



Department of Commerce

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Securities Bulletin

Ohio Securities Bulletin

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[VISIT OUR WEBSITE](#)

The screenshot shows the Ohio Department of Commerce website. At the top, there is a navigation bar with the Ohio.gov logo and the Department of Commerce name. Below the navigation bar, there is a disclaimer: "PLEASE NOTE: The Ohio Division of Securities online filing functions are currently unavailable. Other online filing options, such as the NASAA EFD and BlueExpress, may still be utilized. Should you have any questions or concerns, please contact the Division at 614-644-7381." The main content area features a large article titled "Stop Financial Fraud & Scams - Read Our Investor Alerts" with a background image of a stock market display. To the right of the article, there are several smaller news items, including "More Professionals Required to Report Suspected Elder, Financial Abuse" and "2019 Ohio Securities Conference A Success". At the bottom of the page, there are three main sections: a profile of Commissioner Andrea Spidt, a "FIND FORMS & PUBLICATIONS" search form, and a "LOOK IT UP" search form.

Investment Contracts and the “Guarantee” Myth

By: Janice Hitzeman, Attorney Inspector, Ohio Division of Securities

Ohio’s first blue sky law was enacted in 1913.¹ In 1929, the basic framework for today’s Ohio Securities Act was enacted to prevent the fraudulent exploitation of the investing public through the sale of securities.² This goal is best accomplished through a broad definition of securities.³ The Ohio Securities Act includes an expansive definition of securities as “any certificate or instrument, or any oral, written, or electronic agreement, understanding, or opportunity, that represents title to or interest in, or is secured by any lien or charge upon, the capital, assets, profits, property, or credit of any person or of any public or governmental body, subdivision, or agency.”⁴ Beyond this general definition, the Ohio legislature provided not less than 32 specific investments, which are included in the definition of security. The list of specific transactions includes an “investment contract.”

Ohio courts have determined an investment contract exists when four elements are present: (1) the offeree furnishes initial value to the offeror; (2) the initial value is subject to the risks of the venture or enterprise; (3) an opportunity to make a profit beyond the initial outlay of funds by the offeree; and (4) an absence of direct or meaningful control over the investment by the investor.⁵ This test is commonly referred to as the “risk capital test.”⁶ This article will focus on the second element of the investment contract analysis as it related to guarantees contained within investment offerings.

Administrative cases initiated by the Division are replete with instances where issuers utilize some variation of the word “guarantee” in order to perpetuate fraudulent schemes.⁷ In many of

¹ Ohio Securities Law and Practice § 1.02 (2019).

² *Id.*; see also *In re Columbus Skyline Securities, Inc.*, 74 Ohio St.3d 495, 498 (1996).

³ *Columbus Skyline*, 74 Ohio St.3d at 498; see also *Perrysburg Twp. v. City of Rossford*, 103 Ohio St. 3d 79, 82 (2004); *Reves v. Ernst & Young*, 494 U.S. 56, 60-61 (1990); *Securities & Exchange Comm. v. W. J. Howey Co.*, 328 U.S. 293, 298-299 (1946) (definitions under securities act should be flexible rather than static “to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits”).

⁴ R.C. 1707.01(B).

⁵ *State v. George*, 50 Ohio App. 2d 297, 303-04 (1975). The test in this opinion resembles one formulated in 1946 by the U.S. Supreme Court, which held that under federal securities law, an “investment contract,” and thus a “security,” was present for federal law purposes “where individuals were led to invest money in a common enterprise with the expectation that they would earn a profit solely through the efforts of the promoter or of someone other than themselves.” *Howey*, 328 U.S. at 301.

⁶ The risk capital test has become well-established in Ohio law, with *State v. George* typically cited as the wellspring case. Ohio Securities Law and Practice § 3.06 (2019).

⁷ See, e.g., *In re Alliance Trust*, Order No. 99-394, Ohio Dep’t of Com., Sec. Div. (Sept. 24, 1999)(finding Alliance Trust misrepresented that the membership interests in Alliance Trust were safe and guaranteed); *In re Campbell*, Order No. 15-016, Ohio Dep’t of Com., Sec. Div. (Oct. 10, 2015)(holding that an oral agreement to invest in Chinese Reorganization Gold Loan Bonds with guaranteed return on investments were investment contracts sold to investors through fraud and misrepresentations); see also *In re Radiant Renovations, LLC*, Order No. 06-124, Ohio

these cases, the Division has found the security involved is an investment contract even when the issuer or seller informs the investor that the investment is guaranteed.⁸ For instance, in a case involving a Texas corporation offering “net profit interest investments” in automated teller machines owned and operated by ATM USA, the Division found ATM USA made written representations through its solicitation materials provided to the investor, and oral representations through its agents, that the rate of return for this investment was between 30 percent and 57 percent, and the investment was guaranteed by a financial performance bond issued by The Insurance Firm, Newark, Ohio.⁹ Despite finding the issuer told investors the investment was guaranteed by a bond issued by a third party, the Division found the transactions were investment contracts that fell within the definition of a security. In another case, the Division found a Louisiana company sold unregistered securities through misrepresentations stating their investments would yield a 12 percent to 14 percent return over five years. The Division found the transactions were investment contracts, even though the offering materials stated the investments could be guaranteed by a “performance bond” issued by Fidelity Secured Deposit Corporation in Santa Ana, California.¹⁰

The second prong of the risk capital test requires the initial value to be subject to the risks of the venture or enterprise. In each of the cases cited above, the issuer or solicitor informed the investor(s) the investments were “guaranteed.” Does the inclusion of the word “guarantee” automatically mean the transaction is not subject to the risks of the enterprise and, therefore, not an investment contract? This would be an untenable interpretation in these cases because the use of the word “guarantee” was part of the fraud or misrepresentation to the investors. This simplified analysis would provide a blueprint for every purveyor of a fraudulent scheme to avoid liability under the Ohio Securities Act: just tell the investor their funds are guaranteed. The determination of whether a particular instrument is a security must be made on a case-by-case basis, with the primary emphasis on the economic realities of the investment.¹¹

The application of an “economic realities” analysis to determine whether an investment is a security is not a new area of jurisprudence in Ohio. Courts at both the state and federal level, including the U.S. Supreme Court, have applied this analysis to transactions involving securities

Dep't of Com., Sec. Div. (May 5, 2006); *In re Capital Investors Group*, Order No. 97-132, Ohio Dep't of Com., Sec. Div. (April 23, 1997); *In re Cleobrothers & Co., Inc.*, Order No. 17-033, Ohio Dep't of Com., Sec. Div. (Nov. 17, 2017); *In re Eavenson Family LP*, Order No. 07-032, Ohio Dep't of Com., Sec. Div. (Feb. 28, 2007).

⁸ See generally, footnote 6; see also, e.g., *In re Quadra pay Land, LLC*, Order No. 07-005, Ohio Dep't of Com., Sec. Div. (Jan. 22, 2007); *In re David F. Klima*, Order No. 97-344, Ohio Dep't of Com., Sec. Div. (Oct. 3, 1997); *In re Universal Funding Corp.*, Order No. 97-023, Ohio Dep't of Com., Sec. Div. (Jan. 23, 1997); *In re The Sterling Multi-Media Co.*, Order No. 98-391, Ohio Dep't of Com., Sec. Div. (Sept. 9, 1998).

