

From the Commissioner, Andrea Seidt



Is It Time To Open the Private Markets to Mom and Pop Investors?

On June 18, 2019, the Securities and Exchange Commission issued a concept release requesting public comment on ways it might simplify, harmonize, and improve the exempt offering framework with the goal of expanding retail investor access to investment opportunities and to facilitate greater capital formation. See SEC Harmonization Concept Release at <https://www.sec.gov/rules/concept/2019/33-10649.pdf>.

The 211-page release asks many questions, as far-reaching as whether the SEC should stop regulating the offer of securities altogether to focus exclusively on conduct at the time of sale to nuanced questions regarding investor financial sophistication. The questions are organized into seven topics, examining:

- (1) the efficacy of the whole exempt offering framework;
- (2) opportunities to harmonize specific exemptions, specifically Regulation D’s Rule 504 and 506 exemptions as well the Regulation A and Regulation Crowdfunding exemptions;
- (3) any gaps that might prevent small companies from raising capital;
- (4) challenges with existing investor limitations;
- (5) potential relaxation of the integration doctrine to ease transfer between exemptions;
- (6) retail investment through pooled investment vehicles; and
- (7) creating greater secondary market access and liquidity.

See SEC summary at <https://www.sec.gov/news/press-release/2019-97>. At bottom, all of the release commentary signals the SEC’s strong interest in opening the private markets to regular mom and pop investors.

SEC Investor Advocate Rick Fleming issued his initial thoughts on the concept release on July 11, which you can read at <https://www.sec.gov/comments/s7-08-19/s70819-5800855-187067.pdf>. Fleming asked three foundational questions that were not specifically covered in the concept release, namely:

- (1) do retail investors have an appetite for private securities;
- (2) do early stage companies really want small investors; and
- (3) is there any data indicating that the private markets are safe enough for retail investment?

Without directly saying so, Fleming suggests that the answer to all three questions is likely no. As he points out, the savings rate in the United States is incredibly low. Half of all American households have less than \$10,000 in financial assets – not enough to buy a single share of most private company stock. It would appear that most of the assets to be tapped in the retail market are held in the retirement accounts of the

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working middle class. These are assets that regulators have historically guarded very closely. Even if there were strong retail interest, Fleming notes that small issuers struggle with large numbers of investors on their capitalization table and they simply prefer large sophisticated investors. It will be interesting to see what data the SEC produces in response to Fleming's request to validate the underlying business premise of the release.

The biggest question for me is Fleming's last - will mom and pop's money be safe if they invest in the private markets? Unfortunately, no one has a definitive answer to this question. There is no reliable data on how existing accredited and institutional investors fare in the private markets today to serve as the necessary marker. While the SEC's Division of Economic Research and Analysis has been taking careful note of and publishing data regarding the amount of capital going into the private markets via today's exemptions, the SEC has chosen not to collect or report performance data on these offerings through a closing file or other report. We do not know what the average private investor makes or loses on the average Reg D, Reg A, or Reg CF deal.

We do know, however, that there is significant fraud in the private markets. I have served as faculty at an annual American Law Institute Regulation D Conference to talk about fraud in the exempt offering space. See A Sideline View of Exempt and Unregistered Offerings in 2017-2018; A Sideline View of Exempt Offerings in 2017, ALI CLE Course Materials, available at <https://www.ali-cle.org/search/courses-webcasts-telephone-ondemand-publications-coursematerials/seidt>.

While I present only a partial snapshot as my research does not cover actions taken by the SEC, FINRA, or even all states, I have spotted over a hundred state enforcement actions arising from the private markets in just the past few years.

Thousands of investors lost tens of millions of dollars through current exemptions in those cases (and multiples more in wholly unregistered offerings). About a dozen of our Ohio neighbors are included in the dataset, having lost more than a million dollars in our state alone. More often than not, the victims were senior investors or retirees. According to the North American Securities Administrators Association's (NASAA's) most recent Enforcement Reports, nearly half of the senior financial exploitation cases brought by states involved the sale of an exempt or unregistered security. See 2017 NASAA Enforcement Report (Based on 2016 Data), <http://www.nasaa.org/wpcontent/uploads/2017/09/2017-Enforcement-Report-Based-on-2016-Data.pdf> ; 2018 NASAA Enforcement Report (Based on 2017 Data), <http://www.nasaa.org/wp-content/uploads/2018/10/2018-Enforcement-Report-Based-on-2017-Data-FINAL.pdf>.

The stakes are obviously high, so the Division will be following closely the SEC's next steps following the Harmonization Concept Release. If you submitted a comment to the SEC file or have views on the topics covered in the release, we would love to see or hear them. Ohio is an important state in the capital markets for both entrepreneurs and retail investors so please let your voice be heard.

Ohio Securities Bulletin

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Andrea Seidt Honored by NASAA

The North American Securities Administrators Association (NASAA) presented Commissioner Seidt with a Distinguished Service Award during its annual conference held in Austin, Texas.

Andrea was honored for her work in leading NASAA's Regulation Best Interest working group, which was tasked with reviewing the U.S. Securities and Exchange Commission's (SEC) rule proposal that would, among other things, establish a "best interest" standard of conduct for broker-dealers and associated persons when they make a recommendation to a retail customer (investor) of any securities transaction or investment strategy involving securities, including recommendations of types of accounts. The SEC adopted the rule June 5, 2019, and has begun the implementation process. The rule takes effect in June 2020.

Under Andrea's leadership, the group provided numerous comments during the process, which strengthened the final rule and provided common-sense changes to benefit investors. She will continue to work on a NASAA task force during the implementation process.

Securities Participating in Work-Study Program for High School Students

As part of a program to help students attending Cristo Rey Columbus High School gain work experience, the Department of Commerce and our Division are participating in a national educational model that invests in student workers with economic need to make college-preparatory education possible.

This unique program provides students with the opportunity to earn a significant portion of the cost of their private, college-preparatory education, plus gain professional work experience. Every Cristo Rey Columbus student takes a full load of college-preparatory classes in addition to working one day each week. The partnership provides invaluable mentoring and motivation for the students while reinforcing the thinking strategies and lifelong learning behaviors emphasized in the classroom.



Outreach and Education Update

Presentations at community forums, industry conferences and senior-related events dominated our outreach efforts this past quarter.

In July, we connected with seniors at three events, including the Dayton library's Trotwood branch, the Buckeye State Sheriffs' Association Senior Conference in Athens County, and at the annual Senior Expo at the Ohio State Fair (see details below). In August, we returned to Dayton, this time presenting at the Dayton library's Wilmington-Stroop branch.



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Outreach Schedule



October

- Oct. 23 – Elder Financial Exploitation Symposium, Steubenville
- Oct. 30-31 – Ohio Association of Area Agencies on Aging Conference

November

- Nov. 5 – Grandview Public Library
- Nov. 13 – Ohio Peace Officer Training Academy

December

- Dec. 12-13 – Ohio Prosecuting Attorneys Association Conference

News from NASAA



New Jersey's Christopher Gerold Elected as NASAA President

New Jersey Securities Bureau Chief Christopher Gerold began a one-year term in September after having been elected the 102nd president of the North American Securities Administrators Association.

"As NASAA's president, I will work my hardest to ensure that NASAA advances its history of investor protection. I am committed to see that NASAA remains a vibrant and successful organization," Gerold said in his inaugural address at NASAA's 2019 Annual Meeting in Austin, Texas. "As regulators, the things we do matter. Chances are we may never meet many of the people we are helping

– those who we have prevented from being victims," Gerold said. "Enforcement of state and provincial securities laws is at the heart of what we do every day."

During his address, Gerold said he looks forward to continuing NASAA's collaborative with the SEC and FINRA on investor protection initiatives. "Protecting investors requires all hands-on deck," he said. "We may not always agree, but that does not mean we cannot put differences aside to work toward our common mission of investor protection."

