House
Legislative
Analysis
Section

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UNIFORM SECURITIES ACT

House Bill 6338
Sponsor: Rep. Andrew Richner
Committee: Insurance and Financial Services

Complete to 11-1-02

A SUMMARY OF HOUSE BILL 6338 AS INTRODUCED 9-18-02

The bill would repeal the existing Uniform Securities Act (MCL 451.501 to 451.818) and would replace it with the Uniform Securities Act (2002). The bill would take effect 180 days after its enactment. The bill is not a minor modification of the existing act; due to changes in technology that allows for electronic transactions and transmissions, a changing global economy, court decisions, and federal laws -- such as the National Securities Markets Improvement Act of 1996 (NSMIA) -- enacted since the mid-1990s, the bill would make significant changes and additions to many sections. The bill also closely follows the model uniform securities act adopted in early August by the National Conference of Commissioners on Uniform State Laws (NCCUSL), though the bill does include some provisions unique to this state. Some current provisions and sections would be rewritten extensively or because of the revisions, would, like the section on small company offering registration, be eliminated.

The bill is organized into seven articles. A brief description of the content of the articles follows:

Article 1: General Provisions. The definitions of terms are concentrated in Article 1. Many new definitions would be added, including definitions of "depository institution", "institutional investor", "international banking institution", and "self-regulatory organization". "Bank" would mean a banking institution organized under the laws of the U.S.; a member bank of the federal reserve system; any other banking institution that met all of the following: 1) it was doing business under the laws of a state or of the U.S.; 2) a substantial portion of its business consisted of receiving deposits or exercising fiduciary powers similar to those permitted to be exercised by national banks under the authority of the comptroller of the currency pursuant to federal law; 3) it was supervised and examined by a state or federal agency having supervision over banks; and 4) it was not operated for the purpose of evading the bill; or a receiver, conservator, or other liquidating agent of any institution or firm included in the above.

Many other definitions would be expanded or otherwise amended. For example, where banks and savings institutions now have a blanket exemption from the definition of "broker-dealer", the bill would specify that "broker-dealer" would not include a bank or savings institution if its activities as a broker-dealer were limited to those specified in certain provisions of the federal Securities Exchange Act of 1934, or the bank satisfied the conditions described in another provision of that act. An international banking institution would not be included in the term "broker-dealer". Further, the definition of "security" would be revised. Changes include the addition of an investment in a viatical or life settlement agreement, certain common enterprises, and the inclusion of both a certificated and an uncertificated security.

As to what a "security" doesn't include, the bill would specify that security does not include an insurance or endowment policy or annuity contract under which an insurance company promised to pay a fixed sum of money either in a lump sum or periodically for life or other specified period. The previous exclusion for "a commodity contract" would be deleted. (Note: According to NCCUSL and industry members, this means that variable products would fall into the category of "securities" – meaning that variable products would have to be registered.)

The bill contains references to many federal statutes, and specifies that the references to federal statutes would include the statute and rules and regulations adopted under it. The administrator, which would be the Office of Financial and Insurance Services (OFIS), could adopt by order rules and regulations adopted under the federal statutes defined in the bill or their successor acts, a federal statute similar to one defined in the bill, or a rule or regulation similar to a rule or regulation adopted under the statutes defined in the bill. A reference to a federal agency or department would also be a reference to any successor agency, department, or entity.

Further, the bill would modify, limit, and supersede the Electronic Signatures in Global and National Commerce Act, except for Section 101(c), 15 U.S.C. 7001. Neither would the bill authorize electronic delivery of any of the notices described in Section 103(b) of that act, 15 U.S.C. 7003. The bill would authorize the filing of records and signatures, when specified by provisions of the bill or by a rule or order, in a manner consistent with Section 104(a) of the federal statute, 15 U.S.C. 7004.

Article 2: Exemptions from Registration of Securities and Transactions. Though some of the bill's provisions pertaining to registration exemptions for securities follow closely the language of the current act, the bill would delete some obsolete provisions and modify others to conform to current federal law and recent court decisions. (Note: Regarding insurance company securities, the bill as written would continue to exclude insurance, endowment policies, or annuity contracts under which an insurance company promised to pay fixed sums, but, in accordance with federal securities law, the bill would not exclude variable annuities or other variable insurance products from the registration requirements for securities.)