⁹ *In re ATM USA Corporation*, Order No. 99-487, Ohio Dep't of Com., Sec. Div. (Nov. 23, 1999); see also *In re George*, Order No. 99-383, Ohio Dep't of Com., Sec. Div. (Sept. 17, 1999).

¹⁰ *In re Paramount Payphones, Inc.*, Order No. 99-005, Ohio Dep't of Com., Sec. Div. (Jan. 7, 1999).

¹¹ *Perrysburg*, 103 Ohio St. 3d at 83-84. The Ohio Supreme Court in *Perrysburg* provided an analysis of when a promissory note is a security, but the analysis referred to the application of “economic realities” to the transaction. See also *State v. Silberberg*, 166 Ohio St. 101, 105 (1956).

for decades.¹² In *Landreth Timber Co. v. Landreth*¹³, the U.S. Supreme Court, noted, "... the *Howey* economic reality test was designed to determine whether a particular instrument is an 'investment contract,' not whether it fits within *any* of the examples listed in the statutory definition of "security." The Court further states, "This Court has decided a number of cases in which it looked to the economic substance of the transaction, rather than just to its form, to determine whether the Acts applied."¹⁴

If an investment includes the word "guarantee" or some derivative in its offering, it is necessary to look beyond the language itself in order to determine whether an investment contract is present. Without reviewing the economic realities of the guarantee itself, it is not possible to determine whether it eliminates the "risks of the enterprise" such that the protection of securities laws is unnecessary. In an oft-cited law review article published in 1967 entitled, "The Economic Realities of a 'Security': Is There a More Meaningful Formula?," Professor Ronald J. Coffey states: "In testing for the net effect of a transaction on the buyer's initial value, the economic significance of each constituent event of the whole transaction must be carefully assessed."¹⁵ The article goes on to state: "The subjection of the buyer's initial value to the risks of an enterprise with which he is not familiar and over which he exercises no control seems to be the 'economic reality' which most clearly creates a need for the special fraud procedures, protections, and remedies of the securities laws. There are several manifestations of risk, some of which are difficult to discern, and therefore each transaction must be carefully analyzed to make certain the risk factor has been accurately appraised."¹⁶

Based on a long line of securities jurisprudence, a determination of whether a transaction is an "investment contract" and therefore a "security" under Ohio law cannot be derived solely from the terminology contained within the contract itself. A reasonable analysis must look to the economic realities of the investment. Inclusion of the word "guarantee" or some derivative in offering materials alone cannot sustain a finding that a transaction is not an investment contract and, therefore, not a security. That form of simplified analysis would set a dangerous precedent for would-be fraudsters and would upend the very nature of the Ohio Securities Act and its intended purpose to prevent the fraudulent exploitation of the investing public through the sale of securities. Instead, the Division and courts should review the economic realities of each investment in order to make a reasonable determination for when a "security" exists for the proper application of the Ohio Securities Act.

¹² See generally Ohio Securities Law and Practice § 3.02 (2019).

¹³ 471 U.S. 681, 691 (1985).

¹⁴ *Id.* at 690.

¹⁵ Coffey, *The Economic Realities of a "Security": Is There a More Meaningful Formula?*, 18 W. Res. L. Rev. 367, 384 (1967). Professor Coffey was Ohio's Director of Commerce, under whose jurisdiction the Division of Securities operates, in 1971. Ohio Securities Law and Practice § 3.06 (2019).

¹⁶ *Id.* at 412.

Licensing & Examinations Update

The division's Licensing and Examination Section (L&E) provides timely and important information covering a wide-range of topics from A to Z that affects licensees.

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SEC proposes significant changes to IA Advertising and Solicitation rules

On Nov. 4, the Securities and Exchange Commission (SEC) released proposed changes to its advertising and solicitation rules for investment advisers registered under the Investment Advisers Act of 1940 (see [Release No. IA-5407](#)). The advertising rules have not been substantially amended since their original adoption in 1961, but rather have been the subject of supplementation and interpretation via no-action letters and other SEC guidance over the past 50-plus years. The proposal would entirely replace the existing rule and advances a principles-based approach that allows – subject to certain conditions – the use of testimonials, endorsements, and third-party ratings. The proposed rule also permits performance advertising subject to certain tailored requirements.

Additionally, the SEC proposed amending the cash solicitation rule, to update its coverage since the rule was originally adopted in 1979. The proposal would expand the rule to cover solicitation arrangements involving all forms of compensation (beyond only cash), tailor the required disclosures solicitors must provide to potential clients, and refine the disciplinary events disqualifying a person or entity from acting as a solicitor.

The Ohio Division of Securities will closely monitor the comment period and the SEC's final rules to assess the need for changes to its own rules relating to Ohio-licensed investment advisers.

IARD System Fee Increase for IARs

On Oct. 30, the North American Securities Administrators Association (NASAA) announced a \$5 fee increase for investment adviser representatives (IARs). Beginning Jan. 1, 2020, the initial IARD set-up and renewal system fees will be \$15 each for all IARs. This fee was \$45 when the IARD system first became operational in 2001. IARD system fees fund user and system support as well as system enhancements, including the ongoing redesign of the IARD system to improve its effectiveness and efficiency and to make it more user-friendly for applicants and registrants.

Licensing Statistics

	December 2019	December 2018
Dealers	1,941	1,970
Investment Advisers	860	867
Investment Advisers (Notice Filers)	2,031	1,992
Investment Adviser Representatives	20,125	19,990
Securities Salespersons	194,531	191,160
Investment Officers	98	102
TOTAL	219,586	216,081

Ohio Attorneys Learn Mandatory Reporting Best Practices



The Ohio State Bar Association (OSBA) recently hosted a one-hour lunchtime webinar for its members to obtain continuing legal education (CLE). The webinar, “**Financial Exploitation: Representing Financial Advisers while Adhering to Elder Abuse Reporting Requirements,**” was presented by the Elder Abuse Commission and taught by Kelly Igoe, compliance counsel with the Ohio Department of Commerce’s Division of Securities, and Senior Elder Services Coordinator April Wehrle from the office of Ohio Attorney General Dave Yost.

The webinar’s learning objectives were to discuss:

- 1) the best practices of mandatory reporting for attorneys and their financial services clients,
- 2) how to detect abuse and properly report the suspicion of abuse, neglect and financial exploitation (abuses), and
- 3) how to protect the mandatory reporters from under-reporting such abuses.

The new mandatory reporters added by the passage of Substitute Senate Bill 158, 132nd General Assembly (SB 158) include the Division’s licensees; investment advisers, investment adviser representatives, dealers and salespersons. The Division is expecting all financial services firms have strong elder client policies in place. These policies should contain instructions on how to report the suspicion of abuse and a continued effort to educate their employees to detect issues that may arise with elderly clientele. Several financial services firms are using interview questions to assess if the elderly client has the mental capacity to handle their financial needs, if the client is knowledgeable and understands the documents they have signed, and if are they acting voluntarily.

