

CSI - Ohio

The Common Sense Initiative

Business Impact Analysis

Agency Name: Securities

Regulation/Package Title: 2014 Five Year Review /

Rule Number(s): 1301:6-1-14; 1301:6-3-14.1; 1301:6-3-14.2; 1301:6-3-15; 1301:6-3-15.1; 1301:6-3-16; 1301:6-3-16.1; 1301:6-3-16.3; 1301:6-3-16.5

Date: August 11, 2014

Rule Type:

New

5-Year Review

Amended

Rescinded

The Common Sense Initiative was established by Executive Order 2011-01K and placed within the Office of the Lieutenant Governor. Under the CSI Initiative, agencies should balance the critical objectives of all regulations with the costs of compliance by the regulated parties. Agencies should promote transparency, consistency, predictability, and flexibility in regulatory activities. Agencies should prioritize compliance over punishment, and to that end, should utilize plain language in the development of regulations.

Regulatory Intent

1. Please briefly describe the draft regulation in plain language.

Please include the key provisions of the regulation as well as any proposed amendments

These rules relate to the statutes that provide for the various licenses issued by the Division. Those licenses are securities dealers, securities salespersons, investment advisers (IAs),

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investment adviser representatives (IARs), state retirement system investment officers and the bureau of workers' compensation chief investment officer. The rules set out how a license may be obtained, exceptions to licensing, notice filing requirements for federally registered IAs and, in the case of those dealers and IAs not registered federally, also set out the books and records requirements.

- 1301:6-3-14 – This rule provides exceptions from the general licensing requirement of RC 1707.14. There are no proposed changes.
- 1301:6-3-14.1 – IAs that are registered federally must “notice file” with the Division. This rule provides the procedure to file the notice by those IAs. This rule is proposed to be amended to correct the reference to the federally chartered SRO from NASD to FINRA; to correct a citation to Form ADV and OAC 1301:6-3-15.1; and to require notice filers to submit part 2 of Form ADV, as do state-registered IAs.
- 1301:6-3-14.2 – Ohio law allows, under very limited circumstances, for a dealer to not be registered with the SEC. For those dealers (presently there are 4), there needs to be requirements, similar to the federal law, to keep and maintain certain books and records, communications with customers, and maintain financial records and soundness. This rule sets out those requirements and also provides how a dealer may operate on the premises of a bank in such a way that the public understands the difference between FDIC insured deposits and the uninsured securities sales. There are no proposed changes.
- 1301:6-3-15 – This rule specifies how a license application for a dealer is filed and the attendant requirements. The rule sets out the same provisions for a broker selling on bank premises, for those brokers not covered by the language in 1301:6-3-14.2, and, comparable to federal law, requires notice of the establishment of branch offices and, unless done with FINRA, submit financial statements. The Division proposes to amend the rule so that the designated principals, required by statute, are the ones identified on federal form BD.
- 1301:6-3-15.1 – In 1999, states took over from the SEC the regulation of smaller investment adviser firms. This rule, put in place in 1999, mirrors the federal requirements for IAs and defines terms and provides: how to become licensed (augmenting RC 1707.151), supervisory responsibilities, books and records requirements, custodial (i.e. holding clients' money) requirements and communications with clients. The Division proposes to amend this rule in a number of ways to clarify and modernize the requirements. The definition of qualified client has been changed for federal purposes and should be changed to allow dollar thresholds to be increased. Federal form ADV, to which the rule refers, was changed in 2011 and references to parts of the previous Form ADV need to be changed to accurately cite to the current Form. Financial terminology is proposed to be changed for accuracy (“cash reconciliations” to “bank reconciliations” and “financial

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statements to “income statement and balance sheet”). Records to be maintained would be amended to include social media and other forms of internet communications, advisory contracts to be signed by the parties and a reduction of the time a deficient application may remain pending without action from over one year to 180 days in parity with the current dealer rule.

- 1301:6-3-16 – This rule sets out the licensing requirements and procedure for securities salespersons. The Division proposes to amend this rule by allowing the withdrawal of a deficient application if it remains in the pending category with the CRD for 180 days, in parity with the current dealer rule. The rule is also proposed to be amended to allow for salespersons to be licensed with two affiliated dealers.
- 1301:6-3-16.1 – RC 1707.161 provides that the Division will, by rule, set out the procedures and conditions for an investment adviser representative (IAR) to become licensed. This rule provides for the procedures and the alternative examinations the applicant may pass to become licensed. The rule also allows for an IAR to be affiliated with two different IAs. The Division is proposing that this rule be amended to correct a reference to the NASD (change to the new name FINRA) and also to parity the current dealer rule and allow deficient applications for licensing that have been pending in the CRD for 180 days to be withdrawn.
- 1301:6-3-16.3 – This rule sets out the license process and procedure for state retirement system investment officers’ licenses applications, terminations and renewals. It indicates what educational, experience or designation will meet the requirements of RC 1707.163. There are no proposed changes.
- 1301:6-3-16.5 – RC 1707.164 requires a bureau of workers’ compensation chief investment officer (BWCCIO) to be license by the Division. RC 1707.165 provides for the Division to create a process and procedure for a BWCCIO to become licensed. This rule sets out the procedures to apply, terminate and renew the license. There are no proposed changes.