President Gerold has served as a member of NASAA's Board of Directors and as chair of NASAA's Enforcement Section. He has served as Bureau Chief of the Bureau of Securities within the New Jersey Office of the Attorney General since 2017. He began his legal career as a Deputy Attorney General in the Securities Fraud Prosecution Section of the New Jersey Division of Law, where from 2005 to 2010 he represented the Bureau during investigations and as a lead trial attorney in litigated matters. Before returning to public service, Mr. Gerold was an attorney with the law firm of Chiesa, Shahinian & Giantomasi PC where he was a member of the firm's Securities Litigation and Enforcement Group.

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Congress Urged to Refrain From Further Expanding Private Securities Markets

The North American Securities Administrators Association (NASAA) urged Congress to take no further action to expand the nation's private securities markets until a more careful study of the impact on public markets and investor protection can be conducted.

"NASAA is concerned that our current regulatory regime has gone too far in favoring private capital raising over public markets," testified Michael Pieciak, immediate past president of NASAA and Vermont's Commissioner of Financial Regulation.

Pieciak's testimony came in September during a hearing called to assess the impact the growth in private markets has had on public markets and retail investors conducted by the House Subcommittee on Capital Markets, Securities, and Investment. Read the entire testimony: <https://s30730.pcdn.co/wp-content/uploads/2019/09/NASAA-Written-Testimony-HFSC-IPECM-Commissioner-Michael-Pieciak.pdf>

Annual Enforcement Report Released

NASAA recently released its annual enforcement report, which shows state securities regulators were responsible for more than \$1 billion in monetary relief ordered as a result of state enforcement actions in 2018.

In its 2019 Enforcement Report on 2018 Data, which includes responses from 50 states and the District of Columbia, NASAA reported that state securities regulators conducted 5,320 investigations in 2018 and took 2,067 enforcement actions overall. These actions led to more than \$558 million in restitution ordered returned to investors, fines of \$490 million and criminal relief of 1,753 years, including incarceration and probation.

"This report shows that NASAA members are on the frontlines of investor protection," said Christopher Gerold, NASAA president and chief of the New Jersey Bureau of Securities. "State and provincial securities regulators stand ready to aggressively protect investors from fraud and police the integrity of our capital markets well into the 21st century."

You can download the report at: <https://s30730.pcdn.co/wp-content/uploads/2019/09/2019-Enforcement-Report-Based-on-2018-Data-Final.pdf>

Redesigned Website Launched

The North American Securities Administrators Association (NASAA) launch its new website in late July as the organization commemorated the beginning of its second century of service to investor protection.

The new website URL remains www.nasaa.org, but has an updated design, new navigational tools, improved search functions, and an interactive map to assist users in locating their securities regulator and related resources.

"Our new website is designed with the user in mind," said Michael S. Pieciak, NASAA's immediate past president. "The new website highlights the tremendous investor protection resources available from state and provincial securities regulators, as well as the work of NASAA in advocating for the protection of Main Street investors and responsible capital formation."

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Pieciak said NASAA's website was developed with input from internal and external stakeholders and highlights resources identified by visitors to the site as most useful. Key new features include:

- A homepage menu highlighting content on internal resource pages for investors, industry, policymakers, and members.
- Enhanced search capabilities including the ability to search comment letters, legislative letters, legal briefs, news releases, and other materials by topic and year.
- An improved registration process for NASAA members and non-members to participate in NASAA-sponsored meetings and events. This process allows members and non-members to create an account to process their registration and to track their attendance history.

Registration Update

Corporate Finance Update to Merit Standards

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

To aid it in making this determination, the Division has adopted its own set of general merit standards. They have been compiled on our website at: <https://www.com.ohio.gov/secu/ExistingGuidelines.aspx>.

The Division is publishing this article to update aspects of an existing standard.

Debt Service Clarification

The Division's longstanding merit standard for public debt offerings is as follows:

A proposed public offering of securities of either preferred stock or debt securities will be considered to be made on grossly unfair terms unless the issuer prominently discloses a ratio of earnings to fixed charges or a ratio of earnings to combined fixed charges and preferred stock dividends (calculated in accordance with Regulation S-K, Item 503, under the Securities Act of 1933) of at least 1.00 for the three most recent fiscal years and the latest interim period preceding the date of effectiveness of such public offering.¹

The Division has applied some version of this standard to issuers that file applications for registration by coordination, qualification or description of public offerings of preferred stock or debt securities for over forty years.²

Effective Nov. 5, 2018, the U.S. Securities and Exchange Commission amended Regulation S-K to delete the disclosure requirement of the ratio of earnings to fixed charges in Item 503.³ The SEC noted that "a variety of analytical tools are available today to investors that may accomplish a similar objective as the ratio of earnings to fixed charges" and that information about the offering's effect on fixed charges is still required by Item 504 of Regulation S-K. Due to this change, certain Issuers have inquired as to whether the Division's merit standard is still applicable.

The Division wishes to re-emphasize that the substance of its merit standard will remain and will require positive earnings and/or cash flow coverage to fixed charges for three full years and the most recent interim period.

¹ Ohio Securities Bulletin, July 1986.

² The Division originally wrote about this merit standard in the Ohio Securities Bulletin in July 1973, in which it announced it would review three years of prior earnings and cash flow. In 1986, it updated the standard to coordinate it with the disclosure requirement of Regulation S-K, Item 503 of the U.S. Securities and Exchange Commission.

³ <https://www.sec.gov/rules/final/2018/33-10532.pdf> at 36-7.

The Division is updating this standard in two ways. First, the Division has deleted the reference to Regulation S-K as it is no longer applicable and focusing on the issuer's ability to display positive net earnings. Second, the Division emphasizes that Prospectus disclosure of the ratio is no longer required.

Thus, the standard will now state as follows:

A proposed public offering of debt securities will be considered to be made on grossly unfair terms unless the issuer has positive net earnings over fixed charges for the three most recent full fiscal years and the latest interim period preceding the date of effectiveness.

Industry News

FINRA Investor Education Foundation Publishes “The State of U.S. Financial Capability”

On Sept. 20, the FINRA Foundation released data from its latest Financial Capability Study—one of the largest and most comprehensive financial capability studies in the U.S. More than 27,000 respondents participated in the nationwide study. Conducted every three years beginning in 2009, it measures key indicators of financial capability and evaluates how these indicators vary with underlying demographic, behavioral, attitudinal and financial literacy characteristics—both nationwide and state-by-state. You can see how Ohio fared in the study at <http://www.usfinancialcapability.org/results.php?region=OH>. To read the entire study and access the data, visit www.usfinancialcapability.org.

SEC Adopts New Rule to Modernize Regulation of Exchange-Traded Funds

In late September, the Securities and Exchange Commission announced it had voted to adopt a new rule and form amendments designed to modernize the regulation of exchange-traded funds (ETFs), by establishing a clear and consistent framework for the vast majority of ETFs operating today. The adoption will facilitate greater competition and innovation in the ETF marketplace, leading to more choice for investors. It also will allow ETFs to come to market more quickly without the time or expense of applying for individual exemptive relief. In addition, the Commission voted to issue an exemptive order that further harmonizes related relief for broker-dealers. Read the entire news release: <https://www.sec.gov/news/press-release/2019-190>



Follow Us on Twitter

Follow us [@OHSecuritesDiv](https://twitter.com/OHSecuritesDiv) for news and information about the division, as well as tips to help Ohioans become more savvy investors and avoid getting scammed.

Quarterly Question

I am interested in advertising my investment advisory services on the radio. Are there any rules I should be aware of?

Ohio-licensed investment advisers are reminded that a radio advertisement is subject to the Division's advertising rules just as print, electronic, and television advertising would be. Ohio Administrative Code Rule 1301:6-3-44(A)(1) prohibits investment advisers and their investment adviser representatives from using any advertisement that:

- Contains **any untrue statement of a material fact** or is otherwise misleading;
- Directly or indirectly contains **a testimonial** of any kind, including any statement of a client's experience or endorsement;
- Refers, directly or indirectly, **to past, specific recommendations** made by the adviser that were profitable, unless the advertisement includes a list of all recommendations made by the adviser within the preceding period of not less than one year, and complies with other specified conditions;
- Represents that any **graph, chart, formula, or other device** can, in and of itself, be used to determine which securities to buy or sell, or when to buy or sell such securities, or can assist persons in making those decisions, unless the advertisement prominently discloses the limitations thereof and the difficulties regarding its use; or
- Represents that any report, analysis, or other service will be **provided without charge** unless the report, analysis, or other service will be provided without any obligation whatsoever.