In Ohio, the suspicion of elder abuse sets the stage for a mandatory reporter to begin the reporting process to the County Department of Job and Family Services (CDJFS) in the county where the potential victim resides. The suspicion is not always easy to recognize. The webinar covered warning signs for all types of abuses, and several common methods used to financially exploit seniors as it pertained to bank accounts and securities.

To Report or Not Report

There are many barriers keeping professionals from reporting the suspicion of abuses, but the new requirement to report and the availability of immunity may assist many professionals with making the tough decision. The mandatory reporter does not have to be certain of the abuse or diagnose a condition but only have a “reasonable suspicion” abuse has occurred, is currently occurring or may occur.

Victims cannot be expected to report an abuse. There are several reasons for this; many are in fear of losing their independence or even the retaliation by the alleged abuser, or they do not know or want to acknowledge they are being victimized.

This epidemic goes well beyond a con artist taking advantage of an unsuspecting elderly person, but also assumes the elderly client can manage their finances. There are several additional considerations when working with an elderly client, including cognitive impairments, permanent impairments, and even the potential of reversible impairments.

In addition, the Elder Abuse Commission was officially codified March 20, 2019, within SB 158. SB 158 added Ohio Revised Code sections 5101.74 and 5101.741, which created the Commission, but it is noteworthy that the Commission has met since 2009. (see sidebar *History of Elder Abuse Commission*)

The Division of Securities' expertise in the investigation of financial exploitation has provided us a dedicated position on the Commission. The Division continues to respond to securities fraud perpetrated against all Ohioans, including the vulnerable group of senior citizens in Ohio.

This serious issue is not a new concern for lawyers and their financial services clients but will now require attention to provide legal representation on the best practices of reporting the suspicion of elder abuse, neglect and exploitation. Attorneys must consider assisting clients with the establishment of strong internal policies, practices and continued education in order to facilitate meaningful and quality reporting.

HISTORY OF THE ELDER ABUSE COMMISSION

Elder abuse is by no means a new problem, but a growing epidemic. The creation of the Commission was an early recommendation in the process of addressing the growing problem of elder abuse in Ohio. Then-Ohio Attorney General Jim Petro created the Elder Abuse Task Force in 2005. The Task Force was convened to study and make recommendations regarding Ohio's elder abuse, neglect and exploitation programs and systems. The Task Force focused on three key issues: 1) raise awareness of, and increase the education about, elder abuse 2) provide for statewide coordination for identification, prevention and treatment activities, and, 3) recommend policy, funding and programming to address elder abuse more effectively.

In 2009, the inaugural meeting of the Elder Abuse Commission was held. This brought together various state agencies and interested parties to address the totality of abuses directed toward older Ohioans. The Commission currently is supported and staffed by the Ohio Attorney General's Consumer Protection Section, Elder Justice Unit.

Enforcement Update

Administrative Hearings

Steven Arthur Svetlick, CRD No. 2589535
Andrew Todd Roseberry, CRD No. 2589166
Consolidated Financial Management Group, LLC, CRD No. 119695
Division Order Nos. 19-022, 19-028, 19-029
Hearing Dates: Feb. 10-14, 2020

Daniel Rossi, CRD No. 1190774
FEIC Financial, Inc., CRD No. 25545
Business Equity Advisors, Inc. f/k/a FEIC Business Equity Solutions, Inc.
Division Order Nos. 19-024 and 19-034
Hearing Dates: Feb. 26-28, 2020

Component Sourcing Group, Inc.
Patricia Tzannakos
Division Notice Order No. 19-019
Hearing Date: Continuance granted. New date TBD.

Dock Douglas Treece, CRD 866947
Treece Investment Advisory Corp., CRD No. 110449
Treece Financial Services Corp., CRD 23296
Division Notice Order No. 18-023
Hearing held. Report and Recommendation issued recommending revocation. Awaiting final order.

Sam Aziz CRD No. 1721932
Aziz Capital Management, LLC
Sam Aziz Capital, LLC
Division Notice Order No. 19-006
Hearing request withdrawn. *Goldman* Hearing held. Report and Recommendation issued recommending revocation. Awaiting final order.

LA Stephenson and Company, CRD No. 167629
Lucien Austin Stephenson, CRD No. 3084925
Division Notice Order No. 19-007
Hearing held. Report and Recommendation issued recommending revocation. Awaiting final order.

Administrative Appeals

TAP Management, Inc. et al.
Case No. 17 CV 006942, Franklin County Court of Common Pleas
Appeal from Division Final Order No. 17-022
Filed Aug. 2, 2017
No oral arguments scheduled.

Craig Alan Sutherland, CRD No. 2001873
Case No. 19 CVF 120692, Delaware County Court of Common Pleas
Appeal from Division Order No. 19-040
Filed Dec. 10, 2019
Awaiting certification of record.

Enforcement Update

Administrative Orders

Division Order No. 19-035

Stable Asset Fund, LLC/Stable Asset Fund I, Ltd
Dublin, Ohio

On Nov. 8, 2019, the Division issued a final order to Stable Asset Fund, LLC/Stable Asset Fund I, Ltd. to cease and desist after a hearing was not requested in response to Division Notice Order No. 19-027. The order finds, in part, that Andrew Roseberry, Steven Svetlick, and Consolidated Financial Management Group, LLC (“CFMG”) solicited investment advisory clients to invest in Stable Asset Fund, LLC and Stable Asset Fund I, Ltd. (collectively “SAF”) and continued to provide false and inflated valuation statements showing, in aggregate, SAF’s value at or near \$783,554 after the fund was defunct. The notice order further alleges investors were not informed that: SAF was managed by Roseberry and Svetlick, but was incorporated in the names of their wives; Svetlick and Roseberry were personally funding distributions to a select subgroup of investors because SAF generated no revenue; and respondents had not engaged in due diligence to determine value or prepared a financial statements for Stable Asset Fund for more than 10 years. An administrative hearing requested by counsel for Svetlick, Roseberry and CFMG for related Division notice orders is scheduled to begin Feb. 10, 2020.

Division Order No. 19-036

Katrina Farmer a/k/a Katrina Seiter
A Voice 4 U, LLC
Bellbrook, Ohio

On Nov. 15, 2019, after an administrative hearing, the Division issued a Final Order to Issue Cease and Desist against Katrina Farmer aka Katrina Seiter and A Voice 4 U, LLC, based, in part, on findings they sold promissory notes and equity shares issued by A Voice 4 U, LLC, to Ohio investors that were not properly registered for sale in Ohio. The Order further finds investor funds were used for purchases at retail stores, including Victoria’s Secret, Kings Island, and tanning and nail spas, as well as significant payments to Keen.com for e-mail, chat and telephone psychic readings.

Division Order No. 19-037

Sarbojeet Jana
Abstract Tube, Inc.
Columbus, Ohio

On Nov. 15, 2019, the Division issued a Cease and Desist Order with Consent naming Sarbojeet Jana and his company, Abstract Tubing, based on findings they engaged in crowdfunding to raise capital without properly complying with registration requirements. The order includes findings the offering materials contained material deficiencies related to risk factors, including risks associated with irregular use of investor proceeds and without providing assumptions or a reasonable basis for projections. The order included further findings the financial statements filed with the Form C filing included material anomalies.

