

Date of Hearing: June 10, 2013

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Roger Dickinson, Chair
SB 538 (Hill) – As Amended: April 1, 2013

SENATE VOTE: 27-6

SUBJECT: The Corporate Securities Law of 1968

SUMMARY: Makes various changes to the Corporate Securities Law of 1968 (Securities Law). Specifically, this bill:

- 1) Authorizes Department of Corporations (DOC) to charge annual renewal fees of \$35 per broker-dealer agent and investment advisor representative.
- 2) Authorizes DOC commissioner to apply to the appropriate superior court for a civil judgment of imposed penalties after the exhaustion of administrative penalties for a violation of the Securities Law.
- 3) Expands the types of violations for which DOC is authorized to issue desist and refrain orders (D&R) under the Securities Law.
- 4) Ensures consistency with federal law by updating anti-fraud provisions in the Securities law by providing that it is unlawful for any person, in connection with the offer, sale, or purchase of a security, directly, or indirectly, to employ a device, scheme, or artifice to defraud; make an untrue statement of material fact or fail to state a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading; or engage in an act, practice, or course of business that operates or would operate as a fraud or deceit upon another person.
- 5) Adds California limited partnership and California limited liability companies to list of entities exempt from requirement to file consents to service of process with DOC.
- 6) Changes the length time a licensee may challenge a D&R concerning the Commodities Law to 30 days.
- 7) Makes legislative findings and declarations of the following:
 - a) Regular, periodic regulatory examinations of broker-dealers and investment advisers is critical to the protection of consumers, many of whom rely on broker-dealers and investment advisers for help in managing investments and in making sound financial decisions.
 - b) The DOC lacks license fee revenue sufficient to perform regular, periodic regulatory examinations of broker-dealers and investment advisers at a frequency that would ensure high levels of consumer protection.
 - c) It is the intent of the Legislature that revenue raised through amendments made by this bill to Corporations Code Sections 25608 and 25608.1 be used to perform regular, periodic

regulatory examinations of broker-dealer agency and investment adviser representatives at least once every four years, or more often, if deemed necessary for the protection of the public by the Commissioner of Corporations.

EXISTING LAW

- 1) Provides for the Corporate Securities Law of 1968, administered by DOC (Corporations Code Sections 25000 et seq.), to govern the issuance and sale of securities in California.
- 2) Specifies that it is unlawful for any person to offer or sell any security in this state, unless such sale has been qualified by the Commissioner of Corporations, as specified, or unless the sale is covered by an express exemption from qualification (Corporations Code Section 25110).
- 3) States that, unless a person is otherwise exempt from licensure as a broker-dealer, no person may affect any transaction in, or induce or attempt to induce the purchase or sale of any security in California, unless that person has obtained a certificate from the commissioner, authorizing that person to act in the capacity of a broker-dealer. Further provides that no person shall act on behalf of a licensed broker-dealer or on behalf of a securities issuer, effect any transaction in, or induce or attempt to induce the purchase or sale of any security in this state, unless that broker-dealer and agent have complied with rules adopted by the commissioner for the qualification and employment of those agents (Corporations Code Section 25210).
- 4) Provides that, unless a person is otherwise exempt from licensure as an investment adviser, no person may conduct business as an investment adviser in California, unless that person has obtained a certificate from the commissioner, authorizing that person to act in the capacity of an investment adviser. Further provides that no person shall act on behalf of a licensed investment adviser, offer or negotiate for the sale of investment advisory services; determine which recommendations shall be made to, make recommendations to, or manage the accounts of clients of the investment adviser; or determine the reports or analyses concerning securities to be published by an investment adviser, unless the investment adviser and that person have complied with rules adopted by the commissioner for the qualification and employment of those persons (Corporations Code Section 25230).
- 5) Provides for the Commodities Law of 1990 (Corporations Code Section 29500 et seq.), which governs the sale or purchase, or offer to sell or purchase any commodity under any commodity contract or commodity option, by persons not otherwise regulated as commodities traders under federal law, or not otherwise exempt from regulation in that capacity under state or federal law.

FISCAL EFFECT: According to the Senate Appropriations Committee analysis, approximately \$7.8 million - \$9.8 million in new revenue to the DOC. The revenue estimate is based on the DOC charging a renewal fee ranging from \$28-\$35 for agents and investment adviser representatives, and is based on an assumption that between 15% and 20% of the existing licensees will choose not to renew.

