

## **FEDERAL SECURITIES ACTS**

Investment Advisers Act of 1940 to register/regulate persons giving advice.

Securities Act of 1933 to regulate new “primary” issues market.

Securities & Exchange Act of 1934, to regulate “secondary” market.

Investment Company Act of 1940 to regulate investment companies.

National Securities Markets Act of 1996 to limit Federal and State registration duplication.

\$25,000,000 or more register with SEC (must notify State and pay State fee).

\$25,000,000 or less register with State (not required to register with SEC).

### **INVESTMENT ADVISERS ACT OF 1940**

Require Registration with SEC.

Regulate actions of advisers.

**Investment Adviser Definition:** Same as State

Persons Excluded - Parallel to State EXCEPT “person advising about US Govt. issues”  
(under State Law - that person is NOT excluded)

#### **Exemptions:**

“Intrastate”: Office in 1 State - only giving advice to residents of that State.  
Federal Law applies to “interstate” activity (not “intrastate”).  
Must not advice on sec.listed on Natl. Exch. (since deemed “interstate”).

Insurance company clients only.

No more than 15 clients w/in 12 months; not holding oneself out to public generally, and does not advise investment cos. registered under Inv. Co. Act of 1940. (“de minimus”).

**FEDERAL SECURITIES ACTS, contd.**  
**INVESTMENT ADVISERS ACT OF 1940, contd.**

**Registration Procedure**

File ADV form.

ADV I            General info.    List States registered. Disclosure of liens, banko., bonds    # of firm employees, clients, managed assets.

ADV II            Descriptive info - may be used as “brochure rule” requirement. Services, fees, type of client, type of investments, method of analysis, sources of info, strategies, education, conflict of int.,

*If custody of funds or prepay greater than \$500 6 or more months in advance a balance sheet required.*

SEC grants in 45 days.

National Securities Markets Improvement Act of 1996

Criminal record and spent 1 year or more in prison DENIED registration.

Amendments to ADV (required if material change in filing)

Change:            Name, address, phone

Entity form (ex: partnership to corporation)

Disciplinary actions by St. Adm., court

Begin to take custody of funds

SEC gives 90 day filing period for minor amendments.

ADV-S            S (Subsequent Year) Each year within 90 days of fiscal end, adviser Files ADV-S with SEC (suspended now for \$25M or more reg. w/ SEC).

ADV-W            W (Withdrawal). If cease operation, file w/ SEC.

**FEDERAL SECURITIES ACTS, contd.**  
**INVESTMENT ADVISERS ACT OF 1940, contd.**

**Recordkeeping Rules**

Basic Records:           Cash receipts/disbursements ledger  
                                  Order tickets  
                                  Copies of all communications sent and received  
                                  Copies of all ads, notices, circulars distributed to 10 or more  
                                  Copy of disclosure statement signed by customer under “brochure rule”

If Custody of Funds:    Securities received and delivered ledger  
                                  Purchase and sales ledger  
                                  Securities record  
                                  Confirmations  
                                  Customer statements

If Mngmt. Services:    Record by customer of securities traded, date, amount  
                                  Securities record showing name, amount held for each position

All records maintained for 5 years (with immediate 2 years accessible for inspection).  
(State requires 3 years)

**The “Brochure Rule”**

Required to provide to clients:   Either Part II of ADV or separate printed brochure.

                                  Must be given no less than 48 hours prior to entering ....(called “2 day free look”).

                                  OR

                                  Brochure given at client signing IF provides for 5 day termination w/o penalty.

Updated brochure provided annually to clients.

NOT required if selling investment cos or advisory services less than \$200.

**FEDERAL SECURITIES ACTS, contd.**  
**INVESTMENT ADVISERS ACT OF 1940, contd.**

**Paying for Solicitation**

Adviser permitted to pay person for soliciting clients IF:

1. Adviser is registered with SEC
2. Solicitor has not been suspended, expelled, limited, from associating by SEC

If Fee Paid, there must be:

1. Agreement in writing between adviser and solicitor.
2. Solicitor must provide client with "brochure".
3. Solicitor separate disclosure document to customer.
4. Prior to entering...adviser must obtain signed document from client that received both disclosures from adviser and solicitor.