Advisers should be mindful that the above rules apply not only to paid commercials, but they also govern any **paid-for** appearances or radio spots, regardless of whether the appearance/spot is broadcast live or pre-recorded. If the adviser has paid to participate in these radio appearances/spots in any way, it is considered advertising (defined at [OAC 1301:6-3-44\(A\)\(2\)](#)) and must be disclosed as such.

Finally, all advertising is subject to the Division's record retention requirement (five years), so the adviser should arrange to have the radio commercials/appearances/spots recorded and archived.

FINRA Requests Comment on Rules and Issues Relating to Senior Investors

On Aug. 9, 2019, FINRA issued [Regulatory Notice 19-27](#) announcing its retrospective review of its rules and administrative processes that help protect senior investors from financial exploitation. Specifically, through this process, FINRA will:

- Evaluate the efficacy and efficiency of the rule or rule set as currently implemented, including FINRA's internal administrative processes;
- Seek input from both external and internal stakeholders;
- Draw on the expertise of its advisory committees and other subject-matter experts inside and outside the organization; and
- Seek out the views and experiences of other stakeholders, including industry, member firms, investors, investor advocates, interested groups, and the public.

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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In this request for comment, FINRA posed subsets of questions under each of the following topics:

- Rule 2165 - questions about extending the rule's safe harbor application and unintended consequences that have arisen since the rule became effective.
- Rule 4512 - assessing the effectiveness of the trusted contact provision.
- Reporting Requirements (Rule 4530 and Forms U4/U5) - assessing the need for special Rule 2165 reporting elements.
- Rule 3240 - assessing effectiveness of the Rule and posing potential expansion of the Rule's expansion.
- Sanction Guidelines - should the Guidelines be expanded to address "specified adult" victims.
- General Effectiveness, Challenges, and Economic Impact - seven questions eliciting feedback about experiences with the rule, the economic impact of compliance, the need for additional tools and guidance, other best practices, etc.

In addition to the specific questions posed, FINRA invites comments, data, and supporting evidence on any other aspects of the specified rules. Interested persons are invited to submit comments by **Oct. 8, 2019** and all comments will be posted to FINRA's website for public review.

2020 Renewal Program Deadlines

Attention: Dealers and Investment Advisers: The Ohio Division of Securities participates in FINRA's annual CRD/IARD renewal program. Failing to renew according to the schedule below will result in a firm and all of its associated representatives to lose their Ohio licenses effective Jan. 1, 2020. This year's filing and payment deadlines are:

- Oct. 21 – Firms may begin to submit post-dated Forms U5 and BR Closing/Withdrawal (must be dated Dec. 31, 2019).
- Nov. 1 – Firms may begin to submit post-dated Forms BDW and ADV-W (must be dated Dec. 31, 2019).
- Nov. 11 – Preliminary renewal statements will be available through E-Bill.
- Dec. 16 – Deadline for receipt of Preliminary Renewal payments.
- Dec. 26 – Last Day to submit form filings prior to year-end.
- Dec. 27 through Jan. 1 – CRD and IARD systems are unavailable for any payments or filings due to renewal processing. Late payments and filings cannot be submitted during this time.
- Jan. 2 – Web CRD and IARD are fully operational. Firms that "Failed to Renew" on time and were systematically termed on Dec. 31, 2019 may begin the process of re-applying in Ohio.
- Jan. 17 – Deadline for receipt of Final Statement Payments

Please take note of these important dates and fund your renewal accounts in advance of the payment deadline.

Enforcement Section Update

Administrative Hearings

LA Stephenson and Company, CRD No. 167629
Lucien Austin Stephenson, CRD No. 3084925
Division Notice Order No. 19-007
Hearing Date: Nov. 5, 2019

Component Sourcing Group, Inc.
Patricia Tzannakos
Division Notice Order No. 19-019
Hearing Date: Dec. 16-17, 2019

Conscious Life Planning, CRD No. 282758
Christopher Scott McLaren, CRD 2392869
Division Notice Order No. 19-021
Hearing Date: Dec. 20, 2019

Craig Alan Sutherland, CRD No. 2001873
Division Notice Order No. 17-018
Hearing held. Awaiting final order.

Katrina Farmer a/k/a Katrina Seiter
A Voice 4 U, LLC
Division Notice Order Nos. 17-037 and 18-013
Hearing held. Report and recommendation issued, recommending a cease-and-desist order. Awaiting final order.

Jeffery Mohlman, CRD No. 4431845
Division Notice Order Nos. 17-024 and 18-008
Hearing held. Report and recommendation issued, recommending a cease-and-desist order. Final Order to Cease and Desist issued on Oct. 24, 2019, in Order No. 19-032.

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.

Garry N. Savage, Sr., CRD No. 1195330
Advanced Strategies Agency, Inc., CRD No. 121343
Division Notice Order No. 18-011; Amended NOH 18-021
Hearing held. Report and Recommendation issued recommending revocation. Awaiting final order.

The division's Enforcement Section is a criminal justice agency authorized to investigate and report on all complaints and alleged violations of the Ohio Securities Act and related rules. The Enforcement Section attorneys represent the division in prosecutions and other matters arising from such complaints and alleged violations.

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Raymond A. Erker, CRD No. 2166800
Sageguard Wealth Management, Inc., CRD No. 158748
Division Notice Order No. 18-028
Hearing held. Report and Recommendation issued recommending revocation.
Final Order to Revoke issued on Oct. 24, 2019, in Order No. 19-033.

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.

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Administrative Appeals

TAP Management, Inc. et al.

Case No. 17 CV 006942

Appeal from Division Final Order No. 17-022

Filed Aug. 2, 2017

Administrative Orders

Division Order No. 19-015

Gold Coast Bets, Inc.

AIHG USA, Inc.

Oscar Cook

Frank Torres

Paitilla, Panama

Melbourne, Florida

On June 13, 2019, the Division issued a Notice of Intent to Issue Cease and Desist Order against the above-named respondents based on allegations they engaged in fraud and misrepresentations in the sale of unregistered securities issued by an online casino and sportsbook. The respondents cold called an Ohio resident and described the investment as safe and guaranteed a bi-quarterly return of 125 percent of his principal investment in the amount of \$2,500. The Illinois Secretary of State issued an Order of Prohibition against AIHG and Cook on April 4, 2017, based on the sale of unregistered securities and fraud.

Division Order No. 19-016

Sam Aziz, CRD No. 1711932

Aziz Capital Management, LLC

Dublin, Ohio

On July 8, 2019, the Division issued a Cease and Desist Order against the respondents based, in part, on allegations the respondents engaged in excessive trading in at least twelve client accounts, including accounts of eleven elderly clients to generate commissions exceeding \$2.4 million to himself while misrepresenting the nature and basis of the trades. The Division Order included findings respondents engaged in unauthorized trading on margin in at least one elderly client's account. A request for administrative hearing was originally presented to the Division but was subsequently withdrawn by the respondents. A Goldman hearing was held on Aug. 13, 2019, to determine the status of respondents' licensure with the Division. A Report and Recommendation was issued on Sept. 10, 2019, recommending the revocation of respondents' licensure. This matter is pending final order on the licensure status.

Division Order No. 19-017

Porter Financial Planning, CRD No. 150853

Mickey Darin Porter, CRD No. 5109370

Ottawa Hills, OH

On Aug. 20, 2019, the Division issued a Notice of Opportunity for Hearing and Notice of Intent to Suspend or Revoke the Ohio Investment Adviser License of Porter Financial Planning and the Ohio Investment Adviser Representative License of Mickey Darin Porter based, in part, on allegations the respondents failed to timely provide required information concerning their investment advisory business. The Notice Order alleges the respondents failed to appear and provide access to the firm's books and records for a scheduled on-site examination, failed to provide books and records as directed by the Division for the rescheduled examination, and failed to respond to a deficiency letter issued by the Division.