The bill would include, as an exempted security, certain federal covered securities; securities listed or approved for listing on markets specified by rule under the bill (which, according to information supplied by NCCUSL, would include securities listed on the New York, American, or Nasdaq Stock Exchanges); specified options, warrants, and rights; and certain derivative securities. Regarding securities issued by nonprofit organizations, the bill would extend the exemption only to those securities of which no part of the net earnings inured to the benefit of a private stockholder or other person, or a security of a company that was excluded from the definition of an investment company under the Investment Company Act of 1940. Further, the bill would contain an exemption for securities issued by cooperatives and for equipment trust certificates meeting certain criteria in respect to equipment leased or conditionally sold to a person.

The bill would rewrite some of the provisions in the current act regarding transactions that are exempt from registration, eliminate others, and would add a number of new provisions;

all changes follow the NCCUSL model act. Changes include nonissuer transactions in specified foreign transactions; nonissuer transactions with federal covered investment advisers; specified exchange transactions; rescission offers; out-of-state offers or sales; employee benefit plans; and an exemption for nonissuer transactions involving specified foreign issuer securities traded on designated securities exchanges – specifically, Toronto Stock Exchange issuers that are public reporting issuers under Canadian securities law and that meet the 180-day continuous reporting requirement.

A rule or order under the bill could exempt a security, transaction, or offer, or a class of securities, transactions, or offers, from any or all of the requirements of Sections 301 to 306 and 504 (which pertain to securities registration, registration filings, and denial, suspension, and revocation of securities and also filing of sales and advertising literature). Also, an order could waive any or all of the conditions for an exemption under Section 201 and 202 pertaining to exempt securities and transactions. The administrator could also suspend an application or rule or order and could revoke an exemption or waiver created under this section of the bill, but could only do so prospectively. Except with respect to a federal covered security, an order of the administrator could deny or suspend application of, condition, or limit an exemption created under several sections of the bill with respect to a specific security, transaction, or offer. A person would not be in violation of certain sections regarding rescission orders or denial or suspension orders by an offer to sell or purchase, a sale, or a purchase made after the entry of an order under Section 204 of the bill if the person did not know, and in the exercise of reasonable care, could not have known of the order.

Article 3: Registration of Securities and Notice Filings of Federal Covered Securities. The provisions in Article 3 closely follow the current act, though there are a few additions and modifications that follow the NCCUSL model act. The only securities allowed to be offered or sold under the bill would be federal covered securities; a security, transaction, or offer exempted under the bill; or a security that was registered under the bill. A rule or order under the bill could require, for a security issued by an investment company that was a federal covered security (and not otherwise exempt under the bill), certain records to be filed.

Modifications would be made to provisions pertaining to the conditions under which a registration statement would become effective and also to provisions regarding rules or orders that place conditions on registration. In addition, the bill would allow a rule or order to require as a condition of registration that a security registered under the bill be sold only on a specified form of subscription or sale contract and that a signed or conformed copy of each contract be filed under the bill or preserved for a period of not more than five years. If a posteffective amendment increased the number of securities to be offered or sold, an additional registration fee would be required.

In addition to current reasons that the commissioner can issue a stop order on an offering, the bill would also allow a stop order on an offering that was being made on terms that were unfair, unjust, or inequitable. To the extent practicable, the administrator would have to publish guidelines that provide notice of conduct that violates a provision allowing stop orders for offerings that would work a fraud upon purchasers or that had been made with unreasonable amounts of underwriters' and sellers' discounts, commissions, and so on. However, the

administrator could not institute a stop order proceeding against an effective registration statement on the basis of conduct or a transaction known to the administrator when the statement became effective unless the proceeding were instituted within 30 days after it became effective. Further, the administrator could waive or modify any or all of the requirements of Sections 302, 303, and 304(2) or the requirement of any information or record in a registration statement or in a periodic report under Section 305(9).

Article 4: Broker-Dealers, Agents, Investment Advisors, Investment Adviser Representatives, and Federal Covered Investment Advisers. Article 4 rewrites provisions currently contained in Section 201 regarding broker-dealers and so forth. The revisions incorporate court decisions and recognize the increasingly transnational nature of securities brokerage. Section 402 contains a long list of individuals exempt from registration requirements. An individual would be prohibited from acting as an agent for more than one broker-dealer or more than one issuer at a time (unless the broker-dealer or issuer for which the agent acts were affiliated by direct or indirect common control or were authorized by rule or order under the bill).

