

DEPARTMENT OF BUSINESS OVERSIGHT*Ensuring a Fair and Secure Financial Services Marketplace for all Californians***NOTICE OF RULEMAKING ACTION****TITLE 10. DEPARTMENT OF BUSINESS OVERSIGHT****NOTICE IS HEREBY GIVEN [Government Code Section 11346.5, Subdivision (a)(1)]**

The Commissioner of Business Oversight (Commissioner) proposes to adopt regulations under the Corporate Securities Law of 1968 (Corporate Securities Law). Specifically, the Commissioner proposes to adopt Sections 260.211.4, 260.211.5, 260.211.6 and 260.211.7 in Article 8, Subchapter 2, Chapter 3 of Title 10 of the California Code of Regulations.

The Department of Business Oversight (Department) administers and enforces the Corporate Securities Law. Under the Corporate Securities Law, the Department regulates broker-dealers registered in California and the offer and sale of securities (e.g., stocks and bonds) to the public. Broker-dealers are prohibited from engaging in securities transactions unless they are registered or exempt from registration.

This rulemaking would implement the provisions of Assembly Bill (AB) 667,¹ which created a new exemption from the broker-dealer requirements for finders, or individuals who, for compensation, introduce potential investors and issuers of securities to each other. AB 667 also established a separate regulatory structure for finders to be administered by the Department. Individuals seeking exemption from the broker-dealers requirements as a finder must meet the statutory definition of a finder and comply with certain conditions.

Specifically, the rulemaking 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.

AUTHORITY [Government Code Section 11346.5, Subdivision (a)(2)]

Sections 25206.1, Corporations Code.

REFERENCE [Government Code Section 11346.5, Subdivision (a)(2)]

Section 1798.17, Civil Code; Sections 25206.1, 25212, and 25401, Corporations Code; Sections 13140 – 13144, Government Code; 17 C.F.R. 230.506(d); and 5 U.S.C. Section 552a.

¹ AB 667 (Chap. 743, Stats. 2015).

PUBLIC COMMENTS [Government Code Section 11346.5, Subdivision (a)(17)]

No public hearing is scheduled. Any interested person or his or her duly authorized representative may request, in writing, a public hearing pursuant to Section 11346.8, subdivision (a), of the Government Code. The request for hearing must be received by the Department's contact person designated below no later than 15 days prior to the close of the written comment period.

WRITTEN COMMENT PERIOD [Government Code Section 11346.5, Subdivision (a)(15)]

Where to Submit Comments

Any interested person, or his or her authorized representative, may submit written comments relevant to the proposed regulatory action to the Department, addressed as follows, by any of these means:

Postal Mail

Department of Business Oversight
Attn: Inna Swickard, Legal Division
1515 K Street, Suite 200
Sacramento, CA 95814

Electronic Mail

Comments may be submitted electronically to regulations@dbo.ca.gov. Please identify the comments as PRO 05-15 in the subject line.

Fax

(916) 322-5875

Time for Comments

Comments may be submitted until 5:00 p.m., July 15, 2016. If the final day for the acceptance of comments is a Saturday, Sunday or state holiday, the comment period will close at 5 p.m. on the next business day.

Comments Relating to the Economic and Cost Impact to Business and Individuals

As required under Government Code section 11346.5, the Department has made an initial assessment of the costs, benefits and cost effectiveness of the proposed regulatory action and reasonable alternatives to regulatory action.

In addition to comments relating to the proposed rules, the Department is interested in any perspectives or insights from the public concerning the potential economic and cost consequences to businesses, investors, finders and other individuals from the proposed changes, and whether there are other ways to achieve the regulatory objectives in a more cost effective and less burdensome manner. Interested parties are encouraged, but are not required, to submit written comments to any of the following questions:

1. Would the proposed changes to the regulations under the Corporate Securities Law have an adverse statewide economic impact or the potential for an adverse impact on individuals, or on businesses, including their ability to compete with businesses in other states? If so, please explain how and to what extent the proposed changes may adversely impact businesses and individuals.
2. What are other alternatives to the proposed changes that would lessen any adverse economic impact to businesses or individuals, and accomplish the regulatory objectives of protecting investors and improving regulatory oversight of the industry?
3. What specific operational or other changes would need to be made by businesses to comply with the proposed changes and what are the potential costs of these changes?
4. What other alternatives would be more effective, or as effective as and less burdensome to businesses or individuals, in achieving the regulatory objectives than the proposed changes?
5. What benefits would the proposed changes provide to businesses or individuals?
6. To what extent would the proposed changes create or eliminate jobs or businesses, or expand businesses currently doing business in this state?
7. What performance standards may be used in place of any prescriptive standards in the proposed changes? “Performance standard” means a regulation that describes an objective with the criteria stated for achieving the objective.² “Prescriptive standard” means a regulation that specifies the sole means of compliance with a performance standard by specific actions, measurements, or other quantifiable means.³

INFORMATIVE DIGEST [Government Code Section 11346.5, Subdivision (a)(3)]

² Gov. Code, § 11342.570.