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Division Order No. 19-018

Christopher T. Wendel, CRD No. 1930870 (inactive)
Celina, OH

On Aug. 20, 2019, the Division issued a Cease and Desist Order with Consent naming Christopher T. Wendel, based on findings Wendel sold investments issued by Woodbridge Mortgage Investment Fund 3, LLC and Woodbridge Mortgage Investment Fund 4 which were not properly registered for sale in or from Ohio. The Division found Wendel sold Woodbridge investments to at least three Ohio investors in a total amount of \$415,000 after his securities license was terminated through an AWC with FINRA, in exchange for commissions paid by Woodbridge. On May 21, 2018, the SEC obtained a judgement against the issuer, Woodbridge, and related entities in a civil case filed in Case No. 17-24624 in the U.S. District Court for the Southern District of Florida. The SEC complaint alleged Woodbridge and related entities utilized internal and external sales agents to conduct a Ponzi scheme that raised over \$1.2 billion from more than 8,400 investors nationwide through fraudulent unregistered securities offerings.

Division Order No. 19-019

Component Sourcing Group, Inc.
Patricia Tzannakos
Laguna Hills, CA

On Aug. 23, 2019, the Division issued a Notice of Opportunity for Hearing and Notice of Intent to Issue Cease and Desist Order naming Component Sourcing Group, Inc. and Patricia Tzannakos based, in part, on allegations the respondents engaged in the sale of unregistered securities to ten Ohio investors, five of whom were elderly, in an aggregate amount of \$350,000 through an unlicensed Ohio salesperson, Stevan Nenadov. An administrative hearing was requested in this matter and is scheduled to begin Dec. 16, 2019. On April 30, 2018, the Division issued a Cease and Desist Order with Consent to Stevan Nenadov for his activities related to this matter.

Division Order Nos. 19-020 and 19-030

Alan Kneller, CRD No. 7018362 (inactive)
Capital Asset Management Partners, Inc.
Anthony Publiese IV
Envoyag, LLC
Boca Raton, FL
Delray Beach, FL

On Aug. 23, 2019, the Division issued a Notice of Opportunity for Hearing and Notice of Intent to Issue Cease and Desist Order naming the above individuals and entities based, in part, on allegations the respondents cold-called an Ohio investor to solicit in unregistered stock issued by Envoyag without informing him that 22.5 percent of his investment would be paid to an unlicensed securities dealer and remaining funds would be used for purchases at Taco Bell, Payless Shoes, T.J. Maxx, Piggly Wiggly and other similar businesses. The investor purchased the stock for \$14,000. An administrative hearing was not requested in this matter and a final Cease and Desist Order was issued under Division Order No. 19-030 on Oct. 16, 2019.

Division Order No. 19-021

Conscious Life Planning, CRD No. 282758
Christopher Scott McLaren, CRD 2392869
Cincinnati, OH

On Aug. 27, 2019, the Division issued a Notice of Opportunity for Hearing and Notice of Intent to Suspend or Revoke the Ohio Investment Adviser License of Conscious Life Planning and the Ohio Investment Adviser Representative License of Christopher Scott McLaren based, in part, on allegations the respondents failed to timely respond to a deficiency letter sent to respondent after an on-site examination. The deficiency letter was sent on Dec. 14, 2018, and after three subsequent communications by the Division, the respondents had not provided a response as of the date the Notice Order was issued. An administrative hearing in this matter is scheduled to begin Dec. 20, 2019.

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Division Order No. 19-022

Steven Arthur Svetlick, CRD No. 2589535

Division Order No. 19-027

Stable Asset Fund, LLC/Stable Assest Fund I, Ltd

Division Order No. 19-028

Andrew Todd Roseberry, CRD No. 2589166

Division Order No. 19-029

Consolidated Financial Management Group, LLC, CRD No.

Grove City, Ohio

Dublin, Ohio

On Sept. 6, 2019, and Sept. 17, 2019, the Division issued the above Notice of Intent to Issue Cease and Desist Order and Notice of Intent to Suspend or Revoke the Investment Adviser License of Consolidated Financial Management Group, LLC (“CFMG”) and the Investment Adviser Representative Licenses of Andrew Todd Roseberry and Steven Arthur Svetlick based, in part, on allegations they 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 the respondents did not inform client investors 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 over ten years. The Notice Order alleges Svetlick, Roseberry, and CFMG breached their fiduciary duty to clients and CFMG failed to supervise Roseberry and Svetlick. During the relevant time period, Roseberry was the Chief Compliance Officer for CFMG.

Division Order No. 19-023

Prestige Financial Group, LLC, CRD No. 292438

Zachary Wayne Beavers, CRD 6601292

Dublin, OH

On Sept. 9, 2019, the Division issued a Notice of Opportunity for Hearing and Notice of Intent to Suspend or Revoke the Ohio Investment Adviser License of Prestige Financial Group, LLC and the Ohio Investment Adviser Representative License of Zachary Wayne Beavers based, in part, on allegations the respondents failed to timely respond to a deficiency letter sent to respondent after an on-site examination. The deficiency letter was sent on May 16, 2019, and after three subsequent communications by the Division, the respondents had not provided a response as of the date the Notice Order was issued.

Division Order Nos. 19-024 and 19-034

Daniel Rossi, CRD No. 1190774

FEIC Financial, Inc., CRD No. 25545

Business Equity Advisors, Inc. f/k/a FEIC Business Equity Solutions, Inc.

Youngstown, OH

On Sept. 9, 2019, the Division issued a Notice of Opportunity for Hearing, Notice of Intent to Issue Cease and Desist Order, and Notice of Intent to Suspend or Revoke the Ohio Investment Adviser License of FEIC Financial, Inc. and the Ohio Investment Adviser Representative License of Daniel Rossi based, in part, on allegations the respondents engaged in securities fraud, misrepresentations, fraudulent and deceptive conduct as an investment adviser and investment adviser representative, breach of fiduciary duty, and respondents are not of good business repute. The Notice Order alleges respondents solicited two elderly investment advisory clients to liquidate their Charles Schwab accounts to fund promissory notes in an aggregate amount of \$750,000 issued by Rossi’s company, Business Equity Advisors, Inc. based on misrepresentations the investment would be used

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for business purposes, and without disclosing their investments would be used for Rossi's personal tax liability, payments to a prior investor, travel for Rossi and his wife, and charitable donations earmarked from Rossi's family partnership. The Notice Order further alleges Rossi provided false information in a sworn affidavit to the Division. The Division issued an Amended Notice Order on Oct. 24, 2019, in order to include information about the most recent Form U4 filing by respondent Rossi.

Division Order No. 19-025

Michael Iannarino, CRD No. 1258453
Columbus, OH

On Sept. 12, 2019, the Division issued a Cease and Desist Order with Consent by Michael J. Iannarino based, in part, on findings Iannarino engaged in unlicensed activity by continuing to provide fee-based investment advice for four elderly clients after his securities licensure lapsed. The Consent Order further found Iannarino sold unregistered securities issued by Synergistic Food Brands, Ltd. to two investment advisory clients.

Division Order No. 19-026

GreyMountain Management, Ltd.
Glenridge Capital
Dublin, Ireland

On Sept. 17, 2019, The Division issued a Cease and Desist Order naming GreyMountain Management, Ltd. and Glenridge Capital based, in part, on findings they were acting as securities dealers without proper licensure. The Order further finds the respondents engaged in material misrepresentations and fraud in the sale of securities through their websites and through communications with and cold-calls to an elderly Ohio investor, who invested over \$85,000 through withdrawals from his credit and debit cards. The Notice Order was issued under Order No. 18-020.

