

DEPARTMENT OF BUSINESS OVERSIGHT*Ensuring a Fair and Secure Financial Services Marketplace for all Californians*

INITIAL STATEMENT OF REASONS
FOR ADOPTION OF REGULATIONS UNDER
THE CORPORATE SECURITIES LAW OF 1968
PRO 05/15

As required by Section 11346.2 of the Government Code, the California Department of Business Oversight Commissioner (Commissioner) sets forth below the reasons for the following proposed adoption of Sections 260.211.4, 260.211.5, 260.211.6, and 260.211.7 to Article 8, Subchapter 2, Chapter 3 of Title 10 of the California Code of Regulations.

SPECIFIC PURPOSE OF REGULATIONS [Government Code Section 11346.2, Subdivision (b)(1)]

This regulatory action proposes to implement the provisions of Assembly Bill (AB) 667.¹ AB 667 exempts finders, or individuals who, for compensation introduce potential investors and issuers of securities to each other, from the broker-dealer provisions under the Corporate Securities Law of 1968 (Corporate Securities Law) and establishes a separate regulatory structure for finders.

Individuals who are in the business of engaging in securities transactions must be registered with the Department as a broker-dealer or agent unless exempt.² The Corporate Securities Law exempts certain persons from the broker-dealer requirements, including individuals acting as finders. Individuals seeking exemption as a finder must meet the statutory definition of a finder and specified conditions to qualify for the exemption.³ This proposed rulemaking action would adopt the Statement of Information form to enable individuals to file for the exemption and other regulatory requirements consistent with the legislative intent of AB 667. AB 667 is effective January 1, 2016.

PROPOSED RULES

Section 260.211.4. Exemption for Finders: Form.

This regulatory action proposes to adopt the Statement of Information form that individuals must complete and file with the Commissioner to be exempt from the broker-dealer requirements as a finder. The rulemaking also proposes to adopt the requirements for filing the form and paying the filing fee to the Department. Existing law requires individuals

¹ AB 667 (Chap. 743, Stats. 2015).

² Corp. Code, § 25210.

³ Corp. Code, § 25206.1.

seeking exemption from the broker-dealer requirements as a finder to file an initial statement of information form, which must include the name and complete business or residential address of the finder, and the mailing address of the finder, if different from the business or residential address.⁴ The proposed rule is needed to implement the exemption, which will allow individuals to legally operate as finders in California.

Existing law authorizes the Commissioner to prescribe the information that must be included in the statement of information form.⁵ While the law does not specify that social security numbers are required, this rulemaking action proposes to require individuals to provide in Section I of the Statement of Information the individual's social security number. The individual's social security number is necessary to enable the Department to correctly identify the individual to ensure that he or she is eligible for the exemption. The rulemaking action also proposes to require the individual's contact information and the location of the records, which are needed to facilitate the Department's inspection and investigation of finders to ensure that they are engaging within the permissible finder activities and thus protect against illegal broker-dealer activity.

The proposed rule requires individuals to disclose in Section I of the Statement of Information whether they have committed specified criminal, civil and regulatory acts, or are agents or representatives of a broker-dealer. Existing law provides that an individual is not eligible for the exemption by among other things, engaging in any acts or circumstances provided in Corporations Code section 25212 or Rule 506(d) of Regulation D of the Securities Act of 1993.⁶ A broker-dealer or agent is prohibited under existing law from acting as a finder.⁷ Existing law further provides that an individual who fails to meet the conditions of a finder must register with the Commissioner as a broker-dealer or agent unless exempt under another provision of the law.⁸

Information concerning the individual's disciplinary history and whether the individual is an agent of a broker-dealer is needed to allow the Department to efficiently identify those individuals who do not meet the conditions for the exemption. Individuals who do not meet the conditions of a finder are required to register with the Department as a broker-dealer or agent. Information from the filings will be made available to the public to allow investors and issuers of securities to verify that the individual is authorized to engage in business as a finder. The proposed rule is necessary to help ensure that individuals filing for the exemption meet the exemption requirements and that the Department's public record of individuals who may engage in business as finders is accurate and reliable, which enhances investor protection.

This regulatory action proposes to adopt the Department's information practices and privacy notices. The California Information Practices Act of 1977⁹ and the Federal Privacy Act of 1974¹⁰ require the Department when requesting personal information, including

⁴ Corp. Code, § 25206.1, subd. (c)(1).

