves some investment companies having their assets invested in the securities of other investment companies. The amendment places a 10% limitation in

order to reduce substantially the duplication-of-management-fees effect that is present in a so-called "fund of funds"-type investment philosophy used by any investment company; (4) Language is provided which adds options, financial futures and stock index futures to the list of investments subject to a 5%-of-total-assets limitation; (5) Language is added in par. (c) modifying the prohibition against investment in commodities to permit investment in precious metals not to exceed 10% of the investment company's total assets. The amendment reflects current investment practices by a specialty category of investment company whose investment portfolio is directed primarily toward the equity securities corporations involved in the mining/extraction of precious metals where the investment company includes in its portfolio precious metals or coins that are legal tender in the country of the coin's origin; (6) Language is added in par. (c) modifying the prohibition against investing in commodity futures contracts. The original amended language in the public comment draft of the proposed rules was modified as discussed in the following paragraphs as a result of public comment letters received. Investments in commodity futures contracts would, however, be subject to the 5% limitation contained in (1)(b)2. (7) Language is included in par. (c) adding interests in commodity pools to the list of prohibited investments specified therein.

As a result of public comment letters received relating to the comment draft form of the amendments in new subd. (1)(b)2., the language of the subdivision was modified in the following respects: (i) the reference to puts and calls was deleted as being redundant in light of the addition of the term "options" in the

comment draft form of the rule, because puts and calls are merely types of options; (ii) the reference to straddles and spreads was deleted because they are investment strategies, not securities; (iii) exclusionary language is added with respect to the 5% limitation in subd. (1)(b)2. (which is intended to limit an investment company's "risk" position with respect to those securities to a maximum of 5% of its assets) that would exclude hedging positions or position that are covered by cash or securities. Positions in those instruments that are "hedged" or "covered" are properly excluded from the "at risk" limitations (as was similarly done in the comment draft form of amendments to SEC 3.09(1)(c) that excluded hedging transactions from the prohibition therein in investing in commodity futures contracts).

As a result of public comment letters received, the amendment to s. SEC 3.09(1)(c) regarding investment in commodity futures contracts is revised. The language of the amendment in the form sent out for public comment in July, 1985 provided that the current absolute prohibition on the investment in commodity futures contracts would not apply where commodity futures contract investments are used for hedging purposes. The amendment as revised has language added that cross-references relevant administrative rule provisions under the federal Commodity Exchange Act as administered by the federal Commodity Futures Trading Commission ("CFTC"), where investment company purchases of commodity futures contracts for hedging purposes is already extensively treated. The revision is necessary to make the Wisconsin rule requirements for investments in commodity futures contracts for hedging purposes consistent with the CFTC's regulations on this subject. The cross-referencing of the

CFTC provision is consistent with the use elsewhere in the Wisconsin Uniform Securities Law and Code of cross-references to substantive provisions in federal law, such as in s. 551.23(8) referring to "investment company as defined under 15 USC 80a-3," or in s. 551.60(5) authorizing the Commissioner to "take such action as is authorized under 7 USC 13a-2."

CFTC Regulation 4.5(c)(2)(i) requires investment companies using financial futures to represent that the use of commodity futures or commodity options contracts will be solely for bona fide hedging purposes within the meaning and intent of Section 1.3(z)(1) of the CFTC's regulations. That section goes on to provide that with respect to certain anticipatory or long hedge strategies, an alternative test may be employed to determine whether the investment company's use of futures contracts come within the meaning of the bona fide hedging purposes limitations.

SECTION 9. SEC 3.09(2)(Intro.), is amended to read:

SEC 3.09(2) The policy stated or followed by any investment company, other than one that invests 80% or more of its assets in debt securities, of engaging in any material respect in any of the following or related speculative activities, whether individually or in combination, and the relatively greater risks or costs involved in those

activities, shall be disclosed or clearly referred to in bold face type on the cover of the prospectus or on a prospectus supplement satisfactory in form to the commissioner:

> ANALYSIS: This amendment excludes an investment company that invests 80% or more of its assets in debt securities from the prospectus-cover-page-disclosure requirements of the rule. The amendment is made for the same reason discussed in the ANALYSIS to SECTION 8 describing a similar amendment made to SEC 3.09(1)(b), Wis. Adm. Code. Namely, where an investment company has 80% or more of its assets invested in debt securities, the asset investment limitations have a de minimis impact since collectively such investments cannot exceed 20% of the total assets of the investment company.

SECTION 10. SEC 3.09(2)(b) is amended to read:

SEC 3.09(2)(b) Purchasing securities for short-term trading, other than securities issued by the U.S. government.

> ANALYSIS: This amendment eliminates the prospectus-cover-page-disclosure requirement under the rule where an investment company's investment practice involving purchasing securities for short-term trading is limited to securities issued by the U.S. government. The amendment is based on the breadth and depth of the trading market for U.S. government securities which provides liquidity for such

securities on a short-term basis that is not present for the securities of private sector or municipal issuers.

SECTION 11. SEC 3.16(2)(a) is amended to read:

SEC 3.16(2)(a) If the issuer has engaged in transactions subject to the provisions of sub. (1) with officials of the issuer, its controlling persons or affiliates, the disclosure document for the offering shall ~~disclose all material transactions~~ contain a description of each of those transactions that are material, including any resolution of issues subject to the provisions of sub. (1).

ANALYSIS: This amendment clarifies that if the issuer in a registration application under the Wisconsin Uniform Securities Law has transactions that trigger application of the conflict-of-interest registration standards in SEC 3.16, Wis. Adm. Code, the disclosure document for the offering must contain a description of each of those transactions that are material, including a description of any resolution of issues subject to the provisions of sub. (1).

SECTION 12. SEC 3.18 is amended to read:

SEC 3.18 COMMODITY POOL PROGRAMS. The offer or sale of interests in a limited partnership which will engage in the

buying and selling of and trading in, commodity futures contracts, options thereon, commodity forward contracts or similar instruments, may be deemed unfair and inequitable to purchasers unless the offering complies with the provisions of the ~~Central Securities Administrators Council Statement of Policy on Commodity Pool Programs, adopted January 24, 1978~~ North American Securities Administrators Association Statement of Policy on Registration of Commodity Pool Programs, adopted September 21, 1983. Copies of the Statement of Policy are available from the commissioner's office for a prepaid fee of $4. The Statement of Policy is published in Volume 1 of the Commerce Clearing House Blue Sky Law Reporter and is on file at the offices of the Wisconsin secretary of state and the revisor of statutes.

ANALYSIS: This amendment substitutes for the registration policy previously used by this agency for review of applications for registration in Wisconsin of commodity pool programs, the statement of policy on Registration of Commodity Pool Programs, adopted September 21, 1983 by vote of members of the North American Securities Administrators Association, Inc. ("NASAA"), including Wisconsin, at the NASAA 1983 Fall Conference.

SECTION 13. SEC 3.23(3) is amended to read:

SEC 3.23(3) The prospectus shall contain a full

disclosure of all material facts relating to the issuer and the offering and sale of the registered securities. A prospectus meeting the requirements of form S-1 under the securities act of 1933 that receives full review by the U.S. securities and exchange commission is deemed to satisfy the requirements of this subsection.

ANALYSIS: This amendment provides that an S-1 prospectus under the federal Securities Act of 1933 will presumptively meet the "full disclosure" requirement in the rule only if the prospectus receives a full review as to the adequacy of the disclosures by the staff of the U.S. Securities and Exchange Commission ("SEC"). The amendment is necessary due to the review policy announced by the SEC in October, 1980 that it would no longer conduct a "full review" of all registration statements for adequacy of disclosure. Rather, full review of registration statements would only take place on a selective basis. An applicant whose registration statement will not be receiving full review is advised by letter from the SEC Corporate Finance Division within 5 days from the date the registration statement is filed that the applicant's registration statement will receive either a "limited review" or "no review".

The policy of the rule in its current form when it was initially promulgated in 1970 was premised on the fact that all S-1 registration statements under the federal Securities Act of 1933 were subject to, and received, a full review by the SEC staff for disclosure adequacy. Where full review by the SEC of an S-1 registration statement for disclosure adequacy does not take place,

it is not appropriate for investor protection reasons to accord by rule a presumption of disclosure adequacy.

SECTION 14. SEC 3.27(1) and (2) are amended to read:

SEC. 3.27 EXTENSION OF REGISTRATION STATEMENTS. (1) Application for an extension of the offering period of a registration statement, except one relating to redeemable securities ~~of--an-investment-company-registered-under~~ issued by an open-end management company or a face amount certificate company as defined in the investment company act of 1940, or securities of a finance company licensed under s. 138.09, Stats., shall be filed in the form prescribed by the commissioner not less than 30 days prior to the end of one year from the effective date of the registration statement or an order of extension, whichever is most recent. The application shall be accompanied by a prospectus updated in accordance with s. SEC 3.23(5), a balance sheet of the issuer as of the end of its most recent fiscal year, and a comparative statement of income and changes in financial position and analysis of surplus for each of the 3 most recent fiscal years(or for the period of the issuer's and any predecessor's existence if less than 3 years), all meeting the requirements of s. SEC 7.06, provided that if the date of any of the above financial statements is more than 120 days

(180 days with respect to a corporation organized and operated not for private profit but exclusively for religious, educational, benevolent or charitable purposes) prior to the date of the extension of the registration statement, the statements shall be updated (which may be done without audit) to within the 120-day or 180-day requirement above. Any extension of the offering period of a registration statement shall be by order of the commissioner, subject to such conditions as may be prescribed.

(2) A registration statement relating to redeemable securities ~~of--an-investment-company-registered-under~~ issued by an open-end management company or a face amount certificate company as defined in the investment company act of 1940, or securities of a finance company licensed under s. 138.09, Stats., is deemed to include an application for the continuous offering of the securities. The offering period of the registration statement is automatically extended until it is permitted to be withdrawn or the commissioner issues a stop order suspending or revoking its effectiveness pursuant to s. 551.28, Stats., if the issuer files the reports required under s. SEC 3.28(1), and files with the commissioner not less than annually during the offering period, within 120 days of the end of its fiscal year, a

prospectus updated in accordance with s. SEC 3.23(5), a balance sheet of the issuer as of the end of the fiscal year, and a statement of income and change in financial position and analysis of surplus of the issuer for the fiscal year meeting the requirements of s. SEC 7.06.