Division Order No. 19-031

Harvard Options
Columbus, Ohio
Croydon, United Kingdom

On Oct. 16, 2019, the Division issued a Final Cease and Desist Order against Harvard Options based on findings the firm operates a fraudulent website at www.harvardoptions.com that provides for exaggerated returns up to 95 percent and falsely states Harvard Options was "ranked #1 overall and was also rated #1 in several categories..." on Stockbroker.com. The Division further found, although respondent is not a licensed broker dealer, its website offers "Low commissions and margin rates Pay just \$7.95 for online U.S. equity trades." An administrative hearing was not requested in this matter.

Division Order No. 19-032

Jeffrey Allan Mohlman CRD 4431845
Dayton, Ohio

On Oct. 24, 2019, the Division issued a Final Order to Cease and Desist against Jeffrey Allan Mohlman based, in part, on findings that, while he was licensed as a securities salesperson with Questar Capital Corporation, he engaged in the sale of unregistered promissory notes issued by WMA Enterprises, LLC. The owners and operators of WMA Enterprises, LLC, William and Connie Apostelos, were indicted, convicted, and sentenced in the U.S. District Court for the Southern District of Ohio, in part, for fraudulently inducing hundreds of individuals from around the country to invest over \$70 million in their companies. An administrative hearing was held in this matter. The Recommendation by the Hearing Officer was adopted with modifications set forth in the Findings of Fact and Conclusions of Law issued with the Final Order.

Division Order No. 19-033

Raymond A. Erker CRD No. 2166800
Sageguard Wealth Management, Inc. CRD No. 158748
Westlake, Ohio

On Oct. 24, 2019, the Division issued a Final Order to Revoke the Ohio Investment Adviser Representative License of Raymond A. Erker and the Ohio Investment Adviser License of Sageguard Wealth Management, Inc. based, in part, on findings they failed to timely file amendments to their U4 and ADV to disclose civil and criminal cases and various liens. The Order further finds that, on Jan. 19, 2018, Erker was charged with a felony of the fifth degree in the Cuyahoga County Court of Common Pleas for "by force, stealth or deception, trespass[ing]...in an unoccupied structure...with the purpose to commit therein any theft offense..." The Order further found the victim in the case was an Ohio investment advisory representative who had died shortly before the incident. Erker pled guilty to criminal trespass and was sentenced to 30 days in jail, suspended, and ordered to serve one-year probation. Erker was subsequently charged and convicted of burglary, menacing by stalking, and telecommunications harassment on or about Aug. 17, 2018. The Order finds Erker and his firm are not of good business repute and they failed to comply with exam demands. The Division approved and adopted the Findings of Fact, the Conclusions of Law, and the Recommendation of the Hearing Officer without modification.

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: TBD

State v. Jerry Fuqua

Case No. B 1904019
Hamilton County Court of Common Pleas
Sentencing Hearing: Nov. 7, 2019

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
Trial Date: Dec. 12, 2019

State v. Michael Neubig

Case No. 18 CR 004998
Franklin County Court of Common Pleas
Pre-Trial Date: Dec. 11, 2019

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State v. Shaneal Yogesh Patel

Case No. B1901113
Hamilton County Court of Common Pleas
Hearing Date: TBD (warrant outstanding)

State v. Aaron S. Pitman

State v. George R. Hammons

Case Nos. 19CR139
19CR141
Meigs County Court of Common Pleas
Trial Date: Feb. 25, 2020

State v. Raymond D. Sarrocco

Case No. 19 CR I 04 0257
Delaware County Court of Common Pleas
Arraignment Date: Jan. 14, 2020

State v. Jeffery Luke Westerman

Case No. 18 CR 006309
Franklin County Court of Common Pleas
Pre-trial Date: Nov. 20, 2019

State v. Robert White

Case No. 2019 CR 000149
Clermont County Court of Common Pleas
Trial Date: Jan. 27, 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 and Appeals

State v. Paul Kratochvill

Case No. 18CRSLD001090

Lake County Court of Common Pleas

Paul Kratochvill, 39, of Meadville, Pennsylvania, was sentenced on July 29, 2019, by Judge Vincent Culotta in the Lake County Court of Common Pleas to five years in prison and ordered to pay \$174,000 to his victims. The sentence comes after Kratochvill was convicted after a jury trial, which ended June 27, of two counts of securing writings by deception, both second-degree felonies. Kratochvill was indicted by a Lake County grand jury Oct. 26, 2018, after an investigation by the Ohio Department of Commerce's Division of Securities, the Ohio Attorney General's Office of Criminal Investigation, and the Eastlake Police Department. The indictment alleged

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Kratochvill solicited three individuals to invest \$318,000 with him in the financial markets in return for monthly annuitized payments to the investors. The indictment further alleged Kratochvill did not purchase annuities on behalf of the investors. Instead, he invested their money in high-risk, exchange-traded funds, causing them to lose a substantial amount of their investment. Kratochvill was never licensed as a securities dealer, salesperson, or investment adviser representative in Ohio. This case was prosecuted by the Office of the Lake County Prosecutor Charles E. Coulson, and presented by Lisa Neroda and Nick Giegerich, assistant prosecuting attorneys.

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

Jerry Fuqua, 76, pleaded guilty to one count of theft from the elderly and one count of securing writings by deception, both third-degree felonies, during an Oct. 9 hearing in the Hamilton County Court of Common Pleas. Sentencing is scheduled for Nov. 7. Fuqua faces up to 72 months in prison and a \$20,000 fine.

Following a criminal referral by the Ohio Department of Commerce's Division of Securities, Fuqua was indicted July 30 by a Hamilton County grand jury. 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. Aaron S. Pitman
State v. George R. Hammons
Case No. 19CR139
Case No. 19CR141
Meigs County Court of Common Pleas

On June 18, 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, Aaron S. Pitman, 31, of Mason, Ohio, and George "Roderick" Hammons, 78, of Denver, Colorado, were indicted by a Meigs County grand jury for crimes related to the theft of more than \$1.8 million from two Meigs County victims between Sept. 16, 2013, and July 21, 2014. A pre-trial hearing is scheduled for Feb. 25, 2020.

Pitman was indicted on 11 felony charges, including:

- Two counts of misrepresentation in the sale of securities, both first-degree felonies;
- Two counts of securities fraud, both first-degree felonies;
- One count of selling securities without a license, a first-degree felony;
- Two counts of theft, both second-degree felonies; and
- Four counts of money laundering, all third-degree felonies

Hammons was indicted on six felony charges, including:

- Four counts of money laundering, all third-degree felonies;
- One count of receiving stolen property, a third-degree felony; and
- One count of receiving stolen property, a fourth-degree felony

The indictment alleges Pitman solicited two Meigs County residents to invest in several businesses engaged in the purchase and development of website domains. Pitman allegedly laundered investor money through accounts held in the name of a business owned and operated by Hammons, and money then allegedly was funneled to various businesses and personal accounts maintained by Hammons and Pitman. This case is being prosecuted by the office of Meigs County Prosecutor James Stanley.

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

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The More Things Change....

SEC Regulation Best Interest: What Does It Really Mean for Retail Investors?

By: Robert N. Rapp

“Regulation Best Interest,”¹ adopted by the U.S. Securities and Exchange Commission (SEC) on June 5, 2019, requires securities broker-dealers and their associated persons to act in the “best interest” of a retail customer² when making a recommendation of any securities transaction or investment strategy involving securities. “Best interest” is not defined. However, the baseline requirement is that whatever recommendation is made must be made “without placing the financial or other interest of the broker, dealer or natural person who is an associated person of a broker or dealer making the recommendation ahead of the interest of the retail customer.”³ Regulation Best Interest also requires broker-dealers and their associated persons to use new SEC Form CRS – “Customer Relationship Summary” – at the beginning of their client relationships with retail investors. Form CRS is a structured disclosure form intended to inform retail investors about the types of client and customer relationships and services the broker-dealer offers, conflicts of interest, and the required standard of conduct to which the broker-dealer is bound in providing investment advice.⁴ Broker-dealers must begin compliance with Regulation Best Interest by June 30, 2020.