⁵ Corp. Code, § 25206.1, subd. (c)(1).

⁶ Corp. Code, § 25206.1, subd. (d)(1)(A)(ii).

⁷ Corp. Code, § 25206.1, subd. (a).

⁸ Corp. Code, § 25206.1, subd. (g)(1).

⁹ Civ. Code, § 1798.17.

¹⁰ 5 U.S.C. § 552a.

social security numbers, to notify the individuals whether disclosure of the social security number is voluntary or mandatory, the statutory authority for requesting social security account numbers, and the purpose for which the social security numbers will be used.

The Department's purpose for collecting social security numbers in this proposed rulemaking is to verify the identity of the individual seeking the exemption and to investigate the individual's disciplinary history as necessary for purposes of the exemption. Adopting the notices in the proposed rulemaking enhances disclosure of the privacy laws and helps ensure that individuals who provide their social security number understand how the Department will maintain and use their social security number.

The proposed action requires individuals to pay a fee of \$300.00 to the Department to file the initial Statement of Information and specifies how to pay the fee to the Department. Existing law provides that the fee to initially file for the exemption shall be \$300.00.¹¹ The proposed rule is necessary to provide the Department with the resources needed to administer the new regulatory structure for finders required by AB 667.

Individuals must file the Statement of Information with the Department by postal mail and pay the filing fees by paper check. The Department is in the process of developing the infrastructure needed to allow individuals to file the Statement of Information electronically and anticipates electronic filing to be available by mid-2016.

The proposed rule requires finders to notify the Commissioner of any change to the information provided in the initial Statement of Information by filing an amended form within 10 business days of the change. The proposed rule is necessary to provide the Department with accurate information concerning finders who are operating in California and thereby strengthen the Department's oversight of the activities of finders.

The proposed rule requires individuals filing for exemption as a finder or renewing the exemption to sign the Statement of Information certifying that the information provided in the form is true and correct. The provision is necessary to ensure that finders acknowledge their understanding of the exemption requirements to prevent violations of the law.

Existing law prohibits any person, in connection with the offer, sale or purchase of a security, from engaging in fraud, making untrue statements of material fact or omitting material facts.¹² The proposed rule includes a statement notifying filers that the anti-fraud provisions of the Corporate Securities Law apply to finders. A finder who violates the anti-fraud provisions is subject to enforcement action by the Department. The proposed rule is necessary to ensure that finders are aware that the prohibition against fraudulent and misleading acts applies to their activities.

Section 260.211.5. Annual Renewal of Exemption for Finders: Form.

This regulatory action proposes to adopt the requirements for filing a renewal Statement of Information and paying the renewal filing fee to the Commissioner. Existing law requires

¹¹ Corp. Code, § 25206.1, subd. (c)(2).

¹² Corp. Code, § 25401.

finders to file a renewal statement of information each year with the Commissioner within 30 days of the date the finder filed the initial statement of information.¹³

The Department proposes in this rulemaking to require individuals to file the same Statement of Information form, which was used to initially file for the exemption, to renew the exemption, notify the Commissioner of any amendment to the information previously filed or withdraw the exemption. Requiring finders to use the same form to file information with the Commissioner simplifies the process for individuals and helps the Department to efficiently and cost-effectively administer the exemption.

Existing law authorizes the Commissioner to prescribe the information in the form that must be provided to the Department and further requires finders to affirmatively make certain representations to renew the exemption.¹⁴ The proposed rule requires finders in Section II of the Statement of Information to answer questions concerning their compliance with the statutory requirements for a finder. A finder who has not complied with any one of the requirements in item numbers 1 through 3, or fails to provide a response in item number 4 of Section II, is prohibited from renewing the exemption and must register with the Commissioner as a broker-dealer or agent. The Department has authority to take action against any individual who engages in unlicensed broker-dealer activities, including issuing desist and refrain orders;¹⁵ levying administrative penalties;¹⁶ taking possession of the individual's property, business or assets;¹⁷ and obtaining an injunction and ancillary relief.¹⁸ The proposed rule is necessary to protect investors by ensuring that finders are not engaging in unlicensed broker-dealer activities.