**Advisory Contracts**

In writing.

1. No compensation based on gains.

Exception: clients w/ net worth \$1M w/ at least \$500K under mngmt.

1. Fulcrum Fee: basic fee
2. Performance Fee

2. No reduction in fee if bad performance.
3. No assignment to other adviser w/o consent.
4. Notification for change in composition of adviser (corp to partner, etc.)

**Custody of Funds and Securities**

Balance Sheet in Part II ADV required.

1. Segregate funds from adviser's.
2. Trustee as holder of account.
3. Notify place and manner.
4. Quarterly itemized statements.
5. Independent accountant audit of adviser on "surprise" basis; report filed SEC.

**FEDERAL SECURITIES ACTS, contd.**  
**INVESTMENT ADVISERS ACT OF 1940, contd.**

**Advertisements**

Definition (VERY BROAD):

1. Notice to one or more persons; written or radio/TV.
2. Analysis material to determine which security to buy/sell and when.
3. Any other service w/ regard to services.

If showing “performance”:

1. Entire “universe” of clients must be shown w/ accompanying statement of market conditions during.
2. Truthful, no false or misleading.
3. Prior recommendations ONLY UPON REQUEST; must show ALL recs. over last 12 months with statement “not a predictor of future”
4. Cannot use testimonials.
5. Cannot propose graphs, formulas, computer programs, etc. by themselves  
determine.... Unless limitations of such devices disclosed.
6. Cannot state service is “free” - unless actually.
7. Cannot say “sponsored, recommended or approved by Govt/SEC”.  
(OK to say “registered investment adviser”).
8. Cannot call oneself “Investment Counsel” - unless principal business is rendering supervisory services.

**FEDERAL SECURITIES ACTS, contd.**  
**INVESTMENT ADVISERS ACT OF 1940, contd.**

**Other Requirements**

“Principal Transaction”: Where adviser buys/sells security personally into or out of a customer account.

Adviser Must:

1. Disclose prior to completion adviser acting as broker-dealer.
2. Consent from client.

“Agency Cross Transaction”: Adviser tells one client to SELL and another to BUY.

Adviser Must:

1. Not solicit both “cross” customers.
2. Obtain best possible prices.
3. Obtain written consent adviser acting as broker (commission + conflict).
4. Send at least annual statement w/ number of “cross” transactions w/ commissions received total.

Disclosures: Prior disciplinary and financial problems.  
(Financial if custody/discretion; prepaid of \$500+ 6 mos up-front)

Civil or criminal convictions; guilty or no-contest plea.

Violation of investment statute.

Court order, judgement, decree enjoining.

Proceeding before SEC/State causing loss/suspension reg./auth.

**SEC Appeals:** Appeal SEC order at US Court of Appeals by petition w/in 60 days.

**Violations:** Up to \$10,000, 5 years prison or both (USA is \$5,000 and 3 years).

**FEDERAL SECURITIES ACTS, contd.**  
**SECURITIES ACT OF 1933: Curb excesses in new issue market.**

Required prospectus.

Margin banned on new issues.

Requirements:

1. Reg. statement filed with SEC
  - a. Character of business.
  - b. Use of proceeds.
  - c. Historical audited financials.
  - d. Officer biographies + % holdings.
  - e. Legal issues

Signed by CEO, CFO, majority of Board of Dir.

Accountant's opinion.

Legal opinion.

(Note: All of these parties liable under the Act)

"20 Day Cooling Off Period": when under SEC review.

During 20-Day: NO sales, ads, recommendations, etc.

Underwriters allowed to distribute "preliminary prospectus" (red herring),  
where take "indications of interest".

"Deficiency Letter": sent by SEC if insufficient disclosure; asks for more info.

"90 Day Period Final Prospectus": prospectus MUST be given to purchasers.  
Requirement ends after 90 days.

After 90: Issuer required to make first financial filings w/ SEC  
(required under SEC of 1934).

Exempt: Govt. issues / Private Placements / Non-profits / Banks / Insurance Cos.