ANALYSIS: The amendments to these two rules are necessary to reflect statutory changes made to sec. 551.52(1)(b), Wis. Stats., in 1983 Act 216, effective July 1, 1985. The statutory changes specified the types of investment companies registered under the Investment Company Act of 1940 that the indefinite registration procedure would be available for--namely, open-end management companies and face amount certificate companies. Consequently, the amendment to sub. (2) specifies those entities for purposes of the rule regarding extension of registration statements. The amendment to sub. (1) is necessary to make the language of that rule consistent with sub. (2).

SECTION 15. SEC 4.01(8) is created to read:

SEC 4.01(8) A securities agent license is effective to authorize the licensee to effectuate transactions only in the types or categories of securities that the licensee has been qualified to sell by passing the examinations specified in sub. (3).

ANALYSIS: This SECTION restricts, pursuant to the Commissioner's authority under sec. 551.32(7), Wis. Stats., the effectiveness of a securities agent license, to authorize effectuating transactions only in those types or categories of securities which the agent has been qualified by examination to sell. This rule is consistent with section SEC 4.01(3), Wis. Adm. Code, which exempts an applicant for an initial license as an agent from the requirement to pass certain general securities business examinations where the applicant's proposed securities activities will be restricted and the applicant passes each examination enumerated in section SEC 4.01(3)(b) to (d), Wis. Adm. Code, that relates to the applicant's proposed securities activities.

SECTION 16. SEC 4.03(1)(r) is amended to read:

SEC 4.03(1)(r) A register relating to each offering participated in by the broker-dealer under the registration exemption provisions of s. 551.23(10), (11) and (19), Stats., or made pursuant to an order of exemption issued under s. 551.23(18), Stats., limiting the number of offers or sales permitted in Wisconsin, containing the following information: 1. As to offers made under s. 551.23(11), Stats., or offers made pursuant to an order of exemption issued under s. 551.23(18), Stats., that limits offers, the name and address of each offeree of the broker-dealer, the date the offer was made, the control number on any offering circular or other

advertising material given to the offeree, the names of all persons making the offer, and the date of any sale as a result of the offer~~.~~; and 2. As to offerings made under s. 551.23(10) and (19), Stats., or made pursuant to an order of exemption issued under s. 551.23(18), Stats., that limits sales, the name and address of each purchaser, the date the sale was made, the control number on any offering circular or other advertising material given to the purchaser and the names of all persons making the sale.

ANALYSIS: This amendment makes the contents of the required register consistent with the offer or sale limitations specific to the relevant exemptions. Thus, because s. 551.23(11), Stats., and the specified orders of exemption under s. 551.23(18), Stats., limit the number of offers which may be made in reliance on those exemptions, the register should provide the information necessary to verify compliance with these limits. Similarly, because s. 551.23(10) and (19), as well as the specified orders of exemption under s. 551.23(18), Stats., limit the number of sales which may be made in reliance on those exemptions, the register should provide the information necessary to verify compliance with these limits.

SECTION 17. SEC 4.04(10) is created to read:

SEC 4.04(10) Each broker-dealer shall file annually with the commissioner not later than November 30, a report

identifying each of its branch offices located in this state on Form BDBrO(WI) designated by the commissioner in s. SEC 9.01(1)(b).

ANALYSIS: This SECTION establishing a filing requirement relating to a broker-dealer's Wisconsin branch offices does not require any new or additional information to be filed by a licensed broker-dealer beyond that which is currently filed. This is because the identical information relating to Wisconsin branch offices is currently provided annually by licensed broker-dealers on the forms used under the annual license renewal procedure in s. SEC 4.07, Wis. Adm. Code. The amendment is necessitated by implementation in Wisconsin of renewal of broker-dealer licenses through the Central Registration Depository (CRD) discussed in the ANALYSIS to SECTION 19. Information regarding branch offices located in Wisconsin of licensed broker-dealers will not be available under the CRD and, therefore, the separate notification and filing procedure regarding Wisconsin branch office of broker-dealers is necessary.

SECTION 18. SEC 4.05(7) is amended to read:

SEC 4.05(7) Every broker-dealer whose principal office is located in this state, other than a broker-dealer engaged solely in the offer and sale of either interests in direct participation programs or securities issued by open-end investment companies, face amount certificate companies or

unit investment trusts registered under the investment company act of 1940, shall have at least one licensed person employed on a full-time basis at its principal office.

ANALYSIS: This amendment creates an exclusion from the requirement in the rule that every broker-dealer whose principal office is located in this state must have at least one licensed person employed on a full-time basis at its principal office. The purpose of the rule is to assure that when a customer of a licensed broker-dealer needs immediate securities transaction services or advice regarding the customer's account, there will be at least one licensed securities agent--at the broker-dealer's principal office if not at each branch office--during regular business hours to service the account. The exclusion is provided because customers of broker-dealers engaged solely in the offer or sale of either direct participation program securities or investment company securities--which broker-dealers are often small, one-office operations--do not have transactions that are timing-sensitive requiring immediate execution for buy/sale transactions in trading markets. For those "specialty" broker-dealers, the staffing requirement of the rule in its current form is a hardship and does not appear at this time to be necessary for investor protection purposes. However, the Commissioner of Securities office will monitor the after-effects of creating the exclusion under this rule to determine if any adverse effects on customers take place that would warrant re-evaluation of the appropriateness of the exclusion.

SECTION 19. SEC 4.07(1)(a) is amended to read:

SEC 4.07 LICENSE PERIOD. (1)(a) The license of any broker-dealer ~~whose-name-commences-with-any-of-the-letters-A through-D-expires-March-31-following-the-date-of-issuance--of the--license;--the--license--of--any-broker-dealer-whose-name commences-with-any-of-the-letters-E-through-I-expires-June-30 following-the-date-of-issuance-of-the-license;-the-license-of any-broker-dealer--whose--name--commences--with--any--of--the letters--J--through-O-expires-September-30-following-the-date of--issuance--of--the--license;--and--the--license---of---any broker-dealer--whose-name-commences-with-any-of-the-letters-P through-Z~~ expires at midnight December 31 following the date of issuance of the license.

ANALYSIS: This amendment establishes midnight on December 31 as the uniform expiration date for all broker-dealer licenses. The December 31 date coordinates with the license expiration and renewal dates established by the Central Registration Depository ("CRD") of the National Association of Securities Dealers, Inc. ("NASD"), as developed under contract with the North American Securities Administrators Association, Inc. ("NASAA"). The Commissioner was given the authority to adopt the CRD in Chapter 53, Laws of 1981, effective January 1, 1982. Implementation of the CRD in Wisconsin began during August, 1983.

The CRD eliminates duplicative filing and licensing requirements for broker-dealers and their securities agents that do business in a number of states by providing for a single, central automated system for filing and processing licensing application information and materials. Under the CRD, broker-dealer and agent applicants for license submit the required information to the NASD at its Washington, D.C. main office where the information is placed in a computer bank. Each state that is a member of the CRD system is connected with the central computer from which all licensing information can be examined and retrieved, thus eliminating the need for paperwork relating to license applications.

SECTION 20. SEC 4.07(1)(c) is repealed.

ANALYSIS: This separate SECTION is created at the recommendation of the Rules Clearinghouse to separately treat in this section the repeal of SEC 4.07(1)(c), from the treatment of the repeal and recreation of SEC 4.07(1)(b) in SECTION 21.

SECTION 21. SEC 4.07(1)(b) is repealed and recreated to read:

SEC 4.07(1)(b) The license of an agent for a broker-dealer expires at midnight on December 31 following the date of issuance of the license.

ANALYSIS: This SECTION does the following: (1) combines into one paragraph the two existing rule provisions in sections SEC 4.07(1)(b) and (c), Wis. Adm. Code, relating to the license expiration date for an agent of a broker-dealer; and (2) establishes midnight on December 31 as the uniform expiration date for the license of an agent of a broker-dealer. The December 31 date coordinates with the uniform expiration date of a broker-dealer's license discussed in the ANALYSIS to SECTION 19.

SECTION 22. SEC 4.07(1)(d) and (e) are renumbered SEC 4.07(1)(c) and (d), respectively.

ANALYSIS: These paragraphs are renumbered because of the repeal and recreation of paragraphs (b) and (c) of section SEC 4.07, Wis. Adm. Code, into a single paragraph (b) in SECTION 21.

SECTION 23. SEC 7.01(2)(c) and (d) are amended to read:

SEC 7.01(2)(c) Application for opinion confirming an exemption or an exclusion from a definition.....~~$50~~ $100.

(d) Notice filed under s. 551.22(10) or (14), Stats., or under s. 551.23(12), Stats., or under s. SEC 2.02(10)(b), or (c).....~~$50~~ $100.

ANALYSIS: These amendments increase to

$100 the current $50 fee prescribed under par. (2)(c) for staff examination of applications for issuance of opinions confirming a registration exemption or a definitional exclusion, and the current $50 fee prescribed under par. (2)(d) for staff review of filings made under the statute and rule provisions listed. The higher fees are needed to offset the effects of inflation as well as the costs to process and review these filings which have increased since these fees were last raised in 1977.

SECTION 24. SEC 7.01(5)(b) is amended to read:

SEC 7.01(5)(b) Issuance of an interpretive opinion under s. 551.64(5), Stats. .....~~$200~~ $300.

ANALYSIS: This amendment increases to $300 the current $200 examination fee prescribed under par. (5)(b) for issuance of an interpretive opinion. The higher fee is necessary to offset the effects of inflation as well as the costs to process and review interpretive opinion requests which have increased since this fee was last raised in 1977.

SECTION 25. SEC 9.01(1)(b)14. is created to read:

SEC 9.01(1)(b)14. BDBrO(WI). Broker-dealer Wisconsin branch office report.

ANALYSIS: This SECTION identifies the separate report required to be filed with

the Wisconsin Commissioner of Securities office by Wisconsin branch offices of licensed broker-dealers under section SEC 4.04(10), Wis. Adm. code, created in SECTION 17.