Division Order No. 19-038

Crossroads Community Church, Inc.
Brian Tome
Cincinnati, Ohio

On Nov. 19, 2019, the Division issued a Cease and Desist Order with Consent naming Crossroads Community Church, Inc. and its pastor, Brian Tome, based on findings they engaged in the sale of securities issued by Wesleyan Investment Foundation, Inc. (“WIF”) which were not registered with the division for sale in Ohio. The Consent order further found Crossroads and Tome later engaged in the sale of securities issued by WIF through

Enforcement Update

representations that were at material variance with the offering circulars filed with the Division. The order also found Crossroads acted as an unlicensed securities dealer in selling the WIF securities in exchange for remuneration, specifically loans in excess of \$24M.

Division Order No. 19-039

Redmond, W. LLC
Willie Redmond
Dayton, Ohio

On Dec. 4, 2019, the Division issued a Notice of Opportunity for Hearing and Notice of Intent to Issue Cease and Desist Order naming Redmond, W. LLC and Willie Redmond based, in part, on allegations the respondents acted as unlicensed investment advisers, securities dealers, investment adviser representatives and securities salespersons by soliciting a co-worker to invest with him in exchange for three percent of the profits from trading. The Notice Order alleges Redmond told the investor he would “double her principal investment.” The Notice Order further alleges Redmond operated five investment clubs in or from Ohio between 2012 and 2017.

Division Order No. 19-040

Craig Alan Sutherland, CRD No. 2001873
Columbus, Ohio

On Dec. 4, 2019, after an administrative hearing, the Division issued a Final Order to Suspend the Ohio Investment Adviser Representative and the Ohio Securities Salesperson Licenses of Craig Alan Sutherland for six months based on the following findings: (1) Sutherland was the subject of regulatory action and customer complaints, and further engaged in nondisclosure that impaired his reputation for honesty, integrity and competence in business, (2) Sutherland made unsuitable recommendations to clients in the sale of non-traded REITs and speculative gold mining stock, (3) Sutherland breached his fiduciary duty to his clients, (4) Sutherland issued false, exaggerated and misleading statements to his clients regarding the gold mining stock, and (5) Sutherland failed to properly update his Form U-4. The Order further conditioned his continued licensure with the Division on a prohibition from engaging in the sale, offer for sale of any alternative or non-conventional investment or recommending the purchase of any alternative or non-conventional investment in connection with the rendering of services as an investment adviser representative or salesperson so long as Sutherland remains licensed with the Division. On Dec. 10, 2019, Sutherland filed a Notice of Appeal pro se in case No. 19 CVF 120692 in the Delaware County Court of Common Pleas. On Dec. 17, 2019, Judge James Schuck granted a 30-day stay of the suspension order, which ends on Jan. 16, 2020 based, in part, on Sutherland’s assertion “over 500 individual and small business clients will be irreparably harmed” related to “financial transactions that must be undertaken before Dec. 31 in order to avoid adverse consequences.” Oral arguments may be scheduled after certification of the record from the administrative hearing.

Division Order No. 19-041

Garry N. Savage, Sr., CRD No. 1195330
Advanced Strategies Agency, Inc., CRD No. 121343
Huron, Ohio

On Dec. 6, 2019, after an administrative hearing, the Division issued a Final Order to Revoke the Ohio Investment Adviser Representative License of Garry N. Savage, Sr. and the Ohio Investment Adviser License of Advanced Strategies Agency, Inc. based on a finding they lacked good business repute based on a “very long laundry list of incidents appearing on their records,” including multiple disciplinary actions, multiple customer complaints, settlement awards and judgments, some of which remained unsatisfied and unpaid, and numerous violations of the Ohio Securities Act, along with non-disclosure of these incidents to Division examination staff.

Enforcement Update

Division Order No. 19-042

Solium Financial Services LLC, CRD No. 147933
Woodcliff Lake, NJ

On Dec. 11, 2019, the Division issued a Cease and Desist Order with Consent naming Solium Financial Services, LLC, based on findings Solium self-reported in an application for licensure they had acted as an unlicensed securities dealer in exchange for commissions for a five-year period prior to the issuance of the order. Solium, which was acquired by Morgan Stanley, agreed to commence and complete an offering for return of commissions to all known Ohio residents who paid, directly or indirectly, commissions to Solium during the five-year period prior to and including Dec. 11, 2019. Additional terms are included in the undertaking letter published with the order in this case.

Criminal Trials and Hearings

State v. John Case

Case No. 18 CR 000991
Franklin County Court of Common Pleas
TBD (warrant outstanding)

State v. Brian Keith Decker CRD 4565524 (inactive)

Case No. 18 CR 395
Wood County Court of Common Pleas
Trial Date: Feb. 12, 2020

Brian Decker was arrested in New York after failing to appear for his Wood County trial originally scheduled for July 18, 2019. On Dec. 5, 2019, Decker was indicted in Wood County for failure to appear, a fourth-degree felony in Case No. 2019CR0546. This case was consolidated by court order with Case No. 18 CR 395 and is scheduled for trial on Feb. 12, 2020.

State v. Jeffrey B. Hall CRD No. 1871653 (inactive)

Case Nos. 17 CR 004124/18 CR 001232
Franklin County Court of Common Pleas
Trial Date: Feb. 3, 2020

State v. Benson Jean-Louis

Case No. 18 CR 004814
Franklin County Court of Common Pleas
Sentencing Date: Feb. 7, 2020

State v. Judith O. Nagy

Case No. CR18631581-A
Cuyahoga County Court of Common Pleas
Pre-Trial Date: Jan. 6, 2020

State v. Michael Neubig

Case No. 18 CR 004998
Franklin County Court of Common Pleas
Pre-Trial Date: Feb. 26, 2020

State v. Shaneal Yogesh Patel

Case No. B1901113
Hamilton County Court of Common Pleas
Hearing Date: TBD

Enforcement Update

Shaneal Patel is currently incarcerated with the Florida Department of Corrections for an unrelated offense.

State v. Aaron S. Pitman

State v. George R. Hammons

Case Nos. 19CR139/19CR141

Meigs County Court of Common Pleas

Trial Date (Pitman) and Sentencing Date (Hammons): Feb. 25, 2020

State v. Nicholas J. Pupino

Case No. 2019 CR 01086

Mahoning County Court of Common Pleas

Arraignment Date: Dec. 31, 2019

State v. Raymond D. Sarrocco

Case No. 19 CR I 04 0257

Delaware County Court of Common Pleas

Trial Date: Jan. 21, 2020

State v. Jeffery Luke Westerman

Case No. 18 CR 006309

Franklin County Court of Common Pleas

Pre-trial Date: Jan. 29, 2020

State v. Robert White

Case No. 2019 CR 000149

Clermont County Court of Common Pleas

Trial Date: Jan. 27, 2020

State v. Michael D. Wood

Case No. 19 CR I 11 0776

Delaware County Court of Common Pleas

Arraignment Date: Jan. 6, 2020

For further information on these cases, visit:

https://www.com.ohio.gov/documents/secu_Bulletin2019FirstQuarter.pdf

https://www.com.ohio.gov/documents/secu_Bulletin2018FourthQuarter.pdf

https://www.com.ohio.gov/documents/secu_Bulletin2018ThirdQuarter.pdf

https://www.com.ohio.gov/documents/secu_Bulletin2018SecondQuarter.pdf

http://com.ohio.gov/documents/secu_Bulletin2018FirstQuarter.pdf

http://com.ohio.gov/documents/secu_Bulletin2017FourthQuarter.pdf

http://com.ohio.gov/documents/secu_Bulletin2017ThirdQuarter.pdf

http://com.ohio.gov/documents/secu_Bulletin2017SecondQuarter.pdf

Criminal Cases

State v. Benson Jean-Louis

Case No. 18 CR 004814

Franklin County Court of Common Pleas

On Dec. 12, 2019, Benson Jean-Louis pleaded guilty to one count of grand theft, a fourth-degree felony, and one count of securities fraud, a third-degree felony, during a hearing in the Franklin County Court of Common Pleas. Sentencing is scheduled for Feb. 7, 2020. Following a criminal referral by the Ohio Division of Securities, Jean-Louis, a Haitian citizen and Franklin