³ Gov. Code, § 11342.590.

Policy Statement and Specific Benefits Anticipated from Regulatory Action [Government Code Section 11346.5, Subdivision (a)(3)(C)]

The objective of the proposed regulations is to implement the provisions of AB 667 by:

- Adopting the Statement of Information form that individuals must file with the Department for the exemption;
- Specifying the requirements for filing and renewing the Statement of Information and paying the filing fees to the Department;
- Requiring finders to notify the Department of any subsequent change to the information in the Statement of Information and when withdrawing the exemption;
- Requiring finders to maintain their records at the location identified in the Statement of Information; and
- Clarifying the Commissioner's authority to examine the records of a finder at any time.

The specific benefits anticipated by the proposed rulemaking action include increased investor protection from improving the Department's regulatory oversight of finders and strengthening enforcement of the broker-dealer provisions of the Corporate Securities Law. The proposed rules 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 adoption of rules 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 improve market transparency and promote confidence in the investment capital market by clarifying the securities law with respect to finders, which benefits finders, investors and issuers of securities. A finder whose activities go beyond the introduction of prospective parties is engaging in unlicensed broker-dealer activity and thus subject to a number of legal consequences including rescission of the transaction by the investor,⁴ and the issuer of the securities may be in violation of the law by aiding and abetting the finder in the transaction.⁵ Adopting the regulatory procedures will help distinguish the allowable finder activities from broker-dealer functions, which will provide regulatory certainty for finders and the issuers that rely on them, and help prevent them from unintentionally violating the law.

⁴ Corp. Code, § 25501.5.

⁵ Corp. Code, § 22504.

The proposed rulemaking action is expected to benefit California's economy by promoting investment in California businesses and helping ensure continuing access to capital for small to mid-size businesses. According to the legislative committee analyses for AB 667, the activity of finders is critical to the success of capital-raising efforts by start-up companies and small to mid-sized companies that would otherwise be unable to engage a broker-dealer or access needed capital.⁶ The proposed rules will help business by providing regulatory certainty concerning the use of finders and clarifying the scope of the permissible activities that may be performed by finders, which will foster investor confidence and facilitate access to capital for smaller companies.

The proposed rulemaking benefits the state's fiscal position because the exemption program will be funded by fees paid by finders, and therefore no 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 proposed regulatory action increases transparency in government and encourages public participation in adopting balanced regulations.

Summary of Existing Laws and Regulations, and Effect of Proposed Action
[Government Code Section 11346.5, Subdivision (a)(3)(A)]

Broker-dealers are registered and regulated by the Department under the Corporate Securities Law.⁷ Existing law defines a broker-dealer as, among other things, any person engaged in the business of effecting securities transactions in California for the account of others or his or her own account. Existing law requires broker-dealers to apply for and obtain a certificate from the Department authorizing the person to act as a broker-dealer, unless the person is exempt from the registration requirements.

Existing law specifies the persons or entities that are exempt or excluded from the broker-dealer registration requirements. With respect to this rulemaking action, existing law exempts from the registration requirements an individual who is a finder. Existing law defines a finder as a natural person who, for direct or indirect compensation, introduces or refers one or more accredited investors [as defined in Rule 501(a) of Regulation D under the federal Securities Act of 1933 (17 C.F.R. 230.501(a)] to an issuer or an issuer to one or more accredited investors, solely for the purpose of a potential offer or sale of securities of the issuer in an issuer transaction in this state, and who does not perform certain services. Existing law specifies the services that the individual may not perform including providing services to an issuer for a transaction or related transactions that exceed fifteen million dollars (\$15,000,000), advising any party regarding the investment, participating in negotiating any terms of the investment, receiving any funds in connection with the transaction, and selling or offering for sale any securities owned by the finder.