**FEDERAL SECURITIES ACTS, contd.**  
**SECURITIES ACT OF 1933, contd.**

**Exempt Transactions:**

**Intrastate Offerings - Rule 147**

Federal Law only applies to INTERstate, State handles INTRAsate.

Definition of Exempt:

1. 100% of issue offered/sold to residents of that State.
2. Issuer must be resident of that State.
3. 9-Month restriction after sale complete (resale only to State residents).
4. Form 147 files w/ SEC at least 10 days prior to proposed sale.

**Private Placements - Regulation D**

Maximum of 35 “non-accredited” investors and unlimited # of “accredited”.

Accredited Investor (meets 1 of following):

1. NW of at least \$1M
2. Annual income \$200K past 2 years (joint \$300K)
3. Officer or director of issuer
4. Financial institution assets excess of \$5M
5. Non-profit assets excess of \$5M

**Small Dollar Offerings - Regulation A (Obsolete due to liberal Private Place. Rule)**

Sell up to \$5M each year.

Full Disclosure given “offering circular” 48 hours prior.

**FEDERAL SECURITIES ACTS, contd.**  
**SECURITIES ACT OF 1934: Abuses in trading markets**

General Provisions **MISS PERMMS**

- M Manipulation - (Fraud) - applies whether Exempt or Non-Exempt!
- I Insiders
- S SEC Created
- S Short Sale Rule (to curb shorting to drive value down)
  
- P Proxy Rules (to make takeover attempts fair)
- E Exchanges and member firms (must now register w/ SEC and regulated)
- R Reports (annual and quarter reports)
- M Margin (control given to Fed Reserve)
- M MSRB Municipal Sec. Rulemaking Board (rules - even though exempt)
- S Stabilization (permitted, even though manipulation fraud)

**Manipulation**

Wash Trades: buying/selling same security to create “appearance” of activity  
Trading Pools: grouping of investors on same security to inflate price  
Matched Trades: prearranging a buyer when wishing to sell (or vice versa)  
Circular Rumors: sensational rumor to affect price

“Catch-All Fraud Rule 10-B-5”: For future activities unknown when act written.

IF WRONG - IT CAN BE FRAUD UNDER ACT

**Insiders**

Officer, director or 10% shareholder.  
Required to report trades to SEC monthly.  
Prohibited from trading on “material non-public information”.  
Short swing (within 6 months) profits - must be paid back to corporation.  
Prohibited from “short” selling on own company.

Violation: 3 X profit (or loss avoided) + jail

## **FEDERAL SECURITIES ACTS, contd.**

### **SECURITIES ACT OF 1934, contd.**

General Provisions MISS PERMMS, contd.

#### **SEC Created**

Regulates securities only.

Approves all exchanges rules.

Empowered to suspend trading on national exchange w/ prior notice to US President.

5 Commissioners appointed by US President (w/ advice/consent of Senate).  
(no more than 3 from one political party)

5 Year Commissioner Terms (no other work + cannot direct own security transactions).

#### **Short Sale Rule**

Eliminates “bear raids” (pushing stock price down with shorts).

Short sale effected on an uptick or zero-uptick (not on a downtick).

#### **Proxy Solicitations**

Shareholders get fair chance to vote for regular corporate decisions + exceptional.

Copies of proxy materials filed with SEC 10 days before date mailed to shareholders.

## **FEDERAL SECURITIES ACTS, contd.**

### **SECURITIES ACT OF 1934, contd.**

General Provisions MISS PERMMS, contd.

#### **Exchanges & Member Firms**

Registration By:

##### **Exchange**

##### **Member Firms + Representatives (thus, "Reg. Rep." born)**

1. Minimum net capital
2. Fully-paid customer issues segregated
3. Notice of Free Credit Balance to Customer

Quarterly Notice stating:

- a) Amount of cash balance
- b) funds available upon request
- c) funds not segregated

##### **Broker-Dealer Financial Condition Notification**

Semi-annual financials to customers:

1. Balance Sheet
2. Net Capital

Registration Denial to anyone subject to "Statutory Disqualification":

- If: Has been suspended or expelled from any other self-regulatory org.  
Subject of SEC order suspending or revoking.  
Caused firm's suspension by person's conduct.  
Filed false or misleading app. / omitted to state facts.  
Temp or permanently enjoined from engaging.