The genesis of Regulation Best Interest is the longstanding dichotomy between the “fiduciary” standard of conduct recognized for SEC registered investment advisers and the lesser “suitability” standard for broker-dealers when they both

render personalized investment advice to retail customers. The fiduciary standard applicable to SEC registered investment advisers is judicially⁵ and administratively derived from antifraud provisions of the Investment Advisers Act of 1940.⁶

¹ Regulation Best Interest, Exchange Act Rel. No. 34-86031 (June 5, 2019), is comprised of new Rule 15l-1, 17 C.F.R. § 240.15l-1, and amended Rule 17a-3, 17 C.F.R. § 240.17a-3, under the Securities Exchange Act of 1934.

² “Retail customer” means a natural person or legal representative of a natural person who receives a recommendation and uses the recommendation primarily for personal, family, or household purposes. Rule 15l-1(b)(2), 17 C.F.R. § 240.15l-1(b)(2).

³ Rule 15l-1(a)(1), 17 C.F.R. § 240.15l-1(a)(1).

⁴ Exchange Act Rel. No. 34-86032, Form CRS (June 5, 2019).

⁵ The Investment Advisers Act of 1940 does not directly establish any standard of conduct. The term “fiduciary” never appears in the Act. However, in *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 84 S. Ct. 275, 11 L.Ed.2d (1963), the U.S. Supreme Court stated that the broadly worded antifraud provisions in the Investment Advisers Act and congressional intent to eliminate conflicts of interest between advisers and clients reflected a recognition of “the delicate fiduciary nature” of an investment advisory relationship. 375 U.S. at 192.

⁶ Broker-dealers are expressly excluded from the definition of “investment adviser” in the Investment Advisers Act provided their investment advice is solely incidental to conducting business as a broker-dealer and there is no special compensation attached to it. Investment Advisers Act section 202(a)(11), 15 U.S.C. § 80b-2(a)(11). Although beyond the scope of this article, the “solely incidental” element of the broker-dealer exclusion from the definition of investment adviser is itself addressed as part of the Regulation Best Interest rulemaking package by a separate written SEC interpretation, see Investment Advisers Act Rel. No. IA-5249 (June 5, 2019).

It has always meant that in the performance of advisory services investment advisers owe an “affirmative duty of utmost good faith, and full and fair disclosure of all material facts.”⁷ The duty is continuing throughout the advisory relationship, the terms of which are normally set out in a written contract. The best interests of a client must be paramount, and the investment adviser must in all instances place the client’s interests first, making any recommendation or rendering investment advice with undivided loyalty and care.⁸ The broker-dealer suitability standard on the other hand is transactional, not of a continuing nature in a non-discretionary account. It has often been described with reference to Financial Industry Regulatory Authority (FINRA) Conduct Rule 2111 (“Suitability”), requiring transaction or strategy recommendations consistent with a customer’s investment profile.⁹ As discussed later in this article, historical broker-dealer responsibility to customers has too simply been described only in terms of suitability. Nevertheless, the suitability/fiduciary dichotomy of standards between broker-dealers and investment advisers long persisted.

Given the fact that in many instances personalized investment advice rendered by broker-dealers and investment advisers to retail customers was indistinguishable, over time there were calls for a unified fiduciary standard applicable to both broker-dealers and investment advisers. A RAND Corporation study commissioned by the SEC showed that retail customers of broker-dealers and investment advisers perceived no difference between broker-dealers and investment advisers in rendering advisory services much less appreciate any distinction between legal standards of conduct applicable in their relationships with one or the other.¹⁰ In 2010, with the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), Congress addressed the standards dichotomy by directing the SEC to evaluate the effectiveness of existing legal and regulatory standards of care for broker-dealers and investment advisers, and their respective associated persons, and with new section 211(g) added to the Investment Advisers Act,¹¹ expressly authorized the SEC to establish a fiduciary duty for broker-dealers that “shall be no less stringent than the standard applicable to investment advisers under [antifraud provisions of the Investment Advisers Act] when providing personalized investment advice about securities.” That standard, of course, is the investment adviser fiduciary standard.

With Regulation Best Interest as finally adopted, the SEC disregarded the Dodd-Frank Act express authorization and proceeded under its own established rulemaking authority. Regulation Best Interest does not establish a unified standard. And the newly prescribed “best interest” obligation of broker-dealers does not equate with the fiduciary standard applicable to investment advisers when providing personalized investment advice to retail customers. Indeed, the SEC eschewed adoption of a fiduciary standard for broker-dealers. Despite what it does not do, SEC Chairman Jay Clayton lauded the adoption of Regulation Best Interest as a substantial enhancement of the standard of conduct for broker-dealers “that draws upon key fiduciary principles, including those that apply to investment advisers.”¹² Commissioner Robert J. Jackson Jr., on the other hand, sharply criticized it as failing to require broker-dealers to put the interests of retail investors first.¹³

In the wake of Regulation Best Interest, calls for a uniform fiduciary standard persist, and some states have independently undertaken rulemaking initiatives to mandate a unified fiduciary standard of conduct for broker-

⁷ Capital Gains Research Bureau, Inc., 375 U.S. at 194.

⁸ See SEC Commissioner Louis Aguilar, A Shared Responsibility: Preserving the Fiduciary Standard (IA Compliance Best Practices Summit Mar. 26, 2010).

⁹ As provided in FINRA Rule 2121(a), a customer’s investment profile includes but is not limited to, the customer’s age, other investments, financial situation and needs, tax status, investment objectives, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose.

¹⁰ Angela A. Hung, Noreen Clancy, et al., Investor and Industry Perspectives on Investment Advisers and Broker-Dealers (Dec. 31, 2007) (the “RAND Report”).

¹¹ 15 U.S.C. §80b-11(g). New section 211(g) of the Investment Advisers Act was carried into the Securities Exchange of 1934 by an amendment to section 15, 15 U.S.C. §78o, applicable to SEC registered broker-dealers, expressly to incorporate by reference the Investment Advisers Act section 211 standard of conduct for investment advisers to broker-dealers.

¹² Jay Clayton, Statement at the Open Meeting on Commission Actions to Enhance and Clarify the Obligations Financial Professionals Owe to Our Main Street Investors, at 7 (June 5, 2019) (available at: <https://www.sec.gov/news/public-statement/statement-clayton-065019-iabd>).

¹³ Robert J. Jackson Jr, Statement on Final Rules Governing Investment Advice, at 1-2 (Dissenting, June 5, 2019) (available at: <https://www.sec.gov/news/public-statement/statement-jackson-065019-iabd>).

dealers, investment advisers, and their respective associated persons under their Blue Sky Laws.¹⁴ In a June 14, 2019, statement Massachusetts Secretary of State William Francis Galvin criticized Regulation Best Interest for failing to define the key term “best interest” and setting “ambiguous requirements for how longstanding conflicts of interest in the securities industry must be addressed.”¹⁵ A New Jersey proposed rule establishes a uniform fiduciary standard of conduct for broker-dealers, agents and advisers to be incorporated into “dishonest or unethical business practices” set out in rules under the New Jersey Uniform Securities Law.¹⁶ In Nevada, broker-dealers, investment advisers, and their respective representatives are already expressly held to a statutory fiduciary duty.¹⁷

Beyond mandated use of new Form CRS by both broker-dealers and investment advisers,¹⁸ will Regulation Best Interest actually change anything? It is clear that two separate standards of conduct – one “fiduciary” and one not – are alive and well, and that there is concern for assuring retail investors understand the difference. But what difference? Form CRS for broker-dealers requires only the use of a compound heading: “What are your legal obligations to me when providing recommendations? How else does your firm make money and what conflicts of interest do you have?”¹⁹ And:

“If we provide you with a recommendation, we have to act in your best interest and not put our interest ahead of yours. At the time, the way we make money creates some conflicts with your interests. You should understand and ask us about these conflicts because they can affect the recommendations we provide you. Here are some examples to help you understand what this means.”²⁰

For a “dual registrant” broker-dealer, that is one that is both a broker-dealer and investment adviser or investment adviser representative, under the same Form CRS headings the required statement when acting as an investment adviser – subject to the fiduciary standard – is:

“When we provide you with a recommendation as your broker-dealer or act as your investment adviser, we have to act in your best interest and not put our interests ahead of yours. At the time, the way we make money creates some conflicts with your interests. You should understand and ask us about these conflicts because they can affect the recommendations and investment advice we provide you. Here are some examples to help you understand what this means.”²¹

It would seem that the approach to clarity taken with Form CRS does nothing to alleviate consequences of The RAND Report finding that retail investors were confused about the differences between investment advisers and broker-dealers. Further explanatory content, if any, is left to those creating the Form CRS actually used.