⁶ See Assembly Committee on Banking and Finance, AB 667, as amended on April 6, 2015, hearing date April 20, 2015.

⁷ Unless otherwise noted, all references are to Corp. Code, § 25000 et seq.

Existing law requires an individual seeking exemption from the broker-dealer requirements as a finder to file a statement of information and pay a filing fee of \$300.00 to the Department. Existing law authorizes the Department to prescribe the information in the 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. The proposed rulemaking action would adopt the Statement of Information form to enable individuals to file for the exemption from the broker-dealer requirements.

Existing law requires finders to file with the Department a renewal statement of information and pay a filing fee of \$275.00 within 30 days of the filing of the initial statement of information and annually thereafter. Existing law authorizes the Department to prescribe the information in the form, which must include certain affirmative representations made by the finder. Specifically, the finder must affirm that he or she has complied with and will continue to comply with the statutory prohibitions against performing certain services; has not been sanctioned by the Commissioner or performed any acts pursuant to Corporations Code section 25212 or Rule 506(d) of Regulation D under the Securities Act of 1933,⁸ including certain criminal or civil actions, censure by national securities associations or violation of the Corporate Securities Law or similar regulatory scheme of other states or the federal government; and has obtained the written informed consent from each person introduced or referred to an issuer. Existing law permits finders to receive transaction-based compensation. The finder must also disclose as a condition for renewal whether he or she received compensation from the sale of securities by an issuer in which the finder performed services. The proposed rulemaking would adopt the requirements for renewing the exemption.

Existing law specifies the disclosure and recordkeeping requirements for finders, and provides the remedies available against a finder who violates the requirements. The proposed rulemaking would require finders to maintain the records for the statutory time period, which is five years from the date of filing of the statement of information, at the location designated by the finder and clarify the Commissioner's authority to examine the records of a finder at any time.

Existing law provides that an individual who is engaged in the business of a finder and who does not meet the exemption requirements for a finder is subject to the requirements of a broker-dealer. The proposed rulemaking action would require finders to notify the Department of any change to the information in the Statement of Information and when the finder is no longer operating under the exemption.

Existing law prohibits any person in connection with the offer, sale or purchase of a security from engaging in fraudulent or misleading acts and authorizes the Commissioner to bring an action to enforce the law. The proposed rulemaking would clarify that the anti-fraud provision applies to the activities of finders.

⁸ 17 C.F.R. 230.506(d).

Existing law provides the Department's rulemaking authority to adopt, amend and rescind the rules, including defining any terms, with respect to the exemption for finders.

Existing Federal Regulation or Statute [Government Code Section 11346.5, Subdivision (a)(3)(B)]

The federal Securities Exchange Act of 1934 prohibits any broker or dealer (other than those persons whose business is exclusively intrastate and who do not make use of any facility of a national securities exchange) from effecting, inducing or attempting to induce the purchase or sale of any security unless such person is registered with the U.S. Securities and Exchange Commissioner (SEC).⁹ Unless, a broker-dealer's business is exclusively within California and not through a national securities exchange, there is concurrent federal jurisdiction over the activities, including finders.

Under federal securities law, finders may not receive compensation based upon a percentage of amount invested. However, California law allows such compensation and therefore there may be a conflict with federal securities law because the SEC uses compensation as a factor in determining whether a finder is acting as a broker. A recent federal district court decision¹⁰ disagreed with the SEC's interpretation of what constitutes a broker and therefore the SEC's position may be in flux.

The Legislature in enacting the exemption for finders recognized that individuals have been operating in California as unregulated finders and that regulating them under a separate regulatory structure is beneficial to California's investment capital market because it facilitates capital formation for companies.

Existing State Regulations [Government Code Section 11346.5, Subdivision (a)(3)(D)]

The Department has evaluated whether the proposed regulations are consistent with existing state regulations and concluded that these are the only rules that directly impact finders in securities transactions. Other state laws and regulations, including state tax laws with respect to delinquent tax payers¹¹ and child support,¹² do not impact this regulatory action because existing law does not require the Department to issue a professional or occupational license, certificate, registration or permit to an individual seeking exemption as a finder. Accordingly, the proposed regulatory action is consistent and compatible with existing state regulations and laws, and policy considerations under the Corporate Securities Law, and therefore the proposed amendments are neither inconsistent nor incompatible with existing state regulations.

FORMS INCORPORATED BY REFERENCE [Title 1, California Code of Regulations, Section 20, Subdivision (c)(3)]

⁹ 15 U.S.C. § 78o(a)(1), §15(a)(1) of the federal Securities Exchange Act of 1934.

¹⁰ See *SEC v. Kramer*, 778 F. Supp.2d 1320, 1339 (M.D. Fla 2011).

¹¹ Bus. & Prof., Code, § 494.5.

¹² Fam. Code, § 17520.

This proposed regulatory action does not incorporate any forms by reference.

DISCLOSURES REGARDING THE PROPOSED ACTION [Government Code Section 11346.5, Subdivision (a)(5) and (6), and (12)(A)]

- Mandate on local agencies or school districts: none.
- Cost or savings to any state agency: none.
- Cost to any local agency or school district which must be reimbursed in accordance with Government Code sections 17500 through 17630: none.
- Other nondiscretionary cost or savings imposed on local agencies: none.
- Cost or savings in federal funding to the state: none.
- Significant effect on housing costs: none.

ECONOMIC IMPACT ON BUSINESS [Government Code Section 11346.5, Subdivision (a)(8)]

The Commissioner has made an initial determination that the proposed regulatory action will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states. The Commissioner relied on the legislative committee analyses of AB 667¹³ to support the initial determination. Specifically, the proposed rulemaking 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. The regulatory structure proposed in this rulemaking will require finders to provide simplified filings, which is a less burdensome regulatory approach for business.

The Commissioner has not relied on any other reports, facts, evidence, documents, or testimony to support the initial determination that the regulation will not have a significant adverse economic impact on business.

EFFECT ON SMALL BUSINESS [Title 1, California Code of Regulations, Section 4]

The proposed regulations will not affect small business because finders are not a small business within the meaning of Government Code section 11342.610. Subdivision (b)(1) of Government Code section 11342.610 provides that a small business does not include a securities broker-dealer.

¹³ Legislative analyses are available at www.leginfo.ca.gov.

COST IMPACTS ON REPRESENTATIVE PRIVATE PERSON OR BUSINESS
[Government Code Section 11346.5, Subdivision (a)(9)]

Individuals seeking exemption from the broker-dealer requirements as a finder will incur an initial cost of \$300.00 to comply with the proposed rulemaking and thereafter annual costs of \$275.00. Specifically, the statutory fee to initially file the exemption is \$300.00 and the filing fee to renew the exemption each year is \$275.00. The Department anticipates some costs to individuals from completing the Statement of Information. However, these costs are anticipated to be insignificant because the information required to complete the form is minimal. There is no cost to finders to file amendments to the Statement of Information or to notify the Department when withdrawing as a finder.

The cost of the filing fees is not an additional cost to individuals who engage in securities transactions. Individuals engaged in securities transactions must either register as a broker-dealer or file an exemption, and both require the payment of fees to the Department. The fee for filing an application for a broker-dealer certificate is \$300.00, which is the same amount to file for exemption as a finder.

RESULTS OF THE ECONOMIC IMPACT ANALYSIS [Government Code Section
11346.5, Subdivision (a)(10)]

The Department has determined that:

- The proposed action will not create or eliminate jobs within the state;
- The proposed action will not create new businesses or eliminate existing businesses within this state;
- The proposed action will not expand businesses currently doing business within California;
- As discussed above under the Informative Digest, the proposed action may benefit the health and welfare of California residents by increasing protections for investors; simplifying the regulatory filing process for finders; improving transparency in government and the economic market; and promoting confidence in the investment market, and in particular, investment in California businesses; and
- No benefits or adverse impacts to worker safety or to the state's environment are anticipated from this regulatory action.

BUSINESS REPORTING REQUIREMENT [Government Code Section 11346.5,
Subdivision (a)(11)]

The regulatory action does not require businesses to file a report with the Department.

CONSIDERATION OF ALTERNATIVES [Government Code Section 11346.5, Subdivision (a)(13)]

The Department must determine that no reasonable alternative considered by the Department or that has otherwise been identified and brought to the attention of the Department would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of the law.

AVAILABILITY OF THE NOTICE, STATEMENT OF REASONS, TEXT OF PROPOSED REGULATIONS AND RULEMAKING FILE [Government Code Section 11346.5, Subdivision (a)(16) and (20), and (b)]

As of the date this notice is published, the rulemaking file consists of this notice; the initial statement of reasons, which contains all the information upon which the proposal is based; and the proposed text of the regulation. The notice, initial statement of reasons, and proposed text is available by contacