

MEMORANDUM

TO: USA Drafting Committee, Advisors, and Observers
FROM: Joel Seligman
DATE: March 13, 2002
SUBJECT: Draft of Uniform Securities Act for April 19-21

Please find attached Attachment A which compares this draft to earlier drafts. I have attached a schedule in Attachment B

To complete the Act, we need to resolve several open questions during our April 19-21 meeting:

Article 1

1. Section 102(2)

Should the exclusions be exemptions in Section 402?

2. With respect to the definition of bank in 102(3) and depository institution in 102(5) and the exclusions of bank in 102(4):

A. Should this be an exclusion or exemption?

B. Should the exclusion or exemption apply solely to a bank or also to a depository institution?

C. Should the substance of Section 3(a)(4)(B)(vii), (xi) and 3(a)(4)(E) of the 1934 Act also be excluded or exempted?

D. Should Section 102(5) instead be an exemption?

3. NASAA is concerned with the effectiveness of receipt by a designee in 102(8).

4. Section 102(11) – Institutional Investors

The \$25 million dollar cap: Is this too high? Should it be \$5 million as in Rule 501(a) of the Securities Act of 1933?

5. Section 102(14) – International Banking Institution

6. Section 102(15) – Investment Adviser

7. Section 102(16) – Investment Adviser Representative

A. Should we separately define third party solicitor or solicitor.

The ICAA, ICI, SIA, and FPA propose:

Proposed Section 102(34)

“Third party solicitor” means an investment adviser representative who solicits clients for or refers clients to an investment adviser or federal covered investment adviser for compensation.

Proposed Section 404(c)

(c) The provisions of subsection (a) shall not apply to a third party solicitor of an investment adviser or federal covered investment adviser if:

(1) the third party solicitor is principally employed by or associated with another entity that is either registered or exempt from registration as an investment adviser under Section 403 or is notice filed as a federal covered investment adviser or exempt from notice filing under Section 405 or is registered or exempt

from registration as a broker dealer under Section 401; and

(2) any compensation paid to the third party solicitor for a solicitation or referral is paid through the entity with which the third party solicitor is principally employed or associated.

B. If we include a separate definition for solicitor, do we need to address supervision?

C. Should Section 102(16)(C) be an exemption?

8. Section 102(17) – Investment Advisory Services

9. Section 102(18) – Issuer

10. Section 102(20) – Offer to Purchase

11. Section 102(22) – Place of Business

12. Section 102(24) – Price Amendment

13. Section 102(26) – Record; Section 102(8) – Filing; Section 102(31) – Sign; and Section 104.

14. Section 102(27) – Sale Should Section 102(27)(B)(i)-(iii) be relocated in Article 2 as a transaction exemption?

15. Section 102(29) – Security

16. Section 102(33) – Underwriter

Article 2

1. Section 201(3) - Depository institution and international banking institution securities:

NASAA proposes:

(3) [Depository institution and international banking institution securities.] a security issued by and representing or that will represent an interest in or a direct obligation of, or be guaranteed by,

(A) an international banking institution;

(B) any depository institution a substantial portion of the business of which consists of will consist of either receiving deposits or share accounts that are insured by the Federal Deposit Insurance Corporation, the National Credit Union Share Insurance Fund, or a successor authorized by federal law, or the exercise of fiduciary powers under or similar to those permitted to national banks under the authority of the Comptroller of the Currency pursuant to the first section of Public Law 87-722 (12 U.S.C. 92a); or

(C) any other depository institution, unless the administrator, by rule or order, so specifies under Section 204.

2. Section 201(7) – Nonprofit Organization Securities

3. The ABA urges that we need to rationalize Section 202(4) with Section 202(2). Why, the ABA asked, require registration for issuers that are reporting companies under the 1934 Act? Second, if the securities are guaranteed by such an issuer or issued by a consolidated subsidiary, why should registration be required?

4. Section 202(5)(A) – NRSRO Exemption

5. Section 202(9) – Unit Secured Transactions

6. Section 202(10) – Bankruptcy, Guardian, etc.

7. Section 202(12)(c) – Limited Offering Transactions

A. The ABA asks: If we use the concept of a single issue does the 12 month period in (A) make sense? Why not just restrict to 25 persons that do not exceed \$5 million within a time limit as in a 12 month period?

B. NASAA proposes limiting this exemption to \$1 million.

8. Section 202(18) – Out of state offers or sales: NASAA opposes.

9. Section 202(19) – Employee benefit plans.

NASAA proposes:

(19) [Employee benefit plans.] an offer or sale of a security issued in connection with an employees' stock purchase, savings, option, profit-sharing, pension, or similar employees' benefit plan that complies with Rule 701 under the Securities Act of 1933.

Article 3

1. Section 306(d), (e) – Stop Orders

NASAA urges using §306(d) and (e) processes in §204 actions.

2. Section 307 – Waivers

Article 4

No Section of Article 4 to date has been tentatively approved. All should be carefully reviewed.

The ABA has proposed a new exemption in Section 402(b):

an individual acting for an issuer in offering to purchase or purchasing securities.

Article 5

1. Section 502 – Prohibited Conduct in Providing Investment Advice

NASAA proposes:

(b) [Rulemaking.] It shall be unlawful for an investment adviser or an investment adviser representative other than a supervised person of a federal covered investment adviser to engage in any act, practice, or course of business which is fraudulent, deceptive or manipulative. The administrator shall, for purposes of this paragraph (b), by rule or order prescribe means reasonably designed to prevent investment advisers and investment adviser representative representatives other than supervised persons of a federal covered investment adviser from engaging in such defined fraudulent, deceptive, or manipulative acts, practices, and courses of business.

2. Section 507 – Qualified Immunity

3. Sections 509(f)(1), (g), (j) – Civil Liability

4. Section 510 – Rescission Offers

Article 6

1. Section 601(d) – Investor Education

NASAA proposes new Section 601(d)(2)–(3):

- (2) *There is created a special revenue fund known as the Securities Investor Education and Training fund to provide revenue for educating the public and the securities industry and provided in this Section.*
- (3) *All monies received by the State by reason of civil penalties ordered under this chapter shall be deposited in the Securities Investor Education and Training Fund.*

- 2. Sections 602(c), (d) – Investigations and Subpoenas
- 3. Section 603(a), (b) – Civil Enforcement
- 4. Section 604 – Administrative Enforcement

The SIA proposes a substitute Section 604:

SECTION 604: ADMINISTRATIVE ENFORCEMENT

(a) [Issuance of an order or notice.] Whenever it appears to the administrator that a person whose securities are not registered under Article 3 or who is not registered under Article 4 has engaged, or is about to engage, in an act or practice constituting a violation of this [Act] or a rule adopted or order issued under this [Act], or that a person [intentionally or recklessly] materially aided and abetted the act or practice constituting the violation, if the administrator finds that the order is in the public interest and is necessary for the protection of investors the administrator may:

- (1) issue an order directing the person to cease and desist from engaging in the act or practice or to take other action as is necessary or appropriate to comply with this [Act], and giving notice of opportunity for hearing on the order; and
- (2) issue a notice, giving opportunity for hearing, of

imposition of a civil penalty for the noticed violation.

(b) [Summary process.] Upon the entry of the order, the administrator shall promptly notify each person specified in the order that the order has been entered, the reasons for the postponement or suspension, and that within 15 days after the receipt of a request in a record from the person the matter will be scheduled for a hearing. If a hearing is not requested and none is ordered by the administrator, the order remains in effect until it is modified or vacated by the administrator. If a hearing is requested or ordered, the administrator, after notice of and opportunity for hearing to each person specified in the order, may modify or vacate the order or extend it until final determination.

(c) [Procedural requirements.] An order may not be entered under subsection (a) without:

(1) appropriate notice to the person who is subject to the order;

(2) opportunity for hearing; and

(3) findings of fact and conclusions of law in a record [in accordance with the state administrative procedure act].

(d) [Modification or vacation.] The administrator may modify or vacate a stop order entered under this section if the administrator finds that the conditions that caused its entry have changed or that it is otherwise in the public interest.

(e) [Service of an order or notice.] Service of an order or notice under subsection (a) is not effective unless made in accordance with Section 611.

(f) [Effectiveness of an order.] An order issued under subsection (a)(1) is effective from the date of issuance until such

time as it is vacated or modified by the administrator or a court.

(g) [Contesting of an order or notice; effect of not contesting.] A person against whom an order or notice has been issued under subsection (a) may contest the order or noticed penalty by filing a request for a hearing within 30 days after the date the order or notice is served. If a hearing is not timely requested, the order or noticed penalty becomes final by operation of law.

(h) [Making of a final order; civil penalty.] After service and provision of opportunity for hearing, the administrator shall make findings and

(1) make final, or vacate, an order issued under subsection (a)(1), or modify and make find the modified order; and

(2) issue, or determine not to issue, an order, which shall be final, imposing against a person to whom a notice of civil penalty has been issued under subsection (a)(2) a civil penalty up to a maximum of [\$] for a single violation or [\$] for multiple violations found in the proceeding or in a series of related proceedings.

(i) [Filing of certified final order with court; effect of filing.] If a petition for judicial review of a final order is not timely filed in accordance with Section 609, the administrator may file a certified copy of the final order with the clerk of the court of competent jurisdiction. The certified order so filed shall be treated and have the same effect as a judgment of the court and may be recorded, enforced, or satisfied in the same manner as a judgment of the court.

(j) [Enforcement by court; further civil penalty.] If a person fails to comply with an order under subsection (a)(1), an order

that becomes final by operation of law under subsection (g), an order this is made final under subsection (h) or an order filed with the court under subsection (i), the administrator may petition a court of competent jurisdiction, with service as in accordance with Section 611 on the person against whom the order has been issued, to enforce the order as certified by the administrator. The court shall not require the administrator to post a bond. If the court finds, after service and opportunity for hearing, that the person is not in compliance with the order, the court may adjudge the person in civil contempt of the order. The court may impose a further civil penalty against the person for contempt in an amount not less than [\$] but not greater than [\$] for each violation, and may issue such other rulings as it determines are just and proper in the circumstances.

(k) [Statute of limitation.] No action shall be maintained to enforce any liability created under this Section unless brought within five years of the discovery of the facts constituting the violation.

5. Section 607(b)(6) – Expunged Records

6. Section 607(c)(2).

7. Sections 608 – Uniformity and Cooperation with other agencies

NASAA proposes a new Section 608(b):

(b)(1) This Act shall be applied and construed to protect investors and, to the extent [in a manner] consistent with this purpose, to encourage capital formation. The remedial provisions of this act should be liberally construed to effectuate the purposes of the act.

(2) The exemptions of this [Act] are not available to any person for any securities transaction or investment advisory

service that, while in technical compliance with the provisions of this [Act], is part of a plan or scheme to evade the registration provisions of the [Act]. In such cases, registration under the [Act] is required.

8. Section 609 – Judicial Review

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