An investment advisor could not employ or associate with an individual required to be registered under the bill as an investment advisor representative (who would transact business on behalf of the investment advisor) unless the person was properly registered or exempt from registration. Similarly, an invest advisor could not employ or associate with any individual to engage in activities related to investment advice if the registration of the individual were suspended or revoked or the individual were barred from employment or association with persons in the securities business, unless the investment advisor did not know or could not have known of the suspension, revocation, or bar. The administrator could waive these prohibitions upon request and good cause shown.

The bill would require investment advisor representatives to be registered, and would also provide some exemptions from registration. A person could maintain dual registration as an agent and an investment adviser representative. The bill would also rewrite provisions that had been amended by Public Act 494 of 2000 regarding federally covered securities and federally covered advisors to comply more closely with requirements of the National Securities Markets Improvement Act of 1996 (NSMIA). This section of the bill would also provide for information required to be on applications for registration as a broker-dealer, agent, investment adviser, or investment adviser representative; applicable registration fees; termination or transfer of employment or association; postregistration requirements; financial requirements and recordkeeping; and registration sanctions.

Neither an agent nor an investment adviser representative could have custody of funds or securities of a customer unless supervised according to the bill's requirements. The administrator could prohibit, limit, or impose conditions on the custody of funds or securities of a customer by a broker-dealer or an investment advisor. Individuals registered under Sections 402 or 404 could be required, by rule or order, to participate in SEC-approved continuing education programs.

Provisions pertaining to registration sanctions or restrictions generally follow current law, but, according to NCCUSL, would be modified to reflect subsequent developments that have broadened the scope and remedies of counterpart federal and state statutes. Under the bill, if the administrator found that an order was in the public interest and was authorized under provisions of the bill, an order could censure, impose a bar, or impose a civil penalty in an amount not to exceed $1,000 for a single violation or $10,000 for multiple violations. Some disciplinary measures could only be imposed for violations within the previous ten years. A person could be disciplined under provisions of the bill if he or she, among many things, were convicted of any felony or within the previous ten years had been convicted of a misdemeanor involving a security, a commodity futures or option contract, or an aspect of a business involving securities, commodities, investments, franchises, insurance, banking, or finance. The administrator would be prohibited from instituting disciplinary proceedings solely based on material facts actually known by the administrator unless an investigation or the proceeding were instituted within one year after the administrator actually knew the facts.

Article 5: Fraud and Liabilities. Much of Article 5 follows current law, but several sections have been modified to more closely follow federal law and incorporate recent court decisions. The bill would define the allowable scope of a rule issued under the bill, including specifying the contents of an investment advisory contract entered into, extended, or renewed by an investment adviser. In a criminal proceeding under the bill, a person claiming an exemption, exception, preemption, or exclusion would have the burden of going forward with evidence of the claim. Though willfully violating the bill or a rule or order issued under the bill (except for a few specified provisions) would be a felony (as it is now) punishable by imprisonment for not more than ten years or a fine of not more than $25,000 for each violation, or both, the bill would specify that an individual convicted of violating a rule or order could be fined, but not imprisoned, if the individual did not have knowledge of the rule or order.

The bill would establish a qualified immunity in that a broker-dealer, agent, investment adviser, federal covered investment advisor, or investment adviser representative would not be liable to another of the same for defamation relating to an alleged untrue statement contained in a record required by the administrator or his or her designee, the SEC, or a self-regulatory organization, unless it were proved that the person knew or should have known at the time the statement was made that it was false in a material respect or the person acted in reckless disregard of the statement's truth or falsity.

The bill would state that enforcement of civil liability under Section 509 would be subject to the Securities Litigation Uniform Standards Act of 1998. This section on civil liability would be significantly rewritten to conform to provisions in the federal law. Currently, a purchaser can bring an action against an individual who sells a security in violation of the bill's prohibitions to recover the consideration paid for the security and to recover damages. The bill would specify that actual damages would include costs and reasonable attorney fees as determined by the court.

A person would be liable to the seller under specified circumstances; therefore, the bill would allow a seller to maintain an action against a buyer to recover the security, income received on the security, costs, and reasonable attorney fees on the tender of the purchase price or for actual damages as provided in the bill. A person acting as a broker-dealer or agent that

sells or buys a security in violation of the bill and a person acting as an investment advisor or investment advisor representative who provided investment advice for a fee in violation of the bill's provisions would also be liable to the customer or client and the customer or client could maintain an action. Any person who received any consideration for providing investment advice to another and who employed any deceptive practices in order to defraud the other person would be liable to that person. For each civil action allowed by the bill, a description of what damages and costs could be recovered is given.