**Securities Info. Processor:** collects and processes quotes or trade reports

**Clearing Corp. & Transfer Agents**

## **FEDERAL SECURITIES ACTS, contd.**

### **SECURITIES ACT OF 1934, contd.**

General Provisions MISS PERMMS, contd.

#### **Reports**

Corporate and other reporting requirements (one of the most successful aspects of Act).

Issuers: Register and file annual (10K) & quarterly (10Q) reports with SEC.

Income Statement  
Balance Sheet  
Changes to Retained Earnings (shows dividend)  
Uses of funds (cash flow)

“8K” Filing (w/in 15 days of event):

Bankruptcy  
Changes Board of Directors  
Merger or Divestiture proposed

“10C” Report Filing (w/in 10 days of change):

Change of Name  
5% or more change in number of outstanding shares

“13D” Filing (w/in 10 days):

Accumulation 5% or more position.  
Intention to exercise control - seek Board seat (“D” for

Director)

Others: “13G” Filing (w/in 10 days):

Accumulation 5% or more position.  
Intention to remain passive investor (“G” for Grandpa Golsan)

“13F” Filing (w/in 45 days of Q ending):

Institutional Investors - Report of Holding.  
Manager w/ discretion on accounts collectively holding \$100M+

## **FEDERAL SECURITIES ACTS, contd.**

### **SECURITIES ACT OF 1934, contd.**

General Provisions MISS PERMMS, contd.

#### **Margin Regulations**

Regulation of Credit given to Federal Reserve.

“Reg. T”: credit extended from Broker to Customer

“Reg. U”: credit from bank to broker

NO CREDIT on new issues for 30 days.

#### **MSRB Creation (added in 1975 as amendment)**

Municipal Sec. Rulemaking Board

SEC of 1934 amended in 1975

No authority over issuers (exempt) - only over TRADERS

Cannot enforce - enforcement done by NASD  
(who regulates otc mkt where municipals trade)

#### **Stabilization of New Issues (legal manipulation)**

Managing underwriter allowed to maintain stabilizing bid in mkt. until offer complete.

Only 1 bid allowed.

At or below IPO price - never above.

“Notice of Stabilization” must appear in prospectus.

## **FEDERAL SECURITIES ACTS**

### **INVESTMENT COMPANY ACT OF 1940**

Investment Company Act of 1940 to regulate investment companies.

Three Type of Companies:      Face-Amount Certificate Co.  
   Management Company (Mutual Funds)  
   Unit Investment Trusts

1.      Face-Amount Certificate Company

Almost Obsolete.

Investors pay fixed monthly amount.

Company invests funds in USGovt/ AAA Municipals/Corporate Debt

Certificate promises Guaranteed Rate of Return at a fixed date; receives  
The “face amount” at end of term.

2.      Management Company

Issues shares of stock.

Using investment manager.

“Open-End”

Mutual Fund.

Open-end: as investors place \$ - they get additional shares.

Shares “non-negotiable” - cannot be trades.

Shares are “redeemable” any time.

“Closed-End”

One-time issuance of stock.

Negotiable - trades listed on exchange (“publicly traded fund”).

Shares are NOT redeemable.

## **FEDERAL SECURITIES ACTS INVESTMENT COMPANY ACT OF 1940**

Three Type of Companies, contd.

### 3. Unit Investment Trust

Two types:

#### “Fixed UIT”

Trust selects fixed portfolio of securities (usually bonds).  
No buying or selling after selection. No “management”.  
Sells “units” of fixed portfolio to investors.  
When bonds all matured - trust liquidates.

#### “Participating UIT”

Trust invests in shares of a management co. (mutual fund shares).  
“Contractual Purchase Plans” where investor obligated to make payments to buy units (variable annuities).

Three Type of Companies

1. Face Amount Certificate Cos.
2. Management Company (Mutual Fund)
3. Unit Investment Trusts

More Detail on ..... 2. Management Companies

## **FEDERAL SECURITIES ACTS INVESTMENT COMPANY ACT OF 1940**

More Detail on ..... 2. Management Companies

“Sponsor” of fund establishes fund, investment objective, hires inv. adviser and registers w/ SEC.

100 or more shareholders requires registration.

Start with \$100,000 minimum.

Adviser contract initially can be 2 years with annual renewal thereafter; approved by B of D or majority vote of shares.

No buying on margin (can borrow from banks up to 1/3 total net assets - BUT CANNOT BE SECURED BY THE PORTFOLIO).

If wants to change objective - majority vote of shareholders required.

Shareholder Rights:   Vote for B of D  
                              Vote for changes to objective  
                              Vote annually on adviser  
                              Receive annual and semi-annual reports

Managers of fund cannot exceed 60% of Board.

Affiliated individuals cannot borrow/lend money or buy/sell securities out of/into fund.

Can be either: Non-Diversified  
                  or  
                  Diversified (75% or more in securities; max of 5% in any one; max of 10% voting securities in any one issuer)

Violations:       \$10,000 and up to 5 years in jail.

## **SEC INVESTMENT ADVISER RELEASES**

### **INVESTMENT ADVISERS ACT OF 1940**

Definition of Adviser requiring Reg. with SEC under Investment Advisers Act of 1940.

Expansions in 1981 (IA-770) and 1987 (IA-1092) due to growth in “financial planning”.

#### **IA - 770**

Definition “3 Prong” who is an adviser:

1. Person give advice about a security or stocks in general?

As defined under USA (State) or Federal.

2. Person “in the business” of giving advice about securities?

Rare, isolated advice excluded.

3. Compensated for advice about securities?

Fee, commission or assignment of liability to customer in return.  
Payment in any form.

IF “ YES “ TO ALL 3 - ADVISER!

#### **IA – 1092**

Reaffirmed “3 Prong” and ADDED additional detail:

General recommendation about course of activity.

Pension consultants.

Recommend advisers.

## **SEC INVESTMENT ADVISER RELEASES**

### INVESTMENT ADVISERS ACT OF 1940

#### **Application of Anti-Fraud Statutes**

Fraud is fraud, whether the person was required to Reg. or not.

Exemption:

Advice to no more than 15 client w/in 12 months.

Intrastate (HOWEVER - cannot advise about security listed national exchange)

Adviser to insurance companies.

IA-1092 set Disclosure Requirements for ALL (exempt included) Advisers:

Act in fiduciary capacity (good faith, full and fair disclosure).

Disclose conflicts of interest.

Disclose adviser personally takes same positions.

Disclose if adv. takes position different than recommendations.



## **UNIFORM SECURITIES ACT, contd.**

### **INVESTMENT ADVISER Definition:** *Continued*

Must be defined as a “PERSON” and advising on a “SECURITY”.

PERSON:       Individuals  
                  Corporations  
                  Partnerships  
                  Trusts  
                  Estates  
                  Associations  
                  Joint Stock or Joint Venture Cos.  
                  Governments  
                  Unincorporated or any other Legal Entity

SECURITY:    Any investment in a common enterprise for profit  
                  managed by another party.

Excluded:       Insurance or endowment policies  
                  Fixed annuities  
                  Ownership in Credit Unions (non-profit)  
                  CD's  
                  Pensions, IRA's etc.

**State Administrator:** State Securities Commission, Commissioner, or Secretary

### **INVESTMENT ADVISER Registration Standards:**

1.       Minimum Net Worth
2.       Surety Bond, cash deposit or securities.
3.       Pass Exam

File financial report when required.

## **UNIFORM SECURITIES ACT, contd.**

**REPRESENTATIVE Definition:** Any human employed by an Inv. Adviser.

Excluded: Clerical duties.

### **REPRESENTATIVE Registration:**

If stop working for Adviser ..... individual's registration ineffective.

When begin / terminate work ..... Inv. Adviser must notify State Administrator.

Registration Standards:

1. Surety Bond.
2. Pass Exam.

### **INVESTMENT ADVISER & REPRESENTATIVE Registration Procedure:**

Procedure: File with St. Adm. ....