¹⁴ See, e.g. Massachusetts: Preliminary Solicitation of Public Comments: Fiduciary Conduct Standard for Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives (Mass. Sec. State June 14, 2019).

¹⁵ Id.

¹⁶ Rule Proposal, 51 N.J.R. 439(A) (April 15, 2019) (Amending N.J.A.C. 13:47A-6.3 and adding N.J.A.C. 13:474A-6.4 to provide, among other things, that dishonest and unethical business practices includes a broker-dealer or its agent failing to act in accordance with a fiduciary duty to a customer when making a recommendation or providing investment advice).

¹⁷ See N.R.S. § 90.575(2)(a)-(b). Broker-dealers, sales representatives, investment advisers and representatives of investment advisers are expressly held to the statutory fiduciary duty toward a client that is imposed by N.R.S. § 90.628A.020 regarding “financial planners.” N.R.S. § 628A.020 (“Duties of financial planner”) provides, inter alia, a financial planner has the duty of a fiduciary toward a client.

¹⁸ Form CRS requires SEC registered investment advisers as well as broker-dealers to provide information about the nature of their relationship with retail investors. The objective is to allow for comparability among the two types of firms in a way that is distinct from other required disclosures. Thus, for investment advisers, Form CRS is a separate requirement from Form ADV Part 2, the investment adviser “brochure.” “By highlighting principles relevant to the fiduciary duty, investment advisers and their clients will have greater clarity about advisers’ legal obligations.” SEC Adopts Rules and Interpretations to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships with Financial Professionals, Press Release 2019-89, at 1 (June 5, 2019).

¹⁹ Form CRS Instructions, Item 3 (B).

²⁰ Id., Item 3B(i)(a).

²¹ Id., Item 3B(i)(b).

Beyond the Form CRS mandate for broker-dealers and their associated persons, what has Regulation Best Interest actually changed? Considering the broader fiduciary-like duty of broker-dealers that has always existed now matters more than ever, perhaps nothing. That extant “fiduciary” responsibility is discussed further below.

Historic Broker-Dealer “Fiduciary” Responsibility

A broker-dealer’s duty when making investment recommendations has historically been framed too simply only in terms of “suitability” of recommendations. But there has always been more involved.

The relationship between broker and customer has long been viewed by regulators²² and courts as one involving trust and confidence placed by the customer, at the very least obligating the broker to exercise utmost good faith.²³ States courts have not been reticent in speaking of the broker-customer relationship in fiduciary terms. For example, an Ohio appellate court stated straightaway that “a broker-dealer is a fiduciary who owes his customer a high degree of care in transacting his business.”²⁴ Moreover, very early on, the Second Circuit U.S. Court of Appeals declared that in holding itself out to be competent to advise customers regarding investments, a broker-dealer implicitly represents that it will deal fairly, and not take advantage of a customer’s ignorance.²⁵ This became the “Shingle Theory” of broker-dealer responsibility, which is premised entirely on the common law fiduciary principle that there is a special relationship between a broker-dealer and its customer.

Fiduciary principles have been applied in policing the customer-broker agency relationship in general. And identifying a “fiduciary” relationship of trust and confidence between a customer and broker was never difficult when the broker actively solicited reliance. Customer expectations have no doubt been shaped by broker-dealer marketing that promotes trusted relationships with, for example, “Financial Advisers,” rather than account executives or stockbrokers of old. Retail customer perceptions of a special relationship of trust and confidence have been fueled by broker-dealer marketing and evolving titles of account executives to “financial adviser” or “financial consultant” and professional titles that invite special trust and confidence.²⁶

Over several years, FINRA Dispute Resolution reported that in customer arbitration cases against broker-dealers, breach of fiduciary duty was the most frequently appearing claim. Customers in these cases recited common law principles that a fiduciary relationship is one in which special trust and confidence is placed in the integrity and fidelity of another, and that there is a resulting position of superiority or influence acquired by reason of such special trust that it was breached by a variety of alleged misconduct. Arbitrators adjudicated those claims and made awards to customers without exploring legal niceties in finding bases for a broker-dealer fiduciary duty, or rejecting such claims, as a matter of law.

The “suitability rule” itself has its origin not in a market regulatory construct but rather in the evolution of general notions of broker-dealer conduct based upon agency and fiduciary principles. There ultimately derived from both the Shingle Theory and agency fiduciary principles that brokers must have a reasonable basis for recommendations to customers, and have necessary information on which to disclose, or caution customers, about the risk involved in purchasing a particular security or embarking on a particular strategy.

None of this has gone away.

²² See, e.g., *William J. Stelmack Corp.*, 11 S.E.C. 601, 623 (SEC 1942) (“The status of a dealer in relation to an uninformed client is one of special trust and confidence, approaching and perhaps even equaling that of a fiduciary”).

²³ *Holmes v. Grubman*, 286 Ga. 636, 691 S.E. 2d 196, 201 (Ga. 2010).

²⁴ *Silverberg v. Thomson McKinnon Securities, Inc.*, Case No. 48545, 1985 Ohio App. LEXIS 6140 *10 (8th Dist. App. 1985); see also *Csordas v. Smith Barney, Harris, Upham & Co.*, 1992-1993 Transfer Binder Fed.Sec.L.Rep. (CCH) ¶197,230 (Fla. Cir. Ct. 1992) (The law is clear “that a securities broker owes to his investment customer a fiduciary duty of loyalty and due care”); *Gochnauer v. A.G. Edwards & Sons, Inc.*, 810 F. 2d 1042 (11th Cir. 1987); *Duffy v. Cavalier*, 210 Cal. App. 3d 1514, 259 Cal. Rptr 162 (1989), adhered to, 215 Cal. App.3d 1517, 264 Cal. Rptr 740 (1989) (All brokers are fiduciaries).

But see *De Kwiatkowski v. Bear, Stearns & Co., Inc.*, 306 F. 3d 1293 (2d Cir. 2002) (In a nondiscretionary account the broker’s duties ordinarily end after each transaction is done, and thus do not include a duty to offer unsolicited information, advice, or warnings concerning the customer’s investments).

²⁵ *Charles Hughes & Co. v. SEC*, 139 F.2d 434 (2d Cir. 1943).

²⁶ A stated objective in the adoption of Regulation Best Interest is to align the broker-dealer standard of conduct with retail customers’ reasonable expectations. See Exchange Act Rel. No. 34-86031, at 1.

The More Things Change....

Regulation Best Interest contains no definition of “best interest.” It does not create any unified standard of conduct applicable to broker-dealers and investment advisers envisioned by Congress in the Dodd-Frank Act. And the SEC specifically rejected adoption of the investment adviser fiduciary standard for broker-dealers because it would be inconsistent with the broker-dealer business model built around transaction-based compensation. Notwithstanding inherent conflicts of interest in the broker-customer relationship, said the SEC: “[T]here is broad acknowledgement of the benefits of, and support for, the continuing existence of the broker-dealer business model, including a commission or other transaction-based compensation structure, as an option for retail customers seeking investment recommendations.”²⁷ Regulation Best Interest is nevertheless characterized as changing the broker-dealer standard of conduct to enhance it beyond existing suitability obligations. It may be the safe harbor feature of Regulation Best Interest that actually defines it and whatever change has been made.

The Safe Harbor “Obligations”

Although not labelled as such, Regulation Best Interest is structured as a safe harbor. Without instructing what the best interest obligation is, it will assuredly be satisfied if certain obligations or conditions are met. Four safe harbor “obligations”²⁸ are included in Regulation Best Interest, and are summarized as follows:

- **Disclosure Obligation**

Prior to or at the time of making a recommendation the broker-dealer or associated person must provide, in writing, full and fair disclosure of all material facts relating to the scope and terms of the relationship with the retail customer, and all material facts relating to conflicts of interest associated with the recommendation.

- **Care Obligation**

In making a recommendation the broker-dealer and associated persons must exercise reasonable diligence, care and skill to understand the potential risk, rewards and costs associated with the recommendation, “and have a reasonable basis to believe that the recommendation could be in the best interest of at least some retail customers.” The broker-dealer or associated person must also have a reasonable basis to believe the recommendation is in the best interest of the particular retail customer’s investment profile and other factors associated with the recommendation. The obligation is transactional.

- **Conflict of Interest Obligation**

Maintaining written policies and procedures reasonably designed to identify and at a minimum disclose or eliminate all conflicts of interest associated with recommendations, including identification and mitigation of any conflicts of interest that create an incentive for an associated person to place the interest of the broker-dealer or associated person ahead of the retail customer, and specifically to identify and eliminate “any sales contests, sales quotas, bonuses, and non-cash compensation based on sales of specific securities or specific types of securities within a limited period of time.”

- **Compliance Obligation**

Establishing, maintaining and enforcing written policies and procedures reasonably designed to achieve compliance with Regulation Best Interest.

Regulatory safe harbors set specific conditions or requirements which, if all are met, ensure compliance with the subject rule. Compliance is not dependent upon meeting safe harbor requirements. However, if they are met the regulatory obligation is deemed satisfied. Thus, for Regulation Best Interest the baseline requirement for a broker-dealer and its associated persons to act in the best interest of a retail customer when making a recommendation will be satisfied if these safe harbor obligations are met.

The broker-dealer “Disclosure Obligation” itself is not new. Fiduciary principles long applicable in the broker-customer agency relationship impose various responsibilities on the broker-dealer including, for example, the duty to inform a customer of the risks involved in purchasing or selling a particular security, the duty not to

²⁷ Exchange Act Rel. No. 34-86031, at 8.

²⁸ Exchange Act Rule 15l-1(a)(2)(i)-(iv), 17 C.F.R. §240.15l-1(a)(2)(i)-(iv).

misrepresent any fact that is material to the transaction, and the duty to refrain from self-dealing or refusing to disclose a personal interest the broker has in regard to a particular recommended security.²⁹ Relationship and standard of conduct disclosure is ostensibly new, and obviously Form CRS as the means to do it is new. But as raised earlier, what in fact is being disclosed that brings clarity to the continuing separate standards of conduct between broker-dealers and investment advisers and all that was the subject of the RAND Report? In the Regulation Best Interest adopting Release the SEC does, however, state a presumption that the use of the terms “adviser” and “advisor” by (1) a broker-dealer that is not also registered as an investment adviser or (2) a financial professional that is not also a supervised person of an investment adviser to be a violation of the Disclosure Obligation.³⁰

The “Care Obligation” in practical terms is little more than the extant broker-dealer “suitability rule” with a reasonable basis to believe the recommendation is in the customer’s undefined best interest added to the traditional suitability criteria spelled out clearly in FINRA Conduct Rule 2111. Additional Care Obligation language regarding a broker-dealer’s reasonable basis to believe that a “series of recommended transactions,” even if in the retail customer’s best interest when viewed in isolation, is not excessive and is in the retail customer’s best interest when taken together in light of the customer’s investment profile is essentially a restatement of the extant prohibition of churning or other excessive transaction-related misconduct that has always been targeted in SEC enforcement actions under antifraud provisions.³¹

The “Conflict of Interest Obligation” is new to the extent broker-dealers must eliminate incentive compensation mechanisms tied to specific securities, and must disclose any material limitations placed on securities or investment strategies that may be recommended. But a fundamental obligation to know, and disclose, any conflicts that create an incentive to place the interest of the broker-dealer or its associated person ahead of the interest of the retail customer in recommending a transaction or strategy is not new. A more troublesome consideration attendant to the Conflict of Interest Obligation is that, apparently, by complying with the Disclosure Obligation, which calls specifically for disclosure of all material facts relating to conflicts of interest associated with a recommendation, the separate Conflict of Interest Obligation can be satisfied. A key element of the Conflict of Interest Obligation is stated in the disjunctive: (a) Identify and at a minimum disclose, expressly in accordance with the Disclosure Obligation; or (b) eliminate, all conflicts of interest.³² Although it is stated in the Regulation Best Interest adopting Release that the standard of conduct cannot be satisfied through disclosure alone,³³ in his dissent Commissioner Robert J. Jackson Jr lamented that conflicts may in fact be resolved by disclosure alone.³⁴

The “Compliance Obligation” is simply a requirement for, and enforcement of, written policies and procedures reasonably designed to achieve compliance with Regulation Best Interest. Although logically a part of any regulatory safe harbor, this obligation itself adds nothing of substance to Regulation Best Interest or a prescription of measures to carry it out and clarify ambiguities for broker-dealer associated persons in their retail customer relationships.

The More They Stay The Same?

In 2011, pursuant to a mandate in The Dodd-Frank Act, the SEC staff conducted a study and made recommendations to the Commission for potential new rulemaking, guidance and other policy changes regarding standards of conduct applying when retail customers receive personalized investment advice from broker-dealers or investment advisers. The key staff recommendation at that time was that a uniform

²⁹ See *Leib v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 461 F. Supp. 951, 953 (E.D. Mich. 1978), *aff’d*, 647 F.2d 165 (Table) (6th Cir. 1981).

³⁰ Exchange Act Rel. No. 34-86031, at 156.

³¹ See, e.g., *SEC v. Jovannie Aquino*, No. 1:18-cv-08191 (S.D.N.Y. filed Sept. 7, 2018), Litig. Rel. No. 24528 (July 8, 2019) (Final judgment against former registered representative associated with a broker-dealer for defrauding retail customers by recommending a series of frequent, short term trades which generated large commissions for Aquino at the expense of the retail customers).

³² Exchange Rule 15l-1(a)(2)(iii)(A), 17 C.F.R. §240.15l-1(a)(2)(iii)(A).

³³ Exchange Act Rel. No. 34-86031, at 1.

³⁴ SEC Commissioner Robert J. Jackson, Statement on Final Rules Governing Investment Advice (June 5, 2019). Available at www.sec.gov/news/public-statement/statement-jackson-060519-iabd.

fiduciary standard be adopted.³⁵ The SEC ultimately rejected the recommendation in favor of what is now Regulation Best Interest, which ignores the Dodd-Frank Act express authorization as well as the SEC staff recommendation, and does not establish a fiduciary standard for broker-dealers, or any uniform standard. Instead, as described in the adopting Release, the existing suitability standard of conduct has simply been “enhanced.” But that is itself a problematic characterization. For example, by default to the safe harbor obligations, a central element of Regulation Best Interest is the same suitability standard with some added “best interest” aspirational phraseology that has always applied. Nothing is objectively different.

In the end, all that can be said with certainty is that Regulation Best Interest establishes a broker-dealer standard of conduct that is supposed to be more than “suitability” but somehow less than “fiduciary,” and that “best interest” will be defined case by case. Its ultimate parameters will be subject to development, debate and litigation.³⁶ Both the SEC and FINRA will have examination and enforcement authority for compliance. Perhaps, then, practitioners and market participants will learn the more things have purportedly changed, the more they really have stayed the same.



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³⁵ SEC Staff Study on Investment Advisers and Broker-Dealers, Executive Summary, at v -vi (Jan. 2011).

³⁶ Any preemptive effect of Regulation Best Interest on emergent state laws or rules governing the relationship between broker-dealers and their retail customers will likewise be determined in future judicial proceedings based on the specific language and effect of state law. Rel. No. 34-86031, at 43.