SECTION 26. SEC 31.01(2)(b) is amended to read:

SEC 31.01(2)(b) Payment referred to in par. (a) of this rule which is made in the form of a lump sum, installments, periodic royalties, profits, or cash flow, or is or may be reflected in the price of goods, services, equipment, inventory or real estate sold or leased by the licensor to the distributor or licensee.

ANALYSIS: This amendment provides that payments made under a lease arrangement, as well as those under a sales arrangement, can be used for determining whether a "franchise fee" is present for purposes of the definition of that term in sub. (2).

SECTION 27. SEC 32.02 is amended to read:

SEC 32.02 PERIODIC REPORTS REQUIRED FOR EXEMPT FRANCHISORS. Franchisors, or their agents, or representatives offering to sell or selling franchises in this state under s. 553.22, Stats., or s. SEC 32.05(1)(c) shall file with the commissioner within a period of 120 days

from the last date of each of their fiscal years a copy of their current offering circular prepared in the form required by s. SEC 32.06, or disclosure document prepared in the form required by 16 CFR Part 436, the Federal Trade Commission's disclosure requirements and prohibitions concerning franchising and business opportunity ventures. All periodic reports shall be signed by an officer or general partner of the franchisor in the manner prescribed by s. SEC 32.11.

ANALYSIS: This amendment requires a user of the franchise registration exemption created in SECTION 28 to file the same periodic report information with the Commissioner as is required to be filed under the parallel registration exemption in sec. 553.22, Wis. Stats.

SECTION 28. SEC 32.05(1)(b) is amended to read:

SEC 32.05(1)(b) Any offer to sell or sale of a franchise which includes payment by a person for the right to participate in a distribution or marketing plan where such payment, computed on an annual basis, does not exceed ~~$100~~ $250 in excess of the bona fide wholesale price for such product or service in wholesale transactions.

ANALYSIS: The amendment increases to $250 from its current $100 level, the dollar threshold for use of this

registration exemption. Because the policy basis for the exemption is that in arrangements where only a nominal "franchise fee" is involved the registration process is not warranted, this amendment is necessary to offset the effects of inflation regarding what is considered "nominal" inasmuch as the $100 threshold in the rule has not been increased since 1972 when it was originally promulgated.

SECTION 29. SEC 32.05(1)(c) is repealed and recreated to read:

SEC 32.05(1)(c) Any offer to sell, or sale, of a franchise if all of the following conditions are met:

1. There is filed on behalf of the franchisor an irrevocable guaranty of performance in the form required by the commissioner pursuant to which a corporation owning at least 80% of the franchisor absolutely and unconditionally guaranties the franchisor's performance of its obligations under the franchise agreements.

2. The corporation acting as guarantor in subd. 1. has a net worth on a consolidated basis according to its most recent audited financial statement of not less than $5,000,000.

3. The franchisor either: a. has at least 25 franchisees conducting the business of the franchise at 25 locations in this state at all times during the 5-year period immediately preceding the offer or sale; or b. has conducted business which is the subject of the franchise continuously for not less than 5 years preceding the offer or sale.

4. The franchisor discloses in writing the information required under s. SEC 32.01(3) to each prospective franchisee at least 10 business days prior to the execution by the prospective franchisee of any binding franchise or other agreement or at least 10 business days prior to the receipt of any consideration, whichever first occurs.

5. There is filed, by or on behalf of the franchisor, at least 10 business days prior to the offer of a franchise in this state, a notice of the proposed offer or sale, including any prospectus, circular or other material to be delivered to prospective franchisees and other information the commissioner may require, and the commissioner does not by order withdraw, deny or revoke the exemption within 10 business days.

ANALYSIS: This SECTION replaces the existing rule under SEC

32.05(1)(c)--which was vague and unworkable--with a so-called "blue chip guarantor" exemption using the Commissioner's authority under sec. 553.25, Wis. Stats. The new rule is a companion registration exemption to the so-called "blue chip franchisor" exemption in sec. 551.22, Wis. Stats., and is necessary to cover situations where the intent, but not the language, of the statute exemption applies. The rule accords an exemption on the basis that registration is not necessary because the rule exemption in subd.. 2. and 3. thereof has parallel net worth and number-of-operating franchisee requirements to those prescribed in (1) and (2) of the statutory exemption. Subdivision 4. of the rule exemption has the identical written-disclosure-to franchisee requirement as that established in (3) of the statutory exemption, and subd. 5. of the rule exemption establishes a 10-business day notice filing requirement with the Commissioner of Securities office.

SECTION 30. SEC 32.05(1)(d), is created to read:

SEC 32.05(1)(d). Any offer to sell or sale of a franchise to any of the following:

1. The franchisor of the franchise;

2. A bank, trust company, credit union or savings and loan association purchasing a franchise for its own account.

ANALYSIS: This amendment creates a registration exemption under the Commissioner's authority in sec. 553.25, Wis. Stats., to exempt from registration

any offer or sale of a franchise where it is determined that registration of the franchise is not necessary for the protection of investors. The rule provides a registration exemption for the offer/sale of the franchise to the franchisor itself or to the listed financial institutions in subd. 2. of the rule. Registration is not necessary for the protection of those purchasers because: (1) with respect to the franchisor as a purchaser, no one is more knowledgeable about the franchise than the franchisor; and (2) with respect to the designated financial institutions, they have the financial and investment expertise to adequately evaluate making an investment decision whether or not to purchase a franchise, and they have the bargaining power to enable them to negotiate the terms and conditions of the sale of a franchise. The rule parallels an equivalent so-called "exempt account"/"institutional investor" securities registration exemption in sec. 551.23(8), Wis. Stats., and also parallels a similar rule exemption under the franchise law in Illinois.

SECTION 31. SEC 32.11 is amended to read:

SEC 32.11 SIGNING OF APPLICATIONS. An application for registration under s. 553.26, Stats., a registration renewal statement under s. 553.30, Stats., an application to amend a registration statement under s. 553.31, Stats.,--~~or~~ an application for an opinion confirming an exemption from registration under s. 553.22, Stats., a notice filing under s. SEC 32.05(1)(c) or an application for an order of

exemption under s. 553.25, Stats., shall be signed by an officer or general partner of the applicant, as the case may be, however, it may be signed by another person holding a power of attorney for such purposes from the applicant and, if signed on behalf of the applicant pursuant to such power of attorney, shall include, as an additional exhibit, a copy of said power of attorney or a copy of the corporate resolution authorizing the person signing to act on behalf of the applicant.

ANALYSIS: This SECTION makes the following amendments: (1) Provides that the officer/general partner signature-of-application requirement applies to the filing for a registration exemption under s. SEC 32.05(1)(c) created in SECTION 29; (2) Corrects an inadvertent omission in the rule by requiring an application for issuance of an order of exemption to be signed by an officer/general partner of the applicant. The amendment makes the signature requirement for exemption order applicants the same as that prescribed for all other applicants--whether for registration, registration amendment or renewal, or for an exemption opinion.

SECTION 32. SEC 35.01(1)(a) and (c) are amended to read:

SEC 35.01(1)(a) Application for opinion confirming exemption from registration under s. 553.22, 553.23 or

553.25, Stats., or a notice filing under s. SEC 32.05(1)(c) .....$250.00.

SEC 35.01(1)(c) Application for interpretative opinion under ch. 553, Stats., ...~~$50.00~~$300.00.

ANALYSIS: SECTION makes the following amendments: (1) Prescribes under (1)(a) the same $250 examination fee for review of a franchise exemption filing under the rule created in SECTION 29 as that currently provided in the rule for review of a parallel registration exemption filing under sec. 553.22, Wis. Stats.; (2) Increases to $300 the interpretative opinion fee under Chapter 553, Stats., which has not been changed since 1972 when this rule was originally promulgated. The increase reflects the higher staff and overhead costs and expenses for reviewing and rendering interpretive opinions as well as the effects of inflation since 1972, and makes the fee consistent with the $300 interpretive opinion fee for Chapter 551 matters as amended in SECTION 24.

SECTION 33. SEC 35.02(1)(b) is amended to read:

SEC 35.02(1)(b) All advertising required to be filed by a registrant or by any franchisor, person or applicant doing business within the state of Wisconsin subject to the scope of the chapter within the meaning of s. 553.59, Stats., and required to be filed by virtue of ss. 553.22(4), or 553.26

and 553.53, Stats., shall be filed with the commissioner in duplicate not less than 5 days prior to the date of use thereof or such shorter period as the commissioner may permit, and shall not be used in this state until ~~a copy thereof, marked with allowance for use by the commissioner, has been received from~~ the commissioner has allowed its use.

ANALYSIS: This amendment changes the requirement that a registrant or franchisor who files advertising materials under the rule must wait until allowance for use from of the materials is received the Commissioner--usually through the U.S. mail. The change enables the staff to give verbal allowance for use of advertisements in circumstances warranting expedited treatment. The amendment makes the rule language as well as the advertising review procedure under the rule consistent with that in the companion advertising filing rule under Chapter 551, Stats., in section SEC 7.02(2), Wis. Adm. Code.

* * * *

The rules and amendments contained in this Order shall take effect as provided in sec. 227.026(1)(Intro.), Wis.

Stats., on the first day of the month following publication in the Wisconsin Administrative Register.

Dated this _____ day of _____, 1985.

(SEAL)

_____

ULICE PAYNE, JR.
Commissioner of Securities

WISCONSIN LEGISLATIVE COUNCIL

LCRC FORM 2

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BONNIE REESE
EXECUTIVE SECRETARY

CLEARINGHOUSE REPORT TO AGENCY

[THIS REPORT HAS BEEN PREPARED PURSUANT TO S. 227.029, STATS., AS CREATED BY CH. 34, LAWS OF 1979. THIS IS A REPORT ON A RULE AS ORIGINALLY PROPOSED BY THE AGENCY; THE REPORT MAY NOT REFLECT THE FINAL CONTENT OF THE RULE IN FINAL DRAFT FORM AS IT WILL BE SUBMITTED TO THE LEGISLATURE. THIS REPORT CONSTITUTES A REVIEW OF, BUT NOT APPROVAL OR DISAPPROVAL OF, THE SUBSTANTIVE CONTENT AND TECHNICAL ACCURACY OF THE RULE.]