2. Please list the Ohio statute authorizing the Agency to adopt this regulation.

Ohio Revised Code Section 1707.20. The rules amplify, respectively, RC 1707.14; 1707.141; 1707.142; 1707.15; 1707.151; 1707.16; 1707.161; 1707.163; 1707.165.

3. Does the regulation implement a federal requirement?

No.

Is the proposed regulation being adopted or amended to enable the state to obtain or maintain approval to administer and enforce a federal law or to participate in a federal program?

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If yes, please briefly explain the source and substance of the federal requirement.

No.

4. If the regulation includes provisions not specifically required by the federal government, please explain the rationale for exceeding the federal requirement.

Not applicable

**5. What is the public purpose for this regulation (i.e., why does the Agency feel that there needs to be any regulation in this area at all)? **

- 1301:6-3-14 – In addition to the exceptions to the general rule that all dealers must obtain a license, contained in RC 1707.14, section (D) of that statute provides that the Division may, by rule, exempt any dealer if licensing or registration is not necessary for the protection of investors or in the public interest. Rule 1301:6-3-14 sets out exceptions to the licensing and registration requirements that meet that test. Many of these exceptions were enacted after the Division investigated a request by industry.
- 1301:6-3-14.1 – The regulation of investment advisers (IAs) is preempted by the SEC for IAs with assets under management of \$100 million or more. Below that amount, the states are the primary regulators. However, SEC IAs are required to “notice file” with states that impose such a requirement and RC 1707.141(B) requires SEC registered IAs to notice file with the Division. 1301:6-3-14.1 provides how a notice filing may be accomplished and renewed. The proposed changes to this rule are to correct citations and to align the submissions for a notice filer with the filings from state-registered IAs.
- 1301:6-3-14.2 – RC 1707.14 provides that certain dealers need not register with the SEC. RC 1707.142 requires all dealers licensed by the Division to comply with all capital, custody, margin, financial responsibility, record-making, record-keeping, bonding, financial reporting and operational reporting mandates required of SEC registered dealers. In the alternative, the statute allows the non-SEC registered dealer to comply with rules, created by the Division, relating to the same types of financial, operational and record-keeping requirements. 1301:6-3-14.2 sets out the Division’s rules relating to capital, custody, margin, financial responsibility, record-making, record-keeping, bonding, financial reporting and operational reporting provisions. This provides smaller dealers with an alternative to the SEC requirements.
- 1301:6-3-15 – RC 1707.15 requires the Division to create rules relating to applying for a dealer’s license. 1301:6-3-15 is the rule setting out the procedures for a license application and some of the attendant obligations. The rule creates a safe harbor for dealer’s wishing to partner with depository institutions to offer securities dealer’s services within the bank. When the rule was changed to create this safe harbor it was

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at a time when dealers were seeking such an arrangement. The amendment proposed would align the list of persons who may be a designated principal to the list identified on federal form BD, so that the designated principals, required by statute, have sufficient supervisory capabilities to protect the firm and the investing public.

- 1301:6-3-15.1 – In 1999, when federal law mandated the states create their own regulations of IAs or permit a situation where IAs would not be regulated by the states, Ohio created RC 1707.151 and, in conjunction, OAC 1301:6-3-15.1. These statutory and administrative regulations were based on the federal law: the Investment Advisers Act of 1940. This rule is intended to require comparable, albeit reduced, record-keeping, financial responsibility and operational supervision and reporting, both for the protection of clients and to create a system that allows all IAs to operate equally. The reduction of the period to withdraw an inactive application is to provide parity by bringing the treatment of IAs in line with the current treatment of dealers.
- 1301:6-3-16 – RC 1707.16 requires the Division to promulgate rules to establish how a person may obtain a securities salesperson’s license. This rule sets forth the procedure and the specific examinations that will qualify for the application so the applicant has specific directions. The amendment to limit a deficient pending application to 180 days is proposed because presently, without such a mechanism to withdraw a deficient application, the CRD has become cluttered with applications that were abandoned. The Division presently, and will continue to, contact applicants to encourage the application process to move forward or request that the application be withdrawn. There are instances where applicants choose to not continue with the application and, because there is no penalty, inaction is not a concern. Because the CRD contains hundreds of thousands of individuals, abandoned applications interfere with the system’s integrity. The intent is to provide for the same withdrawal period for all licensees. Allowing dual licensing with affiliated dealers recognizes a business need involving firms under common control that will not lessen investor protection because the parent firm and subsidiaries are jointly responsible for supervision.
- 1301:6-3-16.1 – RC 1707.161 provides for the Division to promulgate rules relating to the licensure of an investment adviser representative. This rule sets out the process and the examination and qualification requirements, the details of which the statute does not describe. The rule provides the specificity required to give guidance to the applicant. The purpose of the amendment regarding withdrawals is the same as discussed in 1301:6-3-16, above.
- 1301:6-3-16.3 – This rule sets out the procedure for applying for a state retirement system investment officer’s license because RC 1707.163 provides that the Division

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issue rules specifying the process and the examination requirements. The rule provides the applicant with the direction needed to comply with the statute.

- 1301:6-3-16.5 – RC 1707.165 provides that the Division issue rules implementing the statutory scheme. This rule sets out the specifics needed to apply and maintain a bureau of workers' compensation chief investment officer license.

6. How will the Agency measure the success of this regulation in terms of outputs and/or outcomes?

The Division's licensing and field examination staff will have constant contact with licensees to discern the impact and success of the rules and any rules that need to be revisited. The Division's annual Securities Conference provides for meetings with advisory groups to begin or continue conversations regarding the Division's rules. The Division receives, and responds to, phone calls and e-mails on a regular basis from licensees and practitioners who wish to discuss a situational issue or the interpretation of a rule or statute. In all of these avenues, the Division has an opportunity to measure how well the rules are achieving their respective goals.

Development of the Regulation

7. Please list the stakeholders included by the Agency in the development or initial review of the draft regulation.

If applicable, please include the date and medium by which the stakeholders were initially contacted.

See attached list. Stakeholders were emailed a package of the rules with a cover letter indicating which rules were No Change and which were amendments. The email was sent Oct. 3, 2014, and comments were requested by Oct. 31. Prior to that, conversations were held individually with representatives of stakeholders for input on various rule changes.

8. What input was provided by the stakeholders, and how did that input affect the draft regulation being proposed by the Agency?

One stakeholder responded, indicating they did not have any comments.

9. What scientific data was used to develop the rule or the measurable outcomes of the rule? How does this data support the regulation being proposed?

The rule follows statutory requirements relating to the Revised Code and the applicable federal law. Since the general structure of the rules has been in place for a number of years, the Division has taken advantage of opportunities to revise the rules.

10. What alternative regulations (or specific provisions within the regulation) did the Agency consider, and why did it determine that these alternatives were not appropriate? If none, why didn't the Agency consider regulatory alternatives?

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The rules herein are based on long-standing state and federal regulation. No other alternatives were required, either because it would cause conflict with the federal requirements or case law, or alter the expectations of the industry and the public.

- 11. Did the Agency specifically consider a performance-based regulation? Please explain. *Performance-based regulations define the required outcome, but don't dictate the process the regulated stakeholders must use to achieve compliance.***

The rules promote transparency and equality. Inasmuch as the rules mandate certain actions, the specificity relates to the outcomes. The rules, generally, are intended to provide guidance how an applicant may obtain a license and a licensee may operate. Where different alternatives are available, such as the examination or accreditation required, alternatives are offered.

- 12. What measures did the Agency take to ensure that this regulation does not duplicate an existing Ohio regulation?**

The Division is the only Ohio agency regulating in this area. All statutes and rules governing, or enforced by, the Division were reviewed to ensure there were no duplications or conflicts. As applicable, federal law is reviewed to avoid duplication or conflict.

- 13. Please describe the Agency's plan for implementation of the regulation, including any measures to ensure that the regulation is applied consistently and predictably for the regulated community.**

These rules have been in place for a significant number of years, providing industry and the investing public notice. The general application of the rules will not change. Those changes that are proposed will be widely disseminated and discussed before application. Because the rules are widely distributed, and the Division staff is accessible, transparency of implementation provides predictable application.

Adverse Impact to Business

- 14. Provide a summary of the estimated cost of compliance with the rule. Specifically, please do the following:**

- a. Identify the scope of the impacted business community;**

All licensees of the Division will be impacted by their respective rules.

- b. Identify the nature of the adverse impact (e.g., license fees, fines, employer time for compliance); and**

The respective statutes require the licenses. There are no fines imposed by the rules, but the rules do require various types of recordkeeping to be completed and maintained, which will impose a burden on the licensee to which the rule applies, some more than others.

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c. Quantify the expected adverse impact from the regulation.

The adverse impact can be quantified in terms of dollars, hours to comply, or other factors; and may be estimated for the entire regulated population or for a “representative business.” Please include the source for your information/estimated impact.

- 1301:6-3-14 – There are no adverse impacts anticipated from this rule. This rule provides exceptions to the general requirement that all persons must be licensed to sell securities.
- 1301:6-3-14.1 – The statute requires that federally registered investment advisers must file with the Division. The rule does not impose additional adverse impact but clarifies procedure.
- 1301:6-3-14.2 – RC 1707.142 provides that certain small dealers may elect to follow alternative rules, developed by the Division, rather than comply with the federal rules for registration. The adverse impact imposed by this rule is one that the dealer chooses as less of an adverse impact than complying with the federal requirements. There are only 4 firms that fit this exemption and no new requests in many years. If an application was made, the Division has been told by an outside vendor that, for IAs, they would charge between \$3- and 5,000 to prepare and file all the licensing materials and provide a compliance manual and related supervisory materials. The Division speculates that it would be comparable. Daily recordkeeping and maintaining those records for the required periods will entail some additional time each day. However, those requirements would be no more extensive than for a federally registered dealer.
- 1301:6-3-15 – The licensing requirements are statutorily imposed, including the examination. The Form BR is required at the federal and SRO level and, according to the SEC, whose form it is, will require 2.75 hours to complete. Financial statements will require time to prepare or the services of an accountant, depending on the complexity of the business and would be the same that the dealer would have to be completed to comply with their federal requirements.
- 1301:6-3-15.1 – This rule requires specific business recordkeeping by IAs. The Division has been told by an outside vendor that they would charge between \$3- and 5,000 to prepare and file the license application, provide a compliance manual and assist in setting up the IA. Once established, the IA will be required to maintain books and records which will take an hour or two a day, depending on the complexity of the business and the number of clients. If the IA maintains custody of customer funds and securities, there will be

additional requirements, including communications to clients, which will add some time to the recordkeeping.

- 1301:6-3-16 – Obtaining and submitting a fingerprint card will cost a nominal amount of time and money. Updating a U-4 will require no more time than is imposed by the same federal requirement. . The examination is imposed by statute.
- 1301:6-3-16.1 - Obtaining and submitting a fingerprint card will cost a nominal amount of time and money. . The examination is imposed by statute.
- 1301:6-3-16.3 - Obtaining and submitting a fingerprint card will cost a nominal amount of time and money. The examination is imposed by statute.
- 1301:6-3-16.5 - Obtaining and submitting a fingerprint card will cost a nominal amount of time and money. The examination is imposed by statute.

15. Why did the Agency determine that the regulatory intent justifies the adverse impact to the regulated business community?

The Division’s mission is to protect the investing public and to maintain an orderly marketplace. These rules are intended to accomplish both. When all licensees are treated equally, no licensee has an advantage over another. At the same time, when the investing public has confidence in the securities market, confidence created by known and predictable regulation, the securities marketplace benefits through the willingness of investors to participate in the market. Maintaining the books and records provides evidence of fair dealing and allows regular communications with clients who depend upon the advice of the professional.

Regulatory Flexibility

16. Does the regulation provide any exemptions or alternative means of compliance for small businesses? Please explain.

There are various exemptions and carve-outs that encompass small business.

1301:6-3-14 contains exceptions to the requirement to obtain a dealer’s license.

1301:6-3-14.1 only applies to SEC registered IAs, which, by definition, are not small businesses.

1301:6-3-14.2 is an entire rule structured so that certain small dealers need not be federally registered.

1301:6-3-15.1 provides a specific method for a sole proprietor to become licensed as an IA. That rule also permits records to be maintained and preserved electronically or hard copy and contains language to avoid the licensee keeping duplicate records.

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17. How will the agency apply Ohio Revised Code section 119.14 (waiver of fines and penalties for paperwork violations and first-time offenders) into implementation of the regulation?

There are no administrative fines or civil penalties associated with these rules.

18. What resources are available to assist small businesses with compliance of the regulation?

The Division receives, and responds to, phone calls on a regular basis from issuers and practitioners that wish to discuss a situational issue or the interpretation of a rule or statute. The Division's annual Securities Conference provides for meetings with the industry and the Bar to begin or continue conversations regarding the Division's rules. The rules are widely disseminated and changes are typically noted in the Ohio Securities Bulletin.

ATTACHMENT
SECURITIES STAKEHOLDER'S LIST

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