The proposed action requires individuals to pay a fee of \$275.00 to the Department to file a renewal Statement of Information. Existing law provides that the renewal filing fee shall be \$275.00.¹⁹ The proposed rule is necessary to provide the Department with the resources needed to administer the new regulatory structure for finders required by AB 667.

Section 260.211.6. Notification of Withdrawal: Finder.

The proposed rule requires finders to notify the Commissioner no later than 15 calendar days after the finder is no longer operating under the exemption by providing the effective date of withdrawal in Section III of the Statement of Information and signing the form. The proposed rule is needed to provide the Department with current information on who is operating as a finder in California to enable the Department to effectively oversee their activities and protect investors against unlicensed broker-dealer activities.

Section 260.211.7. Maintenance of Records.

¹³ Corp. Code, § 25206.1, subd.(d)(1).

¹⁴ Corp. Code, § 25206.1, subd.(d)(1).

¹⁵ Corp. Code, § 25532.

¹⁶ Corp. Code, § 25252.

¹⁷ Corp. Code, § 25253.

¹⁸ Corp. Code, § 25530.

¹⁹ Corp. Code, § 25206.1, subd.(d)(2).

The proposed rule requires finders to maintain records for the statutory time period at the location designated by the finder in Section I of the Statement of Information, and clarifies the Commissioner's authority to examine the records of a finder at any time and to enforce the anti-fraud provision of the Corporate Securities Law against a finder. The proposed rule is necessary to provide the Department with access to the books and records for purposes of examining the finder to ascertain compliance with the law and investigating complaints made against the finder, and to clarify the Commissioner's authority over finders with respect to the anti-fraud provision.

NON-DUPLICATION STANDARD [Title 1, California Code of Regulations, Section 12, Subdivision (b)(1)]

The proposed regulations duplicate state statutes which are cited as authority or reference for the proposed regulations. The duplication is necessary to satisfy the clarity standard of Government Code section 11349.1, subdivision (a)(3). Specifically, the rules in Sections 260.211.4 and 260.211.5 include language which repeats or rephrases in whole or in part state statutes to assist finders in understanding the law, and to provide the Commissioner's authority for requiring them to file certain information with the Department.

BENEFITS ANTICIPATED FROM REGULATORY ACTION [Government Code Section 11346.2, Subdivision (b)(1)]

The benefits anticipated from this regulatory action include protective benefits to investors by improving the Department's regulatory oversight of the finder industry and strengthening enforcement of the Corporate Securities Law. The proposed regulatory action will help prevent illegal broker-dealer activities and ensure that those engaged in business as finders are regulated by identifying individuals who are operating as finders, establishing a regulatory structure to enable the Department to oversee their activities, preventing individuals with disciplinary records from operating as finders and promoting accountability of finders through Department inspections of books and records.

The proposed regulatory action is anticipated to benefit finders through lower regulatory costs by requiring simplified filings, which reduce the cost and time to file for and maintain the exemption.

The proposed rulemaking is anticipated to promote confidence in the investment capital market by clarifying the securities law with respect to finders and identifying those individuals who may engage in business as a finder, which benefit finders, investors and issuers of securities. A finder who engages in unlicensed broker-dealer activity is subject to a number of legal consequences including rescission of the transaction by the investor,²⁰ and the issuer of the securities may be violation of the law by aiding and abetting the finder in the transaction.²¹ The rulemaking action will help distinguish the allowable finder activities from broker-dealer functions and the individuals who are authorized to engage in finder activity, which will provide regulatory certainty for finders and the issuers that rely on them, and help prevent them from unintentionally violating the law.

²⁰ Corp. Code, § 25501.5.

²¹ Corp. Code, § 25504.

The proposed rulemaking is expected to benefit California's economy by promoting investment in California businesses. The rulemaking action helps ensure continuing access to capital for small to mid-size businesses that would otherwise be unable to engage a broker-dealer or access needed capital.

The proposed rulemaking will benefit the state's fiscal position because the exemption program will be funded by filing fees paid by finders, and therefore no adverse impact is anticipated to the state's general fund or other state funds.

By adopting the regulations in compliance with the Administrative Procedure Act, the rulemaking action encourages public participation in adopting balanced regulations and increases transparency in government.

POTENTIAL FOR ADVERSE ECONOMIC IMPACT ON BUSINESS AND INDIVIDUALS
[Government Code Section 11346.3, Subdivision (a)]

The Commissioner has determined that the proposed regulatory action will not have an adverse economic impact or potential for an adverse economic impact on business, including the ability of California businesses to compete with businesses in other states, or on individuals. Based on the legislative committee analyses of AB 667,²² the proposed rules exempting finders from the broker-dealer requirements will facilitate capital formation in California and thus benefit businesses, particularly small and emerging companies, which historically have been the catalysts for California's leading position in technology, biological science, entertainment and other industries. According to the legislative analyses, finders are involved in the vast majority of capital raised to fund early stage businesses in California.

ECONOMIC IMPACT ASSESSMENT [Government Code Section 11346.3, Subdivision
(b)]

(A) The Creation or Elimination of Jobs Within the State.

The Commissioner has determined that this regulatory proposal will not have a significant impact on the creation or elimination of jobs in the State of California. This regulatory proposal is intended to protect investors by requiring individuals who act as finders to file with the Department before engaging in any securities transactions. Requiring finders to file an informational form with the Department is a less burdensome regulatory approach and therefore the proposed regulation will not significantly create or eliminate jobs in California.

(B) The Creation of New Businesses or the Elimination of Existing Businesses Within
the State.

The Commissioner has determined that this regulatory proposal will not have a

²² Legislative analyses are available at www.leginfo.ca.gov.

significant impact on the creation of new businesses or the elimination of existing businesses in the State of California. The Department relied upon the legislative committee analyses of AB 667²³ to support the initial determination that the regulatory action will not have a significant impact on business or any other impact described in Government Code section 11346.3. According to the legislative committee analyses, the sponsor of AB 667, the Corporations Committee of the Business Law Section of the California State Bar, reported that many individuals are acting as unregulated finders in California in connection with securities transactions. Thus the proposed rulemaking will regulate the existing finder industry in California, and is not anticipated to create a new industry or business model.

(C) The Expansion of Businesses Currently Doing Business Within the State.

The Commissioner has determined that this regulatory proposal will likely not result in the expansion of business currently doing business within the state. The regulatory proposal will require regulation of the existing finder industry, which has largely been operating as unregistered broker-dealers in violation of the law.

(D) The Benefits of the Regulations to the Health and Welfare of California Residents, Worker Safety and the State's Environment.

The Commissioner has determined that this regulatory proposal may benefit the health and welfare of California investors because the proposed rules are intended to provide protections to investors through regulatory and enforcement oversight of the finders through the proposed regulations. The regulatory proposal does not benefit worker safety or the state's environment.

TECHNICAL, THEORETICAL AND/OR EMPIRICAL STUDIES, REPORTS OR DOCUMENTS [Government Code Section 11346.2, Subdivision (b)(3)]

The Department did not rely upon any technical, theoretical, or empirical study, report, or other similar document other than the legislative committee analyses for AB 667 in proposing the adoption of the regulations under the Corporate Securities Law.

REASONABLE ALTERNATIVES AND REASONS FOR REJECTING THOSE ALTERNATIVES [Government Code Section 11346.2, Subdivision (b)(4)(A)]

No other reasonable alternatives to the regulation have been identified or brought to the Department's attention that would be more effective in carrying out the purpose for which the action is proposed, or would be as effective and less burdensome to affected private persons, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposal described in this Initial Statement of Reasons.

REASONABLE ALTERNATIVES THAT WOULD LESSEN ANY ADVERSE IMPACT ON SMALL BUSINESSES AND REASONS FOR REJECTING THOSE ALTERNATIVES [Government Code Section 11346.2, Subdivision (b)(4)(B)]

²³ Legislative analyses are available at www.leginfo.ca.gov.
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No reasonable alternative considered by the Department or that have otherwise been identified and brought to the attention of the Department would be as effective and less burdensome to affected private persons, or would lessen any adverse impact on small business. Finders are not a small business within the meaning under Government Code Section 11342.610, subdivision (b).

FACTS, EVIDENCE, DOCUMENTS, TESTIMONY OR OTHER EVIDENCE RELIED ON BY AGENCY [Government Code Section 11346.2, Subdivision (b)(5)(A)]

The Department relied on upon the legislative committee analyses for AB 667 to support the initial determination that the rulemaking action will not have a significant adverse economic impact on business. The Department has not relied on any other facts, evidence, documents, or testimony in determining that this proposed regulatory action will not have a significant adverse economic impact on business.