CLEARINGHOUSE RULE 85-120

AN ORDER to repeal SEC 2.01 (10) and 4.07 (1) (c); to renumber SEC 2.01 (11) and 4.07 (1) (d) and (e); to amend SEC 2.01 (1) (a) 3, 2.02 (3) (b) and (10) (f) 4, 3.01 (1), 3.03 (5), 3.09 (1) (b) and (c) and (2) (intro.) and (b), 3.16 (2) (a), 3.18, 3.23 (3), 3.27 (1) and (2), 4.03 (1) (r), 4.05 (7), 4.07 (1) (a), 7.01 (2) (c) and (d) and (5) (b), 31.01 (2) (b), 32.02, 32.05 (1) (b), 32.11, 35.01 (1) (a) and (c) and 35.02 (1) (b); to repeal and recreate SEC 4.07 (1) (b) and 32.05 (1) (c); and to create SEC 4.01 (8), 4.04 (10), 9.01 (1) (b) 14 and 32.05 (1) (d), relating to securities and franchise registration exemptions; securities registration standards, requirements and procedures; securities broker-dealer and agent licensing requirements and procedures; and securities and franchise examination fees.

Submitted by OFFICE OF THE COMMISSIONER OF SECURITIES.

8- 2-85. Received by Legislative Council.
8-30-85. Report sent to Agency.

RNS:PR:kja;las

Report on Clearinghouse Rule No. 85-120
Date 8-30-85

LEGISLATIVE COUNCIL RULES CLEARINGHOUSE REPORT

(Pursuant to s. 227.029, Stats.)

1. REVIEW OF STATUTORY AUTHORITY [s. 227.029 (2) (a)]

   a. Rules appear to be within the agency's statutory authority ☒
   b. Rules appear to be unsupported by statutory authority, either in whole or in part ☐
   c. Comment attached ☒ yes ☐ no

2. REVIEW OF RULES FOR FORM, STYLE AND PLACEMENT IN ADMINISTRATIVE CODE [s. 227.029 (2) (c)]

   a. Rules satisfactory ☒
   b. Rules unsatisfactory ☐
   c. Comment attached ☒ yes ☐ no

3. REVIEW OF RULES FOR CONFLICT WITH OR DUPLICATION OF EXISTING RULES [s. 227.029 (2) (d)]

   a. Conflict or duplication not noted ☒
   b. Conflict or duplication noted ☐
   c. Comment attached ☐ yes ☒ no

4. REVIEW OF RULES FOR ADEQUACY OF REFERENCES TO RELATED STATUTES, RULES AND FORMS [s. 227.029 (2) (e)]

   a. References appear to be adequate ☒
   b. References appear to be inadequate ☐
   c. Comment attached ☐ yes ☒ no

5. REVIEW OF LANGUAGE OF RULES FOR CLARITY, GRAMMAR, PUNCTUATION AND PLAINNESS [s. 227.029 (2) (f)]

   a. Rules satisfactory ☒
   b. Rules unsatisfactory ☐
   c. Comment attached ☒ yes ☐ no

6. REVIEW OF RULES FOR POTENTIAL CONFLICTS WITH, AND COMPARABILITY TO, RELATED FEDERAL REGULATIONS [s. 227.029 (2) (g)]

   a. No problems noted ☒
   b. Problems noted ☐
   c. Comment attached ☐ yes ☒ no

7. REVIEW OF RULES FOR PERMIT ACTION DEADLINE [s. 227.029 (2) (i)]

   a. No problems noted ☒
   b. Problems noted ☐
   c. Comment attached ☐ yes ☒ no

WLCS

WISCONSIN LEGISLATIVE COUNCIL

RULES CLEARINGHOUSE

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BONNIE REESE
EXECUTIVE SECRETARY

August 30, 1985

CLEARINGHOUSE RULE 85-120

COMMENTS

[NOTE: All citations to "Manual" in the comments below are to the Administrative Rules Procedures Manual, prepared by the Revisor of Statutes Bureau and the Legislative Council, dated June 1984.]

1. Statutory Authority

The proposed rule appears to be within the statutory authority of the Commissioner of Securities. However, the following statutory provisions were cited as rule-making authority which do not specifically confer such authority: ss. 551.58 (1) and 553.22 (4), Stats.

2. Form, Style and Placement in Administrative Code

a. It is not necessary to repeat the code chapter designation "SEC" in listing the sections treated by the proposed order in the relating clause. [See Example, s. 1.02 (1), Manual.]

b. SECTIONS 3 and 21 of the proposed rule are unnecessary. When a rule section is repealed, renumbering of all subsequent subdivisions is not necessary; a gap in the numerical order of the subdivisions of a rule can signal to the reader that a code provision has been repealed.

c. SECTION 20 of the proposed rule attempts to include two rule sections which are affected by different treatments in the same SECTION of the draft. Whenever two rule sections are affected by different treatments, each should be treated separately, in numerical order, in separate SECTIONS of the draft. [See s. 1.04 (2) (b), Manual.]

d. The language being added to s. SEC 3.18 incorporates an outside standard by reference. The analysis following SECTION 12 should indicate whether the Attorney General and Revisor of Statutes have given permission for the incorporation by reference. [See s. 2.03 (1), Manual.]

e. In two places in SECTION 16 of the proposed rule, "As" should be substituted for "as."

f. In SECTION 28 of the proposed rule, a colon should follow "either." The letters "a." and "b." should be substituted for "(i)" and "(ii)."

5. Clarity, Grammar, Punctuation and Plainness

a. In SECTION 6 of the proposed rule, the language establishing the reasonableness of commissions and other compensation is unclear. Is there a distinction between "underwriter's and seller's discounts, commissions and other compensations" and "other expenses paid or payable in connection with the offering and sales of the securities"? It appears from the context that some expenses are included in the second term which are not included in the first; perhaps the distinction would be clearer if there were a definition of "compensation" and "offering expenses."

b. The analysis accompanying SECTION 7 of the proposed rule refers to a distinction between "incentive" and "non-statutory" options. This distinction does not appear in the rule as drafted.

c. In SECTION 13 of the proposed rule, it is unclear whether a prospectus must be approved in some way by the Federal Securities and Exchange Commission in order to be deemed to satisfy the full disclosure requirements.

d. The commissioner's use of a plain language analysis following each SECTION makes the proposed rule more understandable to the reader.

Report Prepared by the
Office of the Commissioner of Securities
Relating to Amendments to the
Rules of the Commissioner of Securities

(a) Findings of Fact

(1) The Office of the Commissioner of Securities has made its annual review of its Administrative Rules promulgated under the Wisconsin Uniform Securities Law and the Wisconsin Franchise Investment Law for the following purposes: making clarifications to existing rule provisions where language is vague or ambiguous; adopting or amending rules necessary to effectively regulate new circumstances or developments which have occurred in the industry and the marketplace that require regulatory treatment; formally adopting and incorporating by reference a securities registration guideline relating to commodity pool programs previously adopted by a national securities administrators association of which Wisconsin is a member.

(2) Copies of the Comment Draft of the rule revisions containing an explanatory ANALYSIS to each amended section were distributed during July, 1985 to the entire mailing list for this agency's Wisconsin Securities Bulletin. The Bulletin mailing list includes the general public, securities broker-dealer and investment adviser licensees, securities and franchise registrants, securities and franchise law practitioners, securities and franchise trade associates and regulatory bodies, and to other interested persons. A cover letter from the Commissioner that accompanied the Comment Draft requested written comments on the proposed revisions or testimony at the public hearing held at the State Capitol in Madison, Wisconsin.

(3) During the public comment period and as a result of the public hearing, five letters were received setting forth specific comments on the rules as proposed.

(4) The public hearing on the rule revisions was held September 17, 1985 at 10:00 a.m. in Room 415 Northwest of the State Capitol.

(5) At the public hearing, testimony was presented by five persons (other than staff), three of whom also submitted comment letters referred to in para. (3).

(6) Several of the comments made in the comment letters and in hearing testimony resulted in changes and modifications to the rules as identified in sub. (c) of this Report.

(7) It is appropriate in the public interest and for the protection of investors for the Wisconsin Commissioner of Securities to exercise his authority under sec. 551.63(2), Wis. Stats., for the purpose of cooperating with the securities administrators of other states in prescribing rules with a view to achieve uniformity in the form and content of registration statements, to propose to adopt and incorporate by reference the securities registration policy adopted by the North American Securities Administrators Association, Inc. ("NASAA") in SECTION 12 of the Proposed Rules. Pursuant to the requirements of sec. 227.025, Wis. Stats., this agency requested and has since received on October 8, 1985, authorization from the Attorney General and the Revisor of Statutes to incorporate by reference the regulatory standard identified in SECTION 12.

(8) It is appropriate in the public interest and for the protection of Wisconsin investors for the Commissioner to seek to exercise his rule-making authority under sections 551.63(1) and (2), 551.23(3)(d), 551.23(18), 551.27(10), (11) and (12), 551.31(4), 551.32(7), 551.33(1), and (2), 551.52(3), 553.22(4), 553.25, 553.27(3), 553.53, 553.58 and 553.72(3), Wis. Stats., to amend, adopt and repeal the attached rules to carry out the purposes of Chapter 551, Wis. Stats., the Wisconsin Uniform Securities Law and Chapter 553, Wis. Stats., the Wisconsin Franchise Investment Law.

(b) Statement Explaining Need for Rules

The statutory rule-making procedures under Chapter 227 of the Wisconsin Statutes are being implemented in this matter for the purpose of making the agency's annual revision to the Rules of the Commissioner of Securities currently in effect promulgated under Chapter 551, Wis. Stats., the Wisconsin Uniform Securities Law and Chapter 553, the Wisconsin Franchise Investment Law. Each SECTION in the

rules that adopts, repeals or amends a rule is followed by a separate explanatory ANALYSIS which discusses the nature of the revision as well as the rationale behind and/or the necessity for it.

The principal areas of the revisions to the rules include: (1) amending certain securities and franchise registration exemptions; (2) amending an existing securities registration policy (relating to open-end investment companies) and amending the securities registration standards dealing with commissions and expenses and with options/ warrants; (3) incorporating by reference a securities registration policy relating to commodity pool programs adopted by NASAA; (4) amending licensing rules to enable implementation of broker-dealer licensing through the Central Registration Depository; (5) amending numerous sections of the securities broker-dealer, agent and investment adviser licensing provisions dealing with recordkeeping and reporting requirements; (6) revising various of the examination fees prescribed for filings made under the securities law and franchise law.

(c) Explanation of Modifications Made as a Result of Public Comment Letters and Public Hearing Testimony

-- As a result of comments received in two comment letters, the proposed rule in SECTION 6 of the attached draft (relating to increasing the presumed-reasonable sales compensation level rule of SEC 3.01(1)) is revised to clarify the intent of the amendments that they apply only to corporate equity offerings. This clarification is done by adding the language "corporate equity" before the language "offerings of" in line 6 of SECTION 6 of the public comment draft of the rule.

The purpose of the principal amendment increasing the presumed reasonable sales commission level--namely, to reduce the disadvantage that "small" securities offerings are placed vis-a-vis large offerings -- was derived from the remarks of various commentators on the regulatory impact certain securities law regulations have on small business capital formation. Those comments were reflected in the March, 1982 Report of the Wisconsin Commissioner of Securities Citizen's Advisory Committee on the Raising of Venture Capital in Wisconsin. Similar remarks have been made by other commentators.

The context in which those comments regarding "reducing the disadvantage faced by small offerings" have been raised, however, is incident to discussions of the impact of securities registration requirements on corporate equity offerings. This was exemplified by the 1982 Citizens Advisory Committee Report language which, on page four thereof, referred to corporate equity offerings in discussing the impact of administrative rule limitations on commissions and offering expenses. Also, the commissions and offering expenses rule provision was just one of several rule provisions discussed in the 1982 Advisory Committee Report--the others included options and warrants, promotional stock and promoters investment--all of which comments based their applicability on corporate equity offerings. Additionally, common stock offerings by corporations is the context in which the majority of small businesses raise capital and is thus the context in which facilitating capital formation by such entities is sought to be furthered. No comments have ever been raised that the commissions and offering expenses limitation in the context of limited partnership offerings or corporate debt offerings is too restrictive. Thus, application of the proposed rule revision in s. SEC 3.01(1) to other types of securities

offerings--such as corporate debt offerings or limited partnership offerings--would be unintended, unnecessary and inappropriate.

Also, it is to be noted that s. SEC 3.01(1) is not intended to be applicable in the context of limited partnership offerings because those offerings are subject to separate and distinct regulatory guidelines that include coverage of commissions and offering expenses (see for example SEC 3.11 regarding real estate limited partnerships, SEC 3.12 regarding oil and gas limited partnerships, SEC 3.13 regarding cattle feeding limited partnerships, SEC 3.18 regarding commodity pool limited partnerships and SEC 3.19 regarding equipment leasing limited partnerships.)

-- As a result of public comment letters received relating to the comment draft form of the amendments in new subd. (1)(b)2., the language of the subdivision was modified in the following respects: (i) the reference to puts and calls was deleted as being redundant in light of the addition of the term "options" in the comment draft form of the rule, because puts and calls are merely types of options; (ii) the reference to straddles and spreads was deleted because they are investment strategies, not securities; (iii) exclusionary language is added with respect to the 5% limitation in subd. (1)(b)2. (which is intended to limit an investment company's "risk" position with respect to those securities to a maximum of 5% of its assets) that would exclude hedging positions or positions that are covered by cash or securities. Positions in those instruments that are "hedged" or "covered" are properly excluded from the "at risk" limitations (as was similarly done in the comment draft form of amendments to SEC 3.09(1)(c) that excluded hedging transactions from the prohibition therein on investing in commodity futures contracts).

-- As a result of public comment letters received, the amendment to s. SEC 3.09(1)(c) regarding investment in commodity futures contracts is revised. The language of the amendment in the form sent out for public comment in July, 1985 provided that the current absolute prohibition on the investment in commodity futures contracts would not apply where commodity futures contract investments are used for hedging purposes. The amendment as revised has language added that cross-references relevant administrative rule provisions under the federal Commodity Exchange Act as administered by the federal Commodity Futures Trading Commission ("CFTC"), where investment company purchases of commodity futures contracts for hedging purposes is already extensively treated. The revision is necessary to make the

Wisconsin rule requirements for investments in commodity futures contracts for hedging purposes consistent with the CFTC's regulations on this subject. The cross-referencing of the CFTC provision is consistent with the use elsewhere in the Wisconsin Uniform Securities Law and Code of cross-references to definitional provisions from federal law, such as in s. 551.23(8) referring to "investment company as defined under 15 USC 80a-3," or in s. 551.60(5) authorizing the Commissioner to "take such action as is authorized under 7 USC 13a-2."

CFTC Regulation 4.5(c)(2)(i) requires investment companies using financial futures to represent that the use of commodity futures or commodity options contracts will be solely for bona fide hedging purposes within the meaning and intent of Section 1.3(z)(1) of the CFTC's regulations. That section goes on to provide that with respect to certain anticipatory or long hedge strategies, an alternative test may be employed to determine whether the investment company's use of futures contracts come within the meaning of the bona fide hedging purposes limitations.

(d) List of Persons Appearing or Registering at Public Hearing Conducted by Commissioner of Securities Ulice Payne, Jr. as Hearing Officer

-- Randall E. Schumann, General Counsel of the Office of the Commissioner of Securities, made an appearance on behalf of the agency's staff to submit documents and information for the record.

-- James R. Fischer, Administrator of the Registration Division, appeared on behalf of the agency's staff to summarize the significant rule revisions relating to securities registration matters.

-- Alan E. Korpady, Administrator of the Franchise Investment Division, appeared on behalf of the agency's staff to summarize the rule revisions relating to franchise matters.

-- Attorney Conrad Goodkind, 780 North Water Street, Milwaukee, Wisconsin 53202.

-- Mr. Douglas Blass, Assistant General Counsel, Investment Company Institute, 1600 M Street N.W., Washington, D. C. 20036

-- Mr. William Gehl, Secretary, Principal Preservation Tax-Exempt Fund, Inc., 215 North Main Street, West Bend, Wisconsin 53095

-- Attorney Joseph P. Hildebrandt, 1 South Pinckney Street, Madison, Wisconsin 53701

-- Mr. Terry Nelson, Legal Assistant, 1 South Pinckney Street, Madison, Wisconsin 53701

Comment Letters received:

-- Comment letter dated September 4, 1985, received September 6, 1985 from National Development and Investment, Inc., 13555 Bishop's Court, Brookfield, Wisconsin.

-- Comment letter dated September 16, 1985, received September 16, 1985 from Randall E. Schumann, General Counsel of the staff of the Wisconsin Commissioner of Securities Office.

-- Comment letter dated September 16, 1985, received September 16, 1985 from Attorney Joseph Hildebrandt, 1 South Pinckney Street, Madison, Wisconsin.

-- Comment letter dated September 16, 1985, received September 17, 1985 from the Investment Company Institute, 1600 M Street N.W., Washington, D.C.

-- Comment letter dated September 17, 1985, received September 17, 1985 from Principal Preservation Tax-Exempt Fund, Inc., 215 North Main Street, West Bend, Wisconsin.

(e) Response to Legislative Council/Rules Clearinghouse Report Recommendations

(1) Acceptance of recommendations in whole:

Under 2. Form, Style and Placement in Administrative Code

-- Consistent with the Rules Clearinghouse comment in para. a. regarding the "Relating Clause", the code chapter designation "SEC" was not repeated in listing the sections treated by the rule-making order.

-- Consistent with the Rules Clearinghouse comment in para. c. regarding SECTION 20 of the Initial comment draft of the rule revisions, the different treatments relating to two rule provisions in that SECTION were placed into separate rules, SECTIONS 20 and 21 of the rule-making order.

-- Consistent with the Rules Clearinghouse comment in para. d. regarding SECTION 12 concerning s. SEC 3.18, the Attorney General and the Revisor of Statutes have been requested to authorize, and have authorized by letter dated October 31, 1985, the incorporating by reference of an outside regulatory standard.

-- Consistent with the Rules Clearinghouse comment in para. e. regarding SECTION 16, the word "as" was capitalized to read "As" at the beginning of both subd. 1. and 2. of that SECTION.

-- Consistent with the Rules Clearinghouse comment in para. f. regarding SECTION 28, concerning s. SEC 32.05(1)(c)3., a colon was added following the word "either", and the letters "a." and "b." were substituted for "(i)" and "(ii)".

(2) Acceptance of recommendations in part:

Under 1. Statutory Authority

-- The Rules Clearinghouse stated that all of the proposed rules appeared to be within the

statutory authority of the Commissioner, and then stated that two of the statutory sections cited in the "Pursuant to" clause at the beginning of the Rule-Making Order did not specifically confer such authority. With regard to one of the sections that was cited by the Rules Clearinghouse--namely, s. 551.58(1)--it appears that the Rules Clearinghouse misread the numbering because the Rule-Making Order specified s. 553.58(1) among the list of statutes cited, not s. 551.58(1). Inasmuch as s. 553.58 is the section of the Wisconsin Franchise Investment Law providing general rule-making authority, its inclusion in the Rule-Making Order is necessary and appropriate, consequently that section remains included in the proposed final form of the Rule-Making Order. Regarding the other statutory section identified by the Rules Clearinghouse as not according rule-making authority (namely, s. 553.22(4)) reference to that section was deleted from the "Pursuant to" clause of the Proposed final form of the Rule-Making Order.

(3) Rejection of recommendations:

-- In item para. b., of Form, Style and Placement in Administration Code, the Rules Clearinghouse stated that SECTIONS 3 and 21 of the rule-making code (which SECTIONS renumbered subdivisions following two rule provisions that were repealed) were unnecessary and recommended that the renumbering not be done. The reasons for the rejection of this recommendation are set forth in item (e) (4) below.

-- In item para. a., of Clarity, Grammar, Punctuation and Plainness, the Rules Clearinghouse suggested that definitions of "compensation" and "offering expenses" be added to SECTION 6 of the rule-making order. The reasons for the rejection of this recommendation are set forth in item (e)(4) below.

-- In item para. b. of Clarity, Grammar, Punctuation and Plainess, the Rules Clearinghouse raised the concern that no distinction was made in the rule in SECTION 7 between "incentive" and "non-statutory" options. The reasons for rejection of this recommendation are set for this item (e)(4) below.

-- In item para. c. of Clarity, Grammar, Punctuation and Plainness, the Rules Clearinghouse, in stating it was unclear whether a prospectus must be "approved" by the SEC to be deemed to satisfy the full disclosure requirements, inferred that clarification on that point should be added to the rule. The reasons for rejection of this inferred recommendation are set forth in item (e)(4) below.

(4) Reasons for not accepting recommendations:

-- The reason for rejecting the recommendation in item (3) regarding renumbering rule provisions following rules that were repealed is that leaving gaps in the numbering sequence of the rules causes numerous questions from and confusion to users of the Rules of the Commissioner of Securities. Such questions and confusion have occurred in the past experience of the agency because in prior instances, whenever a gap in numbering has occurred in the rules, readers of the rules think their copy of the rules is inaccurate or incomplete and telephone the staff to check the accuracy of their copy of the rules.

Additionally, it has been this agency's practice in its annual rule revision for the last 6-7 years to renumber the rule subdivisions following repealed rules, and such renumbering practice has never been called into question before.

-- The reasons for rejecting the recommendation in item (3) suggesting that separate definitions of "compensation" and for "offering expenses" be added to SECTION 6 are as follows: (i) separate language is already contained in the rule indicating that the various kinds and types of sales compensation are to be considered separate and distinct from all other offering expenses--such as legal fees, accounting fees, printing expenses and state registration filing fees; (ii) it is understood by the securities industry brokerage members, securities issuers and securities law practitioners who utilize the rule what "other offering expenses" are; (iii) the current language of the rule has existed for 15 years without any question or confusion regarding what "other offering expenses" are.

-- The reason for rejecting the recommendations in item (3) suggesting that a distinction be made in SECTION 7 between "incentive" and "non-statutory" options is that the rule is not meant to provide any distinction in treatment of the two kinds of stock options. Rather, the reduction in the fair market value percentage standard from 100% to 85% in the rule is intended to apply across-the-board to all "options, whether "incentive" or "non-statutory ".

-- The reasons for rejecting the recommendation in item (3) that language be added to SECTION 13 regarding whether the federal Securities and Exchange Commission (SEC) "approves" a prospectus are: (i) the "full review" terminology used in SECTION 13 is a term of art and corresponds to the same terminology used by the SEC as stated in the ANALYSIS to SECTION 13; (ii) it is illegal to state that any securities offering or disclosure document is "approved" by the SEC.

(f) No final regulatory flexibility analysis is included on the basis that the Office of the Wisconsin Commissioner of Securities has determined, after complying with s. 227.016(1) to (5), Wis. Stats., that the proposed rules will not have a significant economic impact on a substantial number of small businesses.

BRANCH OFFICE RENEWAL FORM

FORM BDBrO(WI)
9/15/85

NAME OF FIRM: _____

ADDRESS OF FIRM: _____

TELEPHONE NO. OF PRINCIPAL OFFICE OF FIRM: _____

1. _____
Street

_____
City, State, Zip Code

_____
Telephone No.

_____
Name of Branch Manager

2. _____
Street

_____
City, State, Zip Code

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Telephone No.

_____
Name of Branch Manager

3. _____
Street

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City, State, Zip Code

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Telephone No.

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Name of Branch Manager

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City, State, Zip Code

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Telephone No.

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Name of Branch Manager

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Name of Branch Manager

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City, State, Zip Code

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Telephone No.

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Name of Branch Manager

8. _____
Street

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City, State, Zip Code

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Telephone No.

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Name of Branch Manager

(THIS SPACE RESERVED FOR USE OF THE SECURITIES OFFICE

FILING FEE _____

RECEIPT NUMBER _____

DATE RECEIVED _____

Statement of Policy

REGISTRATION OF COMMODITY POOL PROGRAMS

Adopted on September 21, 1983, effective January 1, 1984, by

North American Securities Administrators Association, Inc.

[¶ 5335]

I. INTRODUCTION. A. Application. 1. The standards contained in these guidelines pertain to the offer and sale of securities by commodity pool limited partnerships or analogous corporate entities and are designed to establish uniform and consistent standards to be applied by the various state securities Administrators. The Guidelines do not purport to supplant existing or future rules and regulations promulgated by the Commodity Futures Trading Commission or the National Futures Association with respect to transactions in commodities not involving the offer and sale of a security by such programs. The Administrator may modify or waive such Guidelines if the object sought to be achieved thereby is accomplished by other means.

2. Where the individual characteristics of specific Programs warrant modification from these standards, they will be accommodated, insofar as possible, while still being consistent with the spirit of these guidelines.

3. Where applicable, the Administrator may require compliance with the jurisdiction's guidelines for corporate securities and may not allow a security with different rights and privileges to be issued unless there is justification therefor.

4. When required by the Administrator, a Cross Reference Sheet shall be furnished with the application.

B. *Definitions.* As used in these guidelines, the following terms shall mean:

1. *Administrator*—The official or agency administering the security laws of a state.

2. *Advisor*—Any Person who for any consideration engages in the business of advising others, either directly or indirectly, as to the value, purchase, or sale of Commodity Futures Contracts or commodity options.

3. *Affiliate*—An Affiliate of a Person means (a) any Person directly or indirectly owning, controlling or holding with power to vote 10% or more of the outstanding voting securities of such Person; (b) any Person 10% or more of whose outstanding voting securities are directly or indirectly owned, controlled or held with power to vote, by such Person; (c) any Person, directly or indirectly, controlling, controlled by, or under common control of such Person; (d) any officer, director or partner of such Person; or (e) if such Person is an officer, director or partner, any Person for which such Person acts in any such capacity.

4. *Audited Financial Statement*—Financial statements, (balance sheet; statement of operations; statement of changes in financial position) prepared in accordance with generally accepted accounting principles and accompanied by an auditor's report containing an opinion, acceptable to the Administrator, of an independent certified public accountant or independent accountant.

5. *Capital Contributions*—The total investment in a Program by a Participant or by all Participants, as the case may be.

6. *Commodity Futures Contract*—A contract providing for the delivery or receipt at a future date of a specified amount and grade of a traded commodity at a specified price and delivery point.

7. *Futures Broker*—Any Person who engages in the business of effecting transactions in Commodity Futures Contracts for the account of others or for his own account.

8. *Net Assets*—The total assets, less total liabilities, of the Program determined on the basis of generally accepted accounting principles. Net Assets shall include any unrealized profits or losses on open positions, and any other credit or debit accruing to the Program but unpaid or not received by the Program.

9. *Net Asset Value Per Unit*—The Net Assets divided by the number of units outstanding.

10. *Net Profits*—The sum of (a) the net of any profits and losses realized by all trades closed out during the period, and (b) the net of any unrealized profits and losses on open positions as of the end of the period, minus, (c) the net of any unrealized profits or losses on open positions as of the end of the preceding period, (d) all expenses incurred or accrued during the period and (e) cumulative net realized losses, if any, carried forward from preceding periods.

COMMENT: When computing incentive fees under Section IV.B.2., Net Profits shall not include interest earned on funds of the Program, including proceeds of the offering, held from time to time.

11. *Organizational and Offering Expenses*—All expenses incurred by the Program in connection with and in preparing a Program for registration and subsequently offering and distributing it to the public, including, but not limited to, total underwriting and brokerage discounts and commissions (including fees of the underwriter's attorneys), expenses for printing, engraving, mailing, salaries of employees while engaged in sales activity, charges of transfer agents, registrars, trustees, escrow holders, depositories, experts, expenses of qualification of the sale of its securities under federal and state law, including taxes and fees, accountants' and attorneys' fees.

12. *Participant*—The holder of a Program interest.

13. *Person*—Any natural Person, partnership, corporation, association or other legal entity.

14. *Program*—The limited partnership, joint venture or incorporated organization formed and operated for the purpose of investing in Commodity Futures Contracts.

15. *Program Broker*—A Futures Broker that effects trades in Commodity Futures Contracts for the account of a Program.

16. *Program Interest*—A limited partnership or other unit representing ownership in a Program.

17. *Pyramiding*—A method of using all or a part of an unrealized profit in a Commodity Futures Contract position to provide margin for any additional Commodity Futures Contracts of the same or related commodities.

18. *Sponsor*—Any Person directly or indirectly instrumental in organizing a Program or any Person who will manage or participate in the management of a Program, including a Futures Broker who pays any portion of the Organizational Expenses of the Program, and the general partner(s) and any other Person who

regularly performs or selects the Persons who perform services for the Program. Sponsor does not include wholly independent third parties such as attorneys, accountants, and underwriters whose only compensation is for professional services rendered in connection with the offering of the units. The term "Sponsor" shall be deemed to include its Affiliates.

19. *Valuation Date*—The date as of which the Net Assets of the Program are determined.

20. *Valuation Period*—A regular period of time between Valuation Dates.

[¶ 5336]

II. REQUIREMENTS OF THE SPONSOR. A. Experience. Both the Sponsor and the Advisor must be able to demonstrate sufficient knowledge and experience to carry out the Program policies and objectives and to manage Program operations. Ordinarily a minimum of three years of relevant experience will be deemed sufficient.

B. [Financial Condition.] The financial condition of the Sponsor must be commensurate with any financial obligations assumed in the operation of the Program. At a minimum, the Net Worth of the general partner shall be the greater of:

1. An amount equal to 5% of Capital Contributions in all existing Programs in which the Sponsor has potential liability as a general partner plus 5% of the total subscriptions in the Program being offered, or

2. 15% of the gross amount of the current offering in offerings of less than $2,500,000. If the offering exceeds $2,500,000, the Net Worth must be at least 10% of the gross amount of the offering, up to $1 million of Net Worth, but in no case less than $50,000. Net worth of individual general partners shall be determined exclusive of home, furnishings and automobiles. Audited balance sheets of general partners shall be furnished except that in the event that an individual is a general partner, an unaudited balance sheet prepared by a certified public accountant and signed and sworn to by such individual general partner may be accepted for the purpose of determining required Net Worth, in the discretion of the Administrator. Also, evaluation will be made of contingent liabilities to determine the appropriateness of their treatment in the computation of Net Worth.

C. Investment in the Program. The Sponsor must make a permanent investment in the program equal to the lesser of 3% of the Participants' interest or $100,000 at the formation of the Program. A minimum investment by the Sponsor of the lesser of 3% of Net Assets or $100,000 should be maintained during the existence of the Program. In appropriate cases, the Administrator may require the Sponsor to purchase for cash additional interests in the Program.

D. Reports. The Sponsor shall submit to the Administrator any information required to be filed with the Administrator, including, but not limited to, reports and statements required to be distributed to Participants.

E. Tax Ruling or Opinion. If the Program is organized as a limited partnership, the Sponsor must obtain a favorable tax ruling from the Internal Revenue Service or an opinion of qualified tax counsel in a form acceptable to the Administrator concerning the tax status of a limited partnership.

F. Liability and Indemnification. 1. The Sponsor shall not pass on to Participants the liability imposed on the Sponsor by law, except that the Program agreement may provide that a Sponsor shall bear no liability to the Program or to any Participant for any loss suffered by the Program which arises out of any action or inaction of the Sponsor if such course of conduct did not constitute negligence or misconduct of the Sponsor and if the Sponsor, in good faith, determined that such course of conduct was in the best interest of the Program.

2. The Sponsor may be indemnified by the Program against expenses, including attorneys' fees, judgments and amounts paid in settlement, actually and reasonably incurred by the Sponsor in connection with the Program, provided such expenses were not the result of negligence or misconduct on the part of the Sponsor.

3. Any exculpation under Section 1. or indemnification under Section 2. above, unless ordered by a court, shall be made by the Program only as authorized in the specific case and only upon a determination by independent legal counsel in a written opinion that exculpation or indemnification of the Sponsor is proper in the circumstances because he has met the applicable standard of conduct set forth in Section 1. or 2. above.

4. For purposes of this Section F, the Sponsor shall be deemed not to include Affiliates.

COMMENT: Liability and indemnification are both to be qualified by a negligence standard. Affiliate indemnification should not be allowed except as set forth:

1. In the situation where an Affiliate of a Sponsor is being sued for an act of the Sponsor solely because of their relationship, the Affiliate would reasonably be entitled to indemnification.

2. In the situation in which an Affiliate is actually performing the duties of the Sponsor, the Affiliate shall be held to the same standard of conduct that the Sponsor would. The Affiliate would reasonably be entitled to the same indemnification provisions.

5. The Program may not incur the cost of that portion of liability insurance which insures the Sponsor for any liability as to which the Sponsor is prohibited from being indemnified under this Section II.F.

G. Additional Requirements. A Sponsor and Advisor must present evidence that it is or will be in compliance with applicable registration requirements under the Commodity Exchange Act as amended.

[¶ 5337]

III. SUITABILITY OF THE PARTICIPANT. A. Standards To Be Imposed. In view of the limited transferability, the relative lack of liquidity, and the high risk of loss of many commodity pool Programs, suitability standards related to the risks to be undertaken will be required for the Participants, and must be set forth in both the prospectus and a written instrument to be executed by each Participant. Sponsors will be required to set forth in the prospectus the investment objectives of the Program, a description of the type of investor who could benefit from the Program and the suitability standards to be applied in marketing the Program.

B. Sales to Appropriate Persons. 1. The Sponsor and each Person selling limited partnership interest on behalf of the Sponsor shall make every reasonable effort to assure that interests are offered or sold only to Persons for whom the investment is

appropriate in light of the Program suitability standards set forth in the prospectus as required and each Person's investment objectives and financial situation.

2. The Sponsor and his representatives shall ascertain that the Participant can reasonably benefit from the Program, and the following shall be evidence thereof:

(a) The potential Participant has the capacity of understanding the fundamental aspects of the Program, which capacity may be adduced from the following:

(1) nature of employment experience; (2) educational level achieved; (3) access to advice from qualified sources, such as, legal, accounting and tax advisory; (4) prior experience with investments of a similar nature.

(b) The potential Participant apparently understands the following aspects of the Program being sold:

(1) the fundamental risks and possible financial hazards of the investment; (2) the lack of liquidity of the investment; (3) management and control by the Sponsor; (4) the tax consequences of the investment.

3. The potential Participant is able to bear the economic risk of the investment. For purposes of determining the ability to bear the economic risk, unless the Administrator approves a lower suitability standard, Participants shall have a minimum annual gross income of $30,000 and a Net Worth of $30,000, or in the alternative, a Net Worth of $75,000. In high risk offerings, higher suitability standards may be required. In the case of sales to fiduciary accounts, the suitability standards shall be met by the fiduciary or by the fiduciary account or by a donor who directly or indirectly supplies the funds to purchase the Program Interests. Net Worth shall be determined exclusive of home, home furnishings and automobiles.

C. Maintenance of Suitability Records. The Sponsor and/or his representatives shall retain for at least six years all records necessary to substantiate that Program interests were sold only to purchasers for whom such securities were suitable. Administrators may require the Sponsor and/or his representative to obtain from the potential Participant a letter justifying the suitability of such investment.

D. Minimum Investment. The minimum subscription shall not be less than $2,000 and shall be paid in cash at the time of purchase. Assessments of any kind shall be prohibited.

[¶ 5338]

IV. FEES, COMPENSATION AND EXPENSES. A. Organizational and Offering Expenses. 1. All Organizational and Offering Expenses, including commissions, and any other compensation for sales of Program Interests shall be reasonable. In no event shall these expenses exceed 15% of the gross proceeds of the offering, regardless of the source of payment.

2. No Sponsor shall directly or indirectly pay or award any commissions or other compensation to any Person engaged to sell Program interests or give investment advice to a potential Participant; provided, however, that this clause shall not prohibit the payment to a registered broker-dealer or other properly licensed Person of normal sales commissions for selling Program Interests.

[The next page is 1339-3.]

COMMENT: Compensation paid to sales agents from a percentage of commodity brokerage commissions (trail commissions) will not be considered objectionable offering expense under Section IV.A.

B. Compensation. 1. Management Fee. The aggregate annual expenses of every character paid or incurred by the Program, including management and advisory fees based on the Net Assets of the Program but excluding commodity brokerage commissions, incentive fees, legal, audit and extraordinary expenses, calculated at least quarterly on a basis consistently applied, shall be reasonable but in no event shall exceed one half of 1% of Net Assets per month (not to exceed 6% annually); provided the Sponsor shall not receive a management fee if it receives any portion of the brokerage commissions under Section IV.B.3.

The Sponsor(s) shall reimburse the Program quarterly for the amount by which such aggregate monthly expenses exceed the amounts herein provided, up to an amount not exceeding its management and advisory fees for the period for which reimbursement is made, prior to publication of the company's quarterly report and shall promptly notify the Administrator if the aggregate expense limitation is exceeded by reason of any extraordinary expenses.

2. Incentive Fees. The Sponsor or Advisor will be entitled to an incentive fee not to exceed 15% of the Net Profits of the Program, calculated not more often than quarterly on the Valuation Date, over the highest previous Valuation Date. For purposes of this calculation, Program losses shall be carried forward but shall not be carried back.

3. Brokerage Commissions. The Program shall seek the best price and services available in its commodity futures brokerage transactions. A Sponsor shall not effect any transactions in Commodity Futures Contracts with any Futures Broker affiliated directly or indirectly with the Sponsor or with any Advisor providing the Sponsor with research information, recommendations or other services which might be of value to the Sponsor, unless such transactions are effected at competitive rates. In no event will the Program be allowed to enter into any exclusive brokerage contract. If the Sponsor receives any portion of the brokerage commissions from Program operations, the Advisor may not be affiliated with the Sponsor. This prohibition may be waived by the Administrator if the Sponsor can demonstrate adequate safeguards against conflicts of interest between the Program Broker and Advisor. The Administrator may require the Program to file periodic reports concerning all brokerage transactions.

The prospectus must clearly disclose, for each commodity on each exchange on which the Program is expected to trade, the round turn commission to be initially charged to the Program both as a dollar amount and as a percentage of the standard published scheduled rates of the Program Broker. Such round turn commission should include the exchange clearing or similar fees charged for each brokerage transaction. If the trading Advisor acts as trading Adivsor to other commodity pools, the prospectus should indicate whether the proposed rates for the Program are higher or lower than other pools which are advised by the trading Advisor (together with any other information concerning brokerage charges to those other pools which the Sponsor deems relevant).

4. Other Income. a. Any interest or other income earned by any portion of the Program assets shall accrue solely to the benefit of the Program.

b. A Sponsor shall not take any action with respect to the assets or property of the Program which does not benefit the Program. Such a prohibited action, among others,

would be the utilization of Program funds as compensating balances for the Sponsor's own benefit.

5. Expenses of the Program. All expenses of the Program shall be billed directly to and paid by the Program. Reimbursements (other than for Organizational and Offering Expenses) to any Sponsor shall not be allowed, except for reimbursement of the actual cost to the Sponsor of legal and audit services used for or by the Program. Expenses incurred by the Sponsor in connection with administration of the Program, including but not limited to salaries, rent, travel expenses and such other items generally falling under the category of Sponsor's overhead, shall not be charged to the Program.

6. Only those items of compensation permitted herein will be allowed. Any variance must be adequately justified to the Administrator.

[¶ 5339]

V. RIGHTS AND OBLIGATIONS OF PARTICIPANTS. A. Meetings. Meetings of the Participants may be called by the general partner or by Participants holding more than 10% of the then outstanding units for any matters for which the Participants may vote as set forth in a limited partnership agreement or charter document. Such call for a meeting shall be deemed to have been made upon receipt by the general partner of a written request from holders of the requisite percentage of units stating the purpose of the meeting. The general partner shall deposit in the United States Mails within 15 days after receipt of said request, written notice to all Participants of the meeting and the purpose of such meeting, which shall be held on a date not less than 30 or more than 60 days after the date of mailing of said notice at a reasonable time and place.

B. Voting Rights of Limited Partners. The limited partnership agreement must provide that holders of a majority of the then outstanding units may, without the necessity for concurrence by the general partner, vote to (a) amend the limited partnership agreement or charter document, (b) dissolve the Program, (c) remove the general partner and elect a new general partner, (d) elect a new general partner if the general partner elects to withdraw from the Program, and (e) cancel any contract for services with the Sponsor without penalty upon 60 days written notice. The general partner shall not withdraw from the partnership without 90 days prior notice thereof to the Participants.

C. Access to Program Records. 1. The Sponsor shall maintain at the principal office of the Program a list of the names and addresses of and interests owned by all Participants. Such list shall be made available for the review by any Participant or his representative at reasonable times, and upon request, either in Person or by mail the Sponsor shall furnish a copy of such list to any Participant or his representative upon payment of the cost of reproduction and mailing.

2. The Participants and their representatives shall be permitted access to all records of the Program, after adequate notice, at any reasonable time. The Sponsor shall maintain and preserve such records for a period of not less than six years.

D. Annual and Periodic Reports. [Compliance with the provisions of CFTC regulations for Reporting to Pool Participants, 17 C.F.R. § 4.22 [CCH COMMODITY FUTURES LAW REPORTS ¶ 2223B], will be considered sufficient to comply with this Section D.]

1. The partnership agreement shall provide for the transmittal to each Participant of an annual report within 120 days after the close of the fiscal year containing at least the following information:

(a) A balance sheet as of the end of the Program's fiscal year and statements of income, partners' equity, and changes in financial position for the year then ended, all of which shall be prepared in accordance with generally accepted accounting principles and accompanied by an auditor's report containing an opinion (without material qualification) of an independent certified public accountant or independent public accountant.

(b) A statement showing the total fees, compensation, brokerage commissions and expenses paid by the Program, segregated as to type, and stated both in aggregate dollar terms and as a percentage of Net Assets.

2. A Sponsor shall be required to furnish Participants with quarterly reports, which may be unaudited, containing the same information as in (a) and (b) above within 60 days after the end of the quarter.

3. A Sponsor shall provide to all Participants, not later than March 15th of each year, all information necessary for the preparation of the Participants' income tax returns.

4. The Sponsor shall calculate the Net Assets of the fund daily and shall make available upon the request of a Participant, the Net Asset Value Per Unit.

E. Transferability of Program Interests. 1. Assignment of Program interests is permitted, provided that the opinion of the partnership's counsel is given to the effect (i) that such assignment is not a violation of the limited partnership laws in effect in the jurisdiction of the Program's organization, (ii) that such assignment will not cause the Program to be taxable as a corporation or an association rather than as a partnership under the policies of the Internal Revenue Service. No transfers may be made where, after the transfer, either the transferee or the transferor would hold less than the minimum number of units equivalent to an initial minimum purchase, except for transfers by gift, inheritance, intrafamily transfers, family dissolutions, and transfers to Affiliates.

2. The assignment of Program interests may not be prohibited, but may be restricted only to the minimum extent required to preserve its tax status.

F. Participant Liability. A Program shall be structured so that a public investor cannot be exposed to liability in excess of the amount of the remaining balance of his capital account excluding partial redemptions, distributions consisting of a return of capital and accumulated profits.

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VI. DISCLOSURE AND MARKETING REQUIREMENTS. A. Minimum Program Capital. The minimum amount of funds to activate a Program shall be sufficient to accomplish the objectives of the Program, including "spreading the risk." Any minimum less than $500,000, after deduction of all front end charges, will be presumed to be inadequate to spread the risk of the public investors. Provision must be made for the return of 100% of paid subscriptions in the event that the established minimum to activate the Program is not reached. All funds received prior to activation

of the Program must be deposited with an independent custodian, trustee or escrow agent whose name and address shall be disclosed in the prospectus.

COMMENT: The purpose of this requirement is to assure the adequate diversification of the investments of the Program.

B. Sales Literature. Sales literature, sales presentation (including prepared presentations to prospective investors at group meetings) and advertising used in the offer or sale of interests shall conform in all applicable respects to requirements of filing, disclosure and adequacy currently imposed on sales literature, sales presentations and advertising used in the sale of corporate securities.

C. Contents of the Prospectus. 1. Prospectus. A prospectus which is not part of a registration statement declared effective by the Securities and Exchange Commission pursuant to the Securities Act of 1933 shall generally conform to the disclosure requirements which would apply if the offering were so registered.

2. Conflicts of Interest and Transactions with Affiliates. (a) Any conflicts of interest between the Program and any Sponsor, Advisor, Futures Broker or any Affiliate thereof, must be fully disclosed.

(b) Goods and services provided to the Program by the Sponsor must be provided at rates and terms at least as favorable as those which may be obtained from third parties in arm's-length negotiations.

(c) The Sponsor shall also be required to disclose the steps that will be taken to alleviate any real or potential conflict of interest.

(d) If the Program pays higher than the minimum commission rates for commodity brokerage transactions, such fact shall be set forth along with a justification.

(e) Prohibitions. Certain conflicts of interest are presumed to be materially sufficient to render the proposed Program incapable of accomplishing its stated objectives in the best interest of the Participants and shall be controlled as follows:

(1) No loans may be made by the Program to the Sponsor or any other Person.

(2) The funds of a Program shall not be commingled with the funds of any other Person. Funds used to satisfy margin requirements will not be considered commingled.

(3) No rebates or give ups may be received by the Sponsor nor may the Sponsor participate in any reciprocal business arrangements which could circumvent these guidelines. Furthermore, the prospectus and Program charter documents shall contain language prohibiting the above as well as language prohibiting reciprocal business arrangements which would circumvent the restrictions against dealing with Affiliates or other interested parties.

(4) A Program's charter document shall prohibit the commodity trading Advisor or any other Person acting in such capacity from receiving an advisory fee if he shares or participates, directly or indirectly, in any commodity brokerage commissions generated by the Program.

(5) The maximum period covered by any contract of the partnership with the Advisor or Sponsor shall not exceed one year. The agreement must be terminable without penalty upon 60 days' written notice by the Program.

(6) Any other agreement, arrangement or transactions, proposed or contemplated, may be restricted in the discretion of the Administrator if it would be considered unfair to the Participants in the Program.

(7) A Program shall not engage in Pyramiding.

(8) All of the foregoing restrictions shall be disclosed in the prospectus and contained in the partnership agreement or charter document.

3. Notification. Each Participant shall be notified within seven business days from the date of any decline in the Net Asset Value Per Unit to less than 50% of the Net Asset Value on the last Valuation Date. Included in the notification shall be a description of the Participants' voting rights pursuant to Section V.B.

4. Material Changes. Any material changes in the Program's basic investment policies or structure shall require prior written approval by a majority of units held by Participants. A material change shall include, specifically, any transfer or withdrawal of the Sponsor's interest in the Program.

5. Financial Information Required on Application. The Sponsor or the Program shall provide as an exhibit to the application or where indicated below shall provide as part of the prospectus, the following financial information and financial statements:

(a) Balance Sheet of the Program. A balance sheet of the Program as of the end of its most recent fiscal year, prepared in accordance with generally accepted accounting principles and accompanied by an auditor's report without material qualification by an independent certified public accountant or an independent public accountant, and an unaudited balance sheet as of a date note [not] more than 90 days prior to the date of filing.

(b) Balance Sheet of the Sponsor. (1) Corporate Sponsor. A balance sheet of any corporate Sponsor as of the end of its most recent fiscal year, prepared in accordance with generally accepted accounting principles and accompanied by an auditor's report without material qualification by an independent certified public accountant or an independent public accountant and an unaudited balance sheet as of a date not more than 90 days prior to the date of filing. Such statements shall be included in a prospectus.

(2) Individual Sponsor. A Statement of Financial Condition as of a time not more than 90 days prior to the date of filing an application. Such Statement of Financial Condition shall be prepared in accordance with generally accepted accounting principles and reviewed and reported upon by an independent certified public accountant or independent public accountant under the review standards as set forth by the American Institute of Certified Public Accountants. A representation of the amount of such Net Worth must be included in the prospectus.

(c) Filing of Other Statements. The Administrator may, where consistent with the protection of investors, request additional financial statements of the Sponsor, Advisor, Program Broker or any Affiliate thereof, or permit the omission of one or more of the statements required under this section and the filing, and substitution thereof, of appropriate statements verifying financial information having comparable relevance to an investor in determining whether he should invest in the Program.

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VII. MISCELLANEOUS PROVISIONS. A. Fiduciary Duty. The Program agreement shall provide that the Sponsor shall have fiduciary responsibility for the safekeeping and use of all funds and assets of the Program, whether or not in his immediate possession or control, and that he shall not employ, or permit another to employ such funds or assets in any manner except for the exclusive benefit of the Program.

In addition, the Program shall not permit the Participant to contract away the fiduciary obligation owed to the Participant by the Sponsor under common law.

B. Redemptions. The Program shall provide for the redemption of Program interests at least quarterly except that redemption need not be offered until six months after the commencement of trading. The Sponsor shall state the Valuation Date in the prospectus. A Participant must notify the Sponsor in writing at least 10 days prior to the Valuation Date of his wish to redeem his Program Interests. The Sponsor must redeem such Program Interests at the Net Asset Value on the Valuation Date unless the number of redemptions would be detrimental to the tax status of the Program; in which case, the Sponsor shall select by lot so many redemptions as will, in its judgment, not impair the Program's status. Participants shall be notified in writing within 10 days after the Valuation Date whether or not their Program Interests have been redeemed. Payment for the redeemed Program Interests shall be made within 30 days after the Valuation Date. The Sponsor may provide that redemptions may be temporarily suspended if, in the Sponsor's judgment, additional redemptions would impair the ability of the Program to meet its objectives.