Enforcement Update

County resident, was indicted in September 2018 by a Franklin County grand jury on one count of misrepresentation in the sale of securities and one count of securities fraud, both first-degree felonies, and one count of theft, a fourth-degree felony. The indictment alleged from November 2015 through Dec. 31, 2015, Jean-Louis solicited an individual to invest \$250,000 with him in a trading platform based on false information about Jean-Louis' experience and securities licensure. The indictment further alleged Jean-Louis misappropriated a portion of the investment funds for his own use. Jean-Louis did not hold any securities license in Ohio. This case was prosecuted by the Office of the Franklin County Prosecutor Ron O'Brien and presented by Robert Lang, assistant prosecuting attorney.

State v. Jerry Fuqua
Case No. B 1904019
Hamilton County Court of Common Pleas

On Nov. 7, 2019, Jerry Fuqua was sentenced to 18 months in prison and three years supervision after release by Hamilton County Common Pleas Judge Lisa Allen. Fuqua pleaded guilty in October to one count of theft from the elderly and one count of securing writings by deception, both third-degree felonies. He was indicted July 30 by a Hamilton County grand jury following a criminal referral by the Ohio Department of Commerce's Division of Securities. The indictment alleged he solicited \$20,000 from an elderly Ohio investor for fictitious stock certificates issued by Fuqua Corporation, which was shut down by the Ohio Department of Taxation in 2009 for failure to pay corporate franchise tax. This case was prosecuted by the office of Hamilton County Prosecutor Joseph T. Deters.

State v. George R. Hammons
Case No. 19CR141
Meigs County Court of Common Pleas

On Nov. 14, 2019, following a criminal referral by the Ohio Department of Commerce's Division of Securities and the Ohio Attorney General's Bureau of Criminal Investigation, George "Roderick" Hammons of Denver, Colorado, entered a guilty plea to one count of money laundering, and agreed to testify in the trial of State v. Aaron Pitman scheduled to begin Feb. 25, 2020. Sentencing for Hammons is scheduled for Feb. 25, 2020.

State v. Michael D. Wood
Case No. 19 CR I 11 0776
Delaware County Court of Common Pleas

On Nov. 22, 2019, Michael D. Wood was indicted by a Delaware County grand jury for multiple counts of securities fraud and theft. The charges include: two counts of securities fraud, both fourth-degree felonies; three counts of securities fraud, all third-degree felonies; one count of theft from the elderly, a third-degree felony; one count of theft, a fourth-degree felony; and one count of falsification, a first-degree misdemeanor. The indictment alleges Wood solicited five Ohio investors to invest more than \$70,000 in foreign currency investments based on false and fraudulent information. The indictment further alleges Wood misappropriated the investment funds for personal use. Arraignment is scheduled for Jan. 6, 2020. This case is being prosecuted by the Delaware County Prosecutor Melissa A. Schiffel.

State v. Nicholas J. Pupino
Case No. 2019 CR 01086
Mahoning County Court of Common Pleas

On Dec. 19, 2020, following a criminal referral by the Ohio Department of Commerce's Division of Securities, Nicholas Pupino was indicted by a Mahoning County grand jury for one count of securities fraud, a second-degree felony, and one count each of theft from the elderly and forgery, both third-degree felonies. The indictment alleges Pupino solicited an elderly person to invest more than \$99,000 by telling her the funds would be invested into accounts with known

Enforcement Update

insurance companies, which would generate funds to pay future nursing home expenses or to pass to her beneficiaries upon her death. Instead of forwarding the investment funds to the insurance companies, Pupino allegedly deposited the funds into his personal bank account. The indictment further alleges Pupino added his own name to the payee line of investment checks after they were signed by the victim, so he could deposit them into his own account. A warrant has been issued for Pupino's arrest. Arraignment is scheduled for Dec. 31, 2019. This case is being prosecuted by the Office of the Mahoning County Prosecutor Paul J. Gains.

Corporate Finance Update

Non-GAAP Financial Measures in Advertising

Pursuant to Regulation S-K, financial statements must be prepared in accordance with generally accepted accounting principles (GAAP). However, issuers also commonly advertise their offerings by using other financial measures, often referred to as “non-GAAP” measures. For example, real estate investment trusts might publish advertising that discloses their Net Asset Value, Cash Available for Distribution, and Modified Funds from Operations, among others. Each of these is a non-GAAP measure.

Both Regulation G and Item 10(e) of Regulation S-K require issuers to accompany non-GAAP measures with the most directly comparable GAAP financial measure, and a quantitative reconciliation of the non-GAAP measure to its GAAP counterpart. Many, including SEC enforcement officials and the Canadian Securities Administrator, have recently emphasized the importance of similar reconciliation requirements.

While the Division reviews offerings and related sales material using its own standard and not the SEC rules,¹ it agrees with the SEC regarding the reliability and usefulness of GAAP measures and the importance of independent auditors. Accordingly, issuers submitting offering material to the Division using non-GAAP financial measures should expect comments requiring them to accompany such non-GAAP measures with the most directly comparable GAAP financial measure and a reconciliation between the two.

Disclosure of Select Financial Information

Additionally, the Division believes it is misleading to advertise select (as opposed to complete) GAAP financial information, or to exaggerate the prominence of certain financial measures (which usually paint a favorable picture) while downplaying other relevant measures. While the Division reviews advertising material on a case-by-case basis, it will comment on advertising that employs the potentially misleading practices described above. For example, the Division would issue an objection to an issuer that prominently advertises its growth in total assets but refrains from disclosing the growth largely corresponds to an increase in its leverage, or an issuer that discloses an increase in its revenue without revealing it also incurred net losses, or significant expenses.

¹ The Division may suspend a registration (or refuse to grant an application to register) by coordination if it finds the proposed offer or disposition is on grossly unfair terms or the plan of issuance and sale of securities would defraud or deceive, or tend to defraud or deceive, purchasers. See Ohio Revised Code Sections 1707.01(Q)(3), 1707.09, 1707.091, and 1707.13.