COMMENTS:

According to the author, "Broker-dealers, investment advisers, and their employees perform critically important functions on behalf of Californians, over which the state should provide an appropriate level of oversight. Particularly in today's extremely low interest rate environment, people are very

susceptible to aggressive sales pitches on risky investment products that promise high rates of investment return. Investment advisers have a fiduciary duty to their clients, and broker-dealers are required to ensure that the investments they recommend to their customers are suitable for those customers. Neither type of professional should be pitching risky investment products to people for whom these products are inappropriate. Yet, at the present time, DOC lacks the resources necessary to ensure that the state's investment professionals are following the law, and adhering to their duties to investors. The incremental cost to provide DOC with the examiners it needs to conduct regular regulatory examinations of its securities licensees is miniscule – in the range of \$25 to \$30 annually. We owe it to California investors to do what we can to protect them in their dealings with those from whom they seek advice related to their investments.”

Renewal Fees.

Broker-dealers are persons (individuals or firms) that buy and sell securities, either on behalf of customers, or on behalf of themselves. People who work for broker-dealers are called registered representatives or agents. Broker-dealers and their agents generally earn money by charging per transaction. Investment advisers, whether companies or individuals, earn money by advising customers about securities. Individuals who advise customers on behalf of investment adviser firms are called investment adviser representatives.

The law imposes a fiduciary duty on investment advisers in their interactions with their clients, and requires broker-dealers to evaluate the suitability of investments, before they recommend those investments for their clients.

California is home to approximately 3,100 licensed broker-dealer firms, which employ approximately 285,000 agents, and to approximately 3,600 licensed investment adviser firms, which employ just over 50,000 representatives.

Due to funding restraints broker-dealers, their agents, or investment advisor are usually only reviewed when they file their initial application. DOC seeks to conduct these examinations at least once every 4 years but this often does not occur due to funding restraints. The primary way in which DOC monitors this licensee population is via complaints that arise from customers of a licensee. Furthermore, Dodd-Frank Wall Street Reform and Consumer Protection Act has added further stress to DOC by adding approximately 500 investment adviser firms and several thousand investment advisor representatives to DOC's licensee population. California is one of a handful of states that do not currently impose renewal fees on these entities, while other states like Texas charge \$275.

Authorizing DOC to Petition Superior Courts:

At present, DOC is authorized to bring administrative actions against securities law licensees that have violated the law, seeking administrative penalties and, if applicable, ancillary relief, such as restitution, disgorgement, or damages. Licensees, in turn, have full due process rights under the Administrative Procedures Act, when they are the subject of a DOC administrative action.

When DOC prevails at the administrative level, the department sometimes encounters difficulties in collecting on administrative judgments. At present, if a licensee fails to comply with an administrative order, DOC must re-try its case in superior court, if the department wishes to obtain a judgment in the amount of an administrative penalty or other ancillary relief that was awarded via administrative action. This is not only costly and time-consuming for the department; it also imposes

a burden on an already overburdened civil court system.

SB 538 provides authority to DOC that is similar to authority under three of the other laws it administers (Deferred Deposit Transaction Law [Financial Code Section 23058], Check Sellers, Bill Payers and Proraters Law [Financial Code Section 12207], and the Franchise Investment Law [Corporations Code Section 31406]). Similar language also appears in the Labor Code (Section 5806) and Health and Safety Code (Section 25184.1).

Desist and Refrain Orders:

DOC currently has the authority to issue D&Rs to persons violating certain specific provisions of our securities laws. However, DOC lacks broad authority to issue D&Rs for any violation of the Corporate Securities Law of 1968. SB 538 grants DOC the broad D&R authority it currently lacks.

Anti-Fraud Language:

The anti-fraud language in California's securities law has failed to keep up with similar language in federal anti-fraud statutes. SB 538 updates our anti-fraud statutes to ensure consistency with more comprehensive, federal anti-fraud statutes.

Service of Process:

California limited partnerships and limited liability partnerships are currently required to file consents to service of process with the Secretary of State. Existing state securities laws require these entities to additionally file consents to service of process with DOC, if these entities are applying to DOC for qualification for the sale of securities, or if they are filing a request for or notice of exemption from qualification. SB 538 eliminates the duplicative filing requirements, by deleting the requirement that these entities file consents to service of process with DOC.

Timeframe to Challenge a Commodities Law D&R: California's Commodities Law contains an out-of-date provision that grants licensees and unlicensed persons issued D&Rs under this law a full year in which to challenge the issuance of a D&R. While no one disputes the importance of allowing persons to challenge the issuance of a D&R, granting a full year in which to do so is inconsistent with the time periods for challenges that exist in multiple other licensing laws. SB 538 changes the one year time period in California's Commodities Law to 30 days, and brings it in line with most of the other laws administered by DOC.

REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

None on file.

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