1. REGISTRATION APP.  
(if w/ SEC Central Reg. Depository - just notify ADM).
2. Form giving CONSENT TO SERVICE OF PROCESS  
(appoints ADM "attorney" for registrant)  
(only needed upon initial filing)

Administrator can require published announcement.

Annual renewal fee.

Registration effective 30 days from filing (ADM may specify earlier or later).

Expires on December 31st.

## UNIFORM SECURITIES ACT, contd.

### INVESTMENT ADVISER

#### Maintaining Registration Requirements:

Keep records for at least 3 years.

Advisory contracts in writing.

Cannot share in gain or loss.

Fee stated or fixed percentage.

No assign/transfer to another adviser w/o customer approval in writing

Administrator can prohibit custody of client funds (reg. must have stated this may occur)

If take custody ..... must comply w/ Inv. Adv. Act of 1940 (Federal).

Segregate customer funds.

Notify customer where held.

Itemized account statement at least quarterly.

Annual accountant audit.

ADM can require “Brochure Rule” (IA Act of 1940) - 48 hrs before enter into contract

Financial reports as required by ADM.

Inaccurate Information filed - must be corrected by filing correcting amendment.  
Effective 30 days after correction.

Can be inspected.

Can require filing of advertising and sales literature.

## UNIFORM SECURITIES ACT, contd.

### INVESTMENT ADVISER

#### Registration Denied, Revoked or Suspended

Administrator finds ..... (1) in the public interest

And

(2) person .....

- filed incomplete, false or misleading reg. app
- violated Act's provisions
- enjoined by court from doing business
- convicted misdemeanor, felony in securities biz in past 10 years
- violated securities laws of another state/SEC in 10 years
- unethical or dishonest practices
- insolvent
- unqualified or lack of experience

note: Adm. cannot solely if qualified training or knowledge

note: Adm. can require different qualifications for Advisers than for Reps.

- failed to pay fee within 30 days of notice
- improper supervision of employees

## **UNIFORM SECURITIES ACT, contd.**

### **INVESTMENT ADVISER**

#### **Registration Denied, Revoked or Suspended**

If a Denial, Revoke or Suspension is “entered” by the Adm. ....

- Administrator must:
1. Promptly notify applicant & employer and why.
  2. Set hearing within 15 days of written request.

Registered Person Withdrawal from registration not allowed if legal proceedings.

- Cancel of Registration by Adm.
1. adviser has ceased business
  2. moved w/o forward address
  3. mentally incompetent court judgement

Reps. No longer registered if Adviser loses or withdraws.

Reps. Cannot register on his/her own.

#### **Administrator Powers**

Power to conduct investigations inside and outside the State.

Can publish info concerning violation or acts/practices tend operate as fraud – “broadcast” rights

For persons violating or about-to-violate Act:

1. Issue cease and desist
2. Bring action in court to enjoin

Written petition by person submitted to court in 60 days if disagree.

“Offer” (not Adm. jurisdiction) made in newspaper not considered in State if ....

not published in St

OR

has more than 2/3 circulation outside State in past 12 months.

## **UNIFORM STATE LAW – UNETHICAL PRACTICES**

### **Actions prohibited under Uniform State Law.**

Statement of Actions issued by North Am. Securities Administrators Assoc. (NASAA)

### **ADVISORY ACTIVITY PROHIBITED**

Unlawful to .....(very broad)

Employ any defraud device, scheme.

Effect transaction for customer w/o obtaining consent.

Engage in dishonest/unethical practice as defined Adm. rule.

(parallel wording of SEC Rule 10-b-5 “catch all” fraud rule)

Prohibited from advisory contract unless it provides in writing.....

No compensation on gains or appreciation.

No assignment of contract permitted w/o consent.

Customer notified of partnership changes.

Adviser prohibited from taking custody of customer funds if .....

Adm. prohibits this by rule.

If no rule, prohibited if advisor fails to notify Adm. that custody exists.

If take custody of funds Adv. must.....

Segregate customer funds.

Safekeeping with written location notice to customer.

Statement at least quarterly to customer.

## **UNIFORM STATE LAW – UNETHICAL PRACTICES, contd.**

### **UNETHICAL BUSINESS PRACTICES**

#### **Misleading or Untrue Statements**

- Inaccurate market quotations
- Past or future earnings misstatements
- Inaccurate commission statements
- Stating that a securities registration warrants SEC/State “approval”
- Stating that Adv / Rep. Registration warrants SEC/State “approval”
- Promise to perform w/o intent
- Exaggerated performance claims
- Misrepresenting customer account status

#### **Failure to State Important Facts**

- Omission of material fact
- Deliberate selective info given
- Failure to inform transaction to incur larger than normal commission
- Failure to bring customer complaint to attention
- Failure to disclose research rec. given prepared by someone other than firm

#### **Recommendations Based on Inside Info or Hearsay**

- Info security issuer has not made public
- Effecting transaction based on inside info
- Transmitting such material
- Inducing customers to trade based on hearsay or rumor
- Violation to use rumors to generate trades

#### **Not Determining Suitability of Recommendations “Suitability Rule”**

- Failure to inquire customer’s financial situation, needs, objective
- Recommending w/o regard to situation
- Recommending w/o reasonable basis
- Churning
- Excessive trade sizes
- Failure to describe facts and risks

## **UNIFORM STATE LAW – UNETHICAL PRACTICES, contd.**

### **Trades w/o Proper Authorization**

Effect trades w/o written authorization

Exercising discretion w/o written authorization

Under NASAA - written authority must be obtained 10 days after verbal  
(different than discretionary account rules)

### **Failure to Maintain “Arm’s Length” Relationship with Customer**

Borrowing money or securities from accounts

Lending money or securities to customer

Guaranteeing a customer account against loss

Taking custody of client’s funds UNLESS:

Segregates

Safekeeping location notice given

Statement sent quarterly

Surprise audit annually by independent accountant

Commingling customer with adviser funds

Sharing in gains and losses in customer’s account

### **Entering into advisory contract prohibited UNLESS:**

1. In Writing
2. Has Fixed Life
3. Details Fee
4. Details Refund of Fee if Terminated Early
5. No Assignment unless customer approved

### **Charging Excessive Fee (must be comparable to other advisers).**

### **Failure to Disclose Conflict of Interest (Ex: receive fee + commission or “referral fee”)**

### **Disclose Info about Customer Acct. to Someone other than Customer, unless authorized.**

**Advertising - no testimonials, reference to prior recommendations. Can show performance.**

## **UNIFORM STATE LAW – UNETHICAL PRACTICES, contd.**

### **VIOLATIONS - UNIFORM SECURITIES ACT SANCTIONS**

Willful violation of Act can be fraudulent and is a felony under the Act; punishable by:

Restitution to injured-party.

Fine of \$5,000 (but can vary by State).

Imprisonment up to 3 years (but can vary by State).  
(If person can prove no knowledge of rule - they cannot be imprisoned).

Criminal penalties cannot start later than 5 years after alleged violation.

Violation without willful intent - not fraud. Civil liabilities only apply (refund \$).

Adviser Customer Restitution:

Make customer “whole”.

Pay interest on monies invested net of income received.

Pay attorney’s fees.

Civil liability applies to following violations:

Failing to be registered.

Failing to file sales literature and advertising with Adm.

Misrepresenting status of registration.

Making unintentional false statements or omissions of fact.

Note: Civil suits must be brought no later 3 years after contract of sale executed.  
Suits cannot be brought later than 2 years after discovery.

## **UNIFORM STATE LAW – UNETHICAL PRACTICES, contd.**

### **OFFERS OF RESCISSION:**

#### **If adviser discovers illegally offered services in State.**

Offer of Rescission (buyer's right to accept or reject) must be made prior to buyer lawsuit.

Adviser must give Written Offer including:

Statement of how liability may have arisen.

Advise buyer of his rights of rescission.

Info necessary to correct error (if made misstatement or omission).

Offer to repurchase for cash payable upon delivery.

Statement that offer must be accepted within 30 days.

- No suit can be brought by buyer if failed to accept offer in 30 days.

## UNIFORM SECURITIES ACT (State) REGISTRATION OF SECURITIES & EXEMPTIONS

Unless an exemption available, USAct requires securities be registered in the State.

Security must be either ..... 1. Registered in the State under the Act  
Or  
2. Exempt under the Act

Registration effective for 1 year.

Adm. can require quarterly reports.

Registration made only by ..... 1. Issuer  
2. Any person on whose behalf offering is made  
3. Registered broker-dealer.

**Registration by 3 Methods:** 1. Registration by **Filing**  
2. Registration by **Coordination**  
3. Registration by **Qualification**

### Filing

**“Seasoned” companies already filed in past.**

Allows prospectus filed with SEC under Sec. Act. Of 1933 as filing document.

No special State paperwork required.

Effective **5<sup>th</sup> business day** after filing (if no “stop” or “halt” order in effect).

Registration effective with State when SEC reg. effective.

Buyer must get **prospectus at or prior to confirm.**

### Coordination

**First-time issuer coordinating State with SEC reg. under Sec. Act of 1933.**

Effective **10th business day** after filing (if no “stop” or “halt” order in effect).

Buyer must get **prospectus at or prior to confirm.**

### Qualification

Most difficult.

First-time issuer who has not reg. with State or SEC.

Effective **30th business day** after filing (if no “stop” or “halt” order in effect).

Buyer must get **prospectus at or prior to offer.**

## **UNIFORM SECURITIES ACT (State) REGISTRATION OF SECURITIES & EXEMPTIONS, contd.**

### **SECURITIES EXEMPT FROM STATE REGISTRATION**

Government and Municipal

Issuers regulated under other laws (banks, S&L's, insurance cos.)

Large Established Companies (Federal laws apply); "Blue-Chips"

Note: If common stock listed, all of company's securities are exempt.  
(except for joint vent or partnerships of that co – they are not exempt)

Non-Profits

### **EXEMPT TRANSACTIONS**

**Trades that do not involve the public.**

However, anti-fraud provisions still apply.

Exempt Transactions:

#### Isolated Non-Issuer Transactions

Trades for benefit of person other than issuer (secondary market). If more than 5 trades within 12 months – exemption not available. Broker-dealer must not be a resident of state.

#### Non-Issuer Transactions in Outstanding Issues Reg. under 1934 Act

Normal secondary trading of already registered SEC issues. Issuer must have been reporting to SEC at least 180 days (thus exemption no good for IPO's)

#### Non-Issuer Transactions Outstanding Issues Reg. under Inv. Co. Act of 1940

Normal secondary trading of inv. co. issues already registered SEC.

#### Fiduciary Transactions

Transactions made by executor, trustee, administrator, guardian, etc.

## **UNIFORM SECURITIES ACT (State) REGISTRATION OF SECURITIES & EXEMPTIONS, contd.**

### **EXEMPT TRANSACTIONS, Contd.**

#### **Trades that do not involve the public.**

##### Unsolicited Transactions

Trades through broker-dealer pursuant to unsolicited order or offer. Trades must be documented by non-solicitation statement signed by customer.

##### Real-Estate Transactions Secured by Mortgage

As long as mortgage sold as a whole unit (exempt if “securitized”).

##### Transaction between Issuers and Underwriters

Exempt because public not involved.

##### Private Placements

Offer to no more than 10 persons during 12 months.

To qualify:

Seller believe all purchasers buying for investment

No commissions paid other than financial or institutional investors

##### Offers of Sale of Pre-Organization Subscriptions

No commissions allowable. Subscribers no more than 10.

Sales where no commissions (mergers, exchange offers, etc.)

### **REVOCATION OF AN EXEMPTION**

Administrator allowed to deny or revoke any exemption for a transaction by order.  
(Adm. cannot revoke an “exempt security” - ex: Govt/Municipal, banks, savings & loans, insurance cos., non-profits, large “blue chips”)

Adm. “order” cannot be entered unless:

Appropriate prior notice.

Opportunity for hearing given.

Written findings of fact and conclusions of law given.