The bill would establish time limits for the commencement of civil actions as well as specify conditions under which a purchaser, seller, or recipient of investment advice could not maintain a civil action.

Article 6: Administration and Judicial Review. Many current provisions have been incorporated into the bill, but, like other sections of the bill, many sections in Article 6 have been modified to reflect current trends, recent court decisions, and federal law. One new provision is that the administrator could develop and implement investor education initiatives to inform the public about investing in securities, with particular emphasis on the prevention and detection of securities fraud. Such ventures could be done in collaboration with public and nonprofit organizations. The bill would create the Securities Investor Education and Training Fund and allow the administrator to accept grants or donations from persons not affiliated with the securities industry or from nonprofit organizations.

As now, the administrator would have the power, during investigations, to compel a person to produce documents, be a witness, etc. The administrator can refer a matter to the circuit court if a person fails to appear, refuses to testify or produce records, and so on. The bill would specify that a court could hold the person in contempt, order the person to appear, order a person's testimony, order the production of records, grant injunctive relief, order a civil fine, or grant any other appropriate relief. A person could also apply to the circuit court for relief from a request to appear, testify, obey a subpoena, or produce documents.

The bill would outline the assistance that the administrator may provide to an administrator from another state or foreign jurisdiction when the latter is investigating a matter that is under the former's authority. The bill would also broaden the civil remedies available to the administrator through the circuit court when it appears to him or her that a person has, is, or is about to engage in a prohibited act or course of business. As now, the administrator would also have the power to issue a cease and desist order or an order denying, suspending, revoking, or conditioning specific allowable exemptions for a broker-dealer or an investment adviser. The bill would require the administrator to make findings of fact and conclusions of law in accordance with the Administrative Procedures Act before issuing a final order and allow the imposition of a civil fine or charges for actual costs of an investigation or proceeding in a final order. A court could find a person in contempt and impose a civil fine if a person did not comply with a final order.

A penalty under the bill could not be imposed nor would liability arise from conduct engaged in or omitted in good faith conformity with a rule, form, or order of the administrator. All rules, forms, interpretative opinions, and orders would have to be made available to the

public. However, a number of records would not be public records and so would not be available for public examination; for instance, a record obtained by the administrator in connection with an examination under Section 411(13) or an investigation under Section 602, records that contain trade secrets or confidential information, and records containing personal information such as a Social Security number or address. Information obtained in connection with an audit or inspection under Section 411(4) or an investigation under Section 602 could be disclosed for the purpose of a civil, administrative, or criminal investigation, action, or proceeding.

The administrator would have to cooperate, coordinate, consult, and subject to the bill's provisions, share records and information with securities regulators in other states, Canada, foreign countries, the SEC, and so forth in order to effectuate greater uniformity in securities matters between the federal government, self-regulatory organizations, and state and foreign governments. Cooperation authorized by the bill would have to include such things as developing and maintaining uniform forms, conducting a joint examination or investigation, instituting and prosecuting a joint civil or administrative proceeding, sharing and exchanging personnel and records, formulating common systems and procedures, and developing and maintaining a uniform exemption from registration for small issuers and taking other steps to reduce the burden of raising investment capital by small businesses.

Both final orders and rules adopted under the bill would be subject to judicial review pursuant to the Administrative Procedures Act. The bill would also rewrite the sections pertaining to consent to service of process.

Article 7: Transition. The bill would repeal the existing Uniform Securities Act and would replace it with the Uniform Securities Act (2002). The bill would take effect 180 days after its enactment. The existing act would exclusively govern all actions, prosecutions, or proceedings that were pending or that were maintained or instituted on the basis of facts or circumstances occurring before the bill's effective date. However, a civil action could not be maintained to enforce any liability under the current act unless it had been commenced within any period of limitation that applied when the cause of action accrued or within three years after the bill's effective date, whichever was earlier.

In addition, all effective registrations under the current act, all administrative orders relating to the registrations, statements of policy, interpretative opinions, declaratory rulings, no action determinations, and all conditions imposed upon registrations under the current act would remain in effect for the same time period they would have remained in effect if the bill had not been enacted. Though considered to have been filed, insured, or imposed under the bill, they would be governed by the current act. Further, the current act would exclusively govern any offer or sale made within one year after the bill's effective date that was related to an offering made in good faith before the bill's effective date on the basis of an exemption available under the current act.

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■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.