Two Securities Staffers Recognized as Commerce “Shining Stars”

At the Commerce All Staff meeting in October, two Division employees – Executive Assistant Ray Glenn and Enforcement Attorney David Biemel – were among the 50 honored with the first-ever Commerce Shining Star Award. The award was created to celebrate exceptional employees who have made a significant and positive impact on their section or Division.

“At Commerce, these employees demonstrate a sense of urgency, exemplify professionalism, are conscientious, and are dedicated to customer service,” said Commerce Chief of Staff Charity Robl. “They are also innovative and view challenges as opportunities. On top of all that, they are respectful and supportive of a broad range of differences and perspectives.”

Here’s what was included on the nomination entry for each award winner:

***Ray** literally jumps at the chance to help a colleague in need. He completes any task in front of him almost instantly once he’s been asked to do it. He is professional when interacting with internal and external customers. Even if the person on the other side of the communication is agitated or rude, he remains calm and respectful. He always keeps in mind he represents the department in everything he does. He loves learning new things, and when presented with a project or task he’s never completed before, he’s enthusiastic to give it a try and learn from the experience. He has a great attitude, which makes it a pleasure to interact with him.*

***David** is a consummate professional in all his communications. He takes a measured approach in his correspondence, with knowledge of both the law and facts involved in each matter. He’s always a team player and agrees to work or assist on difficult cases, regardless of his current case load. His office is an open door for all staff and employees of the Division.*

Congratulations for Ray and David for their exceptional work.

Tim Jones Promoted

Congratulations to Tim Jones, who was recently promoted to investigation supervisor. Tim has been with the Division for more than 3½ years as an investigator on the Enforcement team. In addition to his current role in researching and investigating complaints of possible violations of the Ohio Securities Act, he will also supervise the work of other Division investigators, manage investigators during the course of their investigations, and provide guidance or assistance to ensure investigations are completed accurately and timely.



Outreach and Education Update

The last quarter of 2019 was another busy time, especially with outreach to professional organizations.

In October, the Division participated in the Ohio Attorney General's Elder Abuse Commission's *Elder Financial Exploitation Symposium* in Steubenville and the *Ohio Association of Area Agencies on Aging* annual conference in Columbus. Both events were attended by social workers, advocates for seniors, law enforcement and other association members. We also presented to the *Erie County Retired Teachers Association* in Huron, providing an overview of the Securities Division and tips for being an informed investor and to prevent fraud.

In early November, as part of the *Securities and Exchange Commission Investor Advisory Committee meeting*, Superintendent Andrea Seidt participated in a panel discussion regarding the SEC's Concept Release on Harmonization of Securities Offering Exemptions. You can view the webcast [here](#). The topic begins at 2:06:30 and Commissioner Seidt's comments begin at 2:40:40.

Later in the month, the Division participated in the *Forum to Address Elder Abuse and Exploitation in Ohio*, held in Columbus. Forum participants included social workers, law enforcement reps, attorneys and financial professionals. Commerce Director Sheryl Maxfield joined with several other agency leaders to discuss best practices for preventing elder fraud. The Division also presented at the *Grandview Public Library*, providing tips to prevent investment fraud to library members.



In December, the Division hosted three *Anti-Fraud Training for Commerce* sessions for employees. In addition to learning about securities fraud, attendees learned how to avoid various types of ID theft from by Viktoria Jurkovic in Financial Institutions and Matt Veccia in Real Estate and Professional Licensing who presented tips on avoiding fraud when buying or selling a home. The Division's last outreach event in 2019 was the annual *Ohio Prosecuting Attorney's Conference* in Columbus.

The Division is already scheduled for several presentations and conferences in 2020. If you would like to schedule an expert to talk to your organization, club or at a senior center, please contact Outreach and Education Manager Dan Orzano: Daniel.Orzano@com.state.oh.us

NASAA News



NASAA Upgrades Exam Resource for State Securities Examiners

The North American Securities Administrators Association (NASAA) announced in mid-November the launch of a significantly enhanced NASAA Electronic Examinations Module (NEMO). This web-based software application is available for use by state securities examiners to conduct examinations of state-registered investment advisers and broker-dealers within their jurisdictions.

“This updated resource enables NASAA to deliver a product to state securities examiners to enhance the effectiveness of their examinations of broker-dealers and investment advisers,” said Christopher W. Gerold, NASAA President and Chief of the New Jersey Bureau of Securities. “Our new system will help securities regulators to quickly identify and address compliance trends to better protect investors.”

The application’s new and robust data generation and reporting capability will assist NASAA in assessing the health of the industry, formulating policy initiatives, and publishing examination priorities.

Launched initially in 2010, the NEMO software application allows state securities examiners to conduct BD and IA examinations in a secure, digital environment and allows statistical reporting. The application has proven to be a significant enhancement toward improving efficiencies for state securities examiners.

The NEMO application is part of an ongoing initiative by NASAA to make greater use of technology to improve efficiencies for regulators and others. For example, earlier this year, NASAA expanded the functionality of its Electronic Filing Database (EFD) to accommodate the submission of Form NF-UIT notice filings for unit investment trusts (UITs) to state securities regulators. The EFD system was launched in 2014 and initially used to facilitate the filing of Form D for Regulation D, Rule 506 offerings with state securities regulators and to pay related fees.

Industry News

SEC Division of Enforcement Publishes Annual Report for Fiscal Year 2019

In early November, the Securities and Exchange Commission’s (SEC) Division of Enforcement issued its 2019 fiscal year report, which details the division’s efforts and initiatives on behalf of investors, highlights several significant actions, and presents the activities of the division from both a qualitative and quantitative perspective.

The report describes the Division’s efforts guided by five core principles:

- focus on the Main Street investor
- focus on individual accountability
- keep pace with technological change

Division News

- impose remedies that most effectively further enforcement goals, and
- constantly assess the allocation of resources.

In fiscal year 2019, the SEC brought a diverse mix of 862 enforcement actions, including 526 standalone actions. Through these actions, the SEC obtained judgments and orders totaling more than \$4.3 billion in disgorgement and penalties. The SEC also returned roughly \$1.2 billion to harmed investors as a result of enforcement actions.

Read the report [here](#).

Division News

2019 Ohio Securities Conference Review

The 2019 Ohio Securities Conference was another sold-out event.

This year's conference, which took place Oct. 25 at the Westin Hotel in downtown Columbus, played host to more than 170 people. Planning is already underway for 2020, so look for details in future issues of the *Ohio Securities Bulletin* and on our [website](#).



"This was our 46th annual conference and we had an excellent lineup of industry experts speaking this year," said Ohio Securities Commissioner Andrea Seidt. "We covered several important topics, including alternative investment products, compliance-focused issues, federal securities litigation, and complex financial crime including cryptocurrency, all of which tied into our theme of 'What Keeps You Up At Night?'"



The conference began with a discussion with Ohio Department of Commerce Director Sheryl Maxfield and Communications Director Mikaela Hunt regarding the opioid crisis and its potential financial impact on Ohioans who may be faced with covering treatment costs for family members. The discussion included ways both regulators and investment professionals can address the financial aspect, including a proposed awareness campaign by the Division of Securities to educate and provide resources for those in the industry and the public as they confront the high cost of

treating opiate addiction.

Co-sponsored by the Division and the University of Toledo College of Law, the annual conference is the only continuing legal education program dedicated exclusively to Ohio securities law and practice.

Conference Materials Available Online

If you missed the annual conference, you can access the available materials [here](#).

Advisory Group Section Updates

Representative from the Enforcement, Licensing and Corporate Finance sections hosted separate Advisory Group sessions and reported on activities from the previous fiscal year. Here are the minutes from each section:

Enforcement

Enforcement Section attorneys provided an update on recent cases, including information about recent administrative actions initiated against Division licensees engaged in alleged churning and reverse churning, as well as a recent NASAA settlement and administrative consent order related to non-compliance with blue sky laws.

The Division discussed two criminal cases resulting in convictions within the previous year, including *State v. Kimm Hannan*, CRD 2402527 (inactive), filed in Stark County, and *State v. Gregory John Schmidt*, CRD 708094 (inactive) filed in Montgomery County.

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Matthew Fornshell, partner with Ice Miller, LLP, was a guest speaker for the meeting. Mr. Fornshell is the appointed receiver in the case, *Lt. Gov. State of Ohio v. Joanne C. Schneider, et al.*, filed under Case No. 04-548887 in Cuyahoga County. The receivership case, which provided some recovery to aggrieved investors, is winding down. Joanne Schneider previously pled guilty to multiple criminal counts, including securities fraud, selling unregistered securities, engaging in a pattern of corrupt activity, aggravated theft, and money laundering and was sentenced to nine years in prison. The Enforcement Advisory Committee Meeting was attended by 72 individuals.

Licensing

In connection with the 2019 Ohio Securities Conference, the Division hosted a meeting of the Licensing Advisory Committee. Advisory committee materials are available on the [Division's Conference website](#). Approximately 30 participants attended the meeting. Zach Haughawout, director of STABLE Account with the office of Ohio Treasurer Robert Sprague, opened the meeting with an informative presentation regarding Ohio's STABLE Account. STABLE Accounts allow individuals with disabilities the ability to save and invest without losing benefits such as Medicaid or Supplemental Security Income (SSI). This information was shared with attendees so they may assist clients facing these issues.

The meeting then turned to Licensing Chief Anne Followell, who gave an update on Licensing section staff members and a snapshot of licensee statistics and trends. She also discussed the examination program's accomplishments during the past year, common exam deficiencies, and recent administrative actions involving licensee non-compliance.

The following additional topics were also discussed:

- New mandatory reporting requirements for Ohio-licensed dealers, salespersons, and Investment Adviser Representatives (IARs) of suspected elder abuse pursuant to Ohio's Adult Protective Services laws (effective March 2019).
- Cybersecurity update, including most common cybersecurity deficiencies and available resources.
- Updates to the *Ohio Investment Adviser and IAR Handbook* (March 2019)
- Reminder of upcoming 2020 renewal filing deadlines.



Followell then opened the meeting for new business, and attendees asked questions. At the conclusion of the hour, the meeting was adjourned so attendees could return to the conference.

Corporate Finance



The Advisory Committee discussed three changes to the Division's merit standards.

The first change regards the Division's merit standard on debt securities and preferred stock. The Division had required issuers of public debt offerings or preferred stock to demonstrate positive earnings and/or cash flow for three years and the most recent interim period. The standard needed to be updated, as it specifically incorporated a calculation from item 503 of Regulation S-K (which the U.S. Securities and Exchange Commission removed on November

5, 2018). Thus, the Division amended this merit standard by removing the reference to the calculation in Item 503. Despite this change, the Division will continue to require Issuers to demonstrate positive earnings. There were no comments on this topic.

The second change regards the use of certain Issuer names the Division believes is misleading. This issue has arisen in real estate investment trust offerings where the name of the issuer depicts a specific property type, yet the issuer retains unlimited discretion to invest in any kind of real estate. Issuers will often use sales literature depicting the specific property types of the real estate type identified in the issuer's name. The Division has objected to this practice and required Issuers to limit such investments to 25 percent. This was further discussed in [Ohio Securities Bulletin, Issue 2, 2019](#). There were no comments on this topic.

The third item regarded the merit standard prohibiting varying prices in public offerings. A recent example of this occurred when an issuer sought to offer promotional rates of debt investments to new investors. Other investors who purchased the same debt securities at or around the same time bear the same risk as the new investors but receive a lower rate. The Division has objected to this practice. A Division merit standard on varying prices has existed since 1973 and is published in Ohio Securities Law and Practice, §12.19 and OSB 3.01. The Division intends to reemphasize this merit standard and add it to the list of merit standards referenced on its website. There were no comments on this topic.

The committee next discussed the trend of filers using the NASAA EFD system. The Division accepts Rule 506 offerings filing the Form D through the NASAA EFD system. The Division also continues to accept a paper Form D filing for Rule 506 offerings. Attendees were cautioned other jurisdictions may require the submission through the NASAA EFD system and they should not assume other jurisdictions accept the paper filing as well.

The Division also addressed a common question regarding Rule 506 offerings — the requirement to file amendments. Some of these inquiries refer to the filing as a “renewal.” Stated plainly, there is no “renewal” contained in Regulation D. Rather, these inquiries are referring to Rule 503(a)(3)(iii) which requires an annual amendment if the offering is continuing. R.C. section 1707.03(X)(3) states in part, “. . .no filing fee shall be required to file amendments to the Form D.” The Division believes and advises the filing of the amendment is a conservative compliance measure without any added cost.

Division News

The Division next emphasized a common problem it observes on Form D's — the payment of fees to unlicensed sales agents and the result of unregistered and unlicensed sales for both the issuer and finder. Item 15 of the Form D requests the amount of "Finder's Fee's" to be identified on the Form D. This does not mean the payment is in compliance with state or federal licensing provisions.

The Division concluded the meeting by noting several legislative or regulatory proposals or concepts are being reviewed with regards to federal exemptions. The Division is continuing to monitor developments in this area, most notably the Concept Release on Harmonization of Securities Offering Exemptions by the U.S. Securities and Exchange Commission at SEC Release No. 33-10649; 34-86129; IA-5256; IC-33512
<https://www.sec.gov/rules/concept/2019/33-10649.pdf>

The meeting concluded with the Division reminding attendees of our availability throughout the year to assist with compliance issues.

The Ohio Securities Exchange provides a platform where views and opinions related to the securities industry can be shared from sources outside the Division of Securities. The division encourages members of the securities community to submit articles pertaining to Ohio securities law and regulations.

If you are interested in submitting an article, contact the editor, Dan Orzano, Daniel.Orzano@com.state.oh.us for the publication schedule and submission requirements. The division reserves the right to edit submitted articles for publication.

Disclaimer

The view and opinions expressed in the Ohio Securities Exchange solely represent those of the contributors. The Division of Securities takes no position on the material presented.

The Continued Evolution of Advisor Recruiting

By: Brian P. Nally
Reminger Co., L.P.A

The recruitment of advisors is as competitive as ever, and recent changes in the securities industry have made transitioning between firms as complicated as ever.

Historically, the Protocol for Broker-Dealer recruiting provided some clarity to firms and advisors about how to properly change firms. The Protocol was adopted in 2004 by Merrill Lynch, UBS PaineWebber and Smith Barney and quickly developed into an almost industry-wide agreement between firms, with more than 1,800 current signatories. The Protocol was designed to ease the legal burdens behind an advisor moving firms by spelling out steps one could follow to communicate with clients, take certain client information, move business to new firms, and avoid being sued in the process.

There has been a recent shift away from the Protocol, however, with three of the largest investment firms pulling out since late 2017. Morgan Stanley, UBS, and Citibank have all withdrawn from the Protocol, which means advisors with these firms may no longer rely on the provisions of the Protocol that permit advisors to take certain client data and solicit clients when transitioning from one Protocol firm to another. Advisors looking to leave these firms, as well as any other non-signatory to the Protocol, will now be faced with an increased litigation risk. Lawsuits arising out of these issues typically start with the filing of a lawsuit in federal or state court and typically involved a request by the former firm that the advisors be temporarily stopped from speaking with any clients or taking any client information. Courts are often presented with evidence showing what the advisor did leading up to their departure, whether they downloaded client information, whether they emailed client information to themselves or others, and whether they made any attempts to solicit clients. In the modern age of technology, much of this activity can be easily traced through analysis of computer systems and other forms of information technology. And for cases with FINRA Broker-Dealers, there will likely be a companion FINRA arbitration matter to decide the merits of the case.

The timing of these changes is interesting for a few reasons. The percentage of revenue generated from commissions—the traditional source of revenue for Broker-Dealers—has decreased in recent years as the percentage of fee-based revenue has increased. With this trend toward fee-based or advisory business, there is a potential incentive for Broker-Dealers to create structural impediments to advisors looking to take their business to a small Registered Investment Advisor (RIA). The independent-broker dealer model has also continued to grow in popularity in recent years, with independent broker-dealers seeing a compound annual growth rate in assets of 11%, nearly double that of wirehouses, according to recent research from industry consultant Cerulli report. Some of the more well-known independent broker-dealers—notably, most of which are signatories to the Protocol—are part of a group that has traditionally relied on recruiting efforts to attract high-producing advisors to drive growth. This growth model is at odds with the traditional wirehouse model or bank broker-dealer model, which often relies on name-recognition and talent retention. The timing of Morgan Stanley,

UBS, and Citibank withdrawing from the Protocol is also interesting because it comes at a time when the investment industry is hyper-focused on putting clients' best interests first. Starting with the Dodd-Frank Act, then the Department of Labor's fiduciary rule, and now with the Securities and Exchange Commission's proposed Regulation Best Interest (Reg. BI), the industry has been grappling with how to best define rules requiring all professionals—whether classified as a registered representative providing advice for a commission or as an advisory providing advisory services for a fee—to place their client's interests ahead of the firm's and the advisor's.

The practical application of these issues recently came to a head in a federal court lawsuit between a firm and advisor. In *Edward D. Jones & Co., L.P. v. John Kerr*, 2019 U.S. Dist. LEXIS 197182 (S.D. Ind. Nov. 14, 2019), the court denied a request for a temporary restraining order and preliminary injunction by Edward Jones—a non-Protocol firm—in a dispute with a former employee/advisor, John Kerr. Mr. Kerr had been employed as a financial advisor with Edward Jones for over 20 years and developed a substantial client base from his personal network in the community. As part of his agreement with Edward Jones, Mr. Kerr signed a contract requiring him to return “property” to Edward Jones, which was defined to include identities of and information concerning the customers of Edward Jones, and contained a one-year prohibition on his ability to solicit clients of the firm. Like most disputes centered around these issues, the facts were described differently by the parties. Edward Jones alleged Mr. Kerr was facing disciplinary issues, which prompted Edward Jones to summons Mr. Kerr to a meeting in St. Louis. Edward Jones alleged Mr. Kerr believed he would be terminated at the meeting and therefore began planning his transition to a new firm. According to Edward Jones, this included printing confidential client reports for the benefit of his future employer and solicitation of Edward Jones's clients following his departure from the firm. Mr. Kerr disputed these allegations and explained he had no expectation of being terminated leading up to the meeting in St. Louis and printed client reports as part of his preparation for the meeting. Mr. Kerr further argued he never used the client reports and instead destroyed them prior to joining his new firm. Mr. Kerr further explained he contacted his former Edward Jones clients to “announce” his transition to his new firm and insisted he did not “solicit” any clients—saying he never asked any clients to transfer their assets to his new firm—and denied using any of Edward Jones's information when issuing his announcement.

The court's decision turned on two main points. The court analyzed Edward Jones's own protocol for new advisors, including a detailed analysis of scripts Edward Jones gave to new advisors about how to “announce” their new affiliation without “soliciting” a client's business. Because Edward Jones made its own distinction between a proper “announcement” and an improper “solicitation,” the court concluded Mr. Kerr's actions were consistent with Edward Jones's own protocol for what new advisors should do when joining a new firm:

“We join this majority in holding that Mr. Kerr's announcement does not qualify as a solicitation where there is no evidence to show that Mr. Kerr did anything but inform his former clients of his new employment. Nor is there evidence that he wrongfully appropriated Edward Jones's information to generate these notices.”

The court also considered Mr. Kerr's fiduciary obligation as a Certified Financial Planner (CFP) to inform clients of material changes to the management of their assets, which included a duty to notify clients of his departure from Edward Jones. Consistent with court's concern about the

duties and obligations owed to clients, the court also explained its decision was premised on “a judicial reluctance to restrict financial advisors’ communications with their clients” because “[c]onsumers are entitled to know when their trusted financial advisors will no longer be available to serve them.” The court further explained that “the relationship between a financial advisor and her clients as ‘a personal relationship dependent on personal trust,’ vesting in the clients the right to be fully informed about the status of their accounts by the advisor with whom they are familiar and have an established relationship.” The court concluded by stating:

“Such financial advisors can most assuredly be prohibited from ‘soliciting’ clients when doing so contravenes their employment agreements, but they should not be foreclosed from issuing good-faith communications to clients notifying them that he or she has left a firm. Such a restriction infringes on the rights of consumers more than it protects the plaintiff-employers...Courts generally are very wary of issuing preliminary injunctions that restrict communications by financial advisors that merely inform clients of a material change in the management of their assets.”

With the evolution surrounding advisor recruitment, firms and advisors continue to evaluate how to properly balance legitimate protections of a firm’s business with an advisor’s right to make a living and need to comply with duties owed to clients, as well as the rights and expectations of the clients themselves.



Brian P. Nally is a Shareholder at Reminger Co., L.P.A. in Cleveland, Ohio. He focuses his practice on securities litigation and arbitration, and has experience representing financial services clients in state and federal court, as well as arbitration before the Financial Industry Regulatory Authority (FINRA) and American Arbitration Association (AAA). Brian also has experience representing clients in regulatory investigations and enforcement actions brought by FINRA, the Securities and Exchange Commission, professional boards (e.g., the CFP Board), state-departments of securities, and state-departments of insurance. Since 2014, he has been recognized as a “Rising Star”

by Ohio Super Lawyers Magazine, a recognition given to less than 2.5% of lawyers in Ohio, and is rated “AV Preeminent” by Martindale-Hubbell, the highest peer review rating for the highest level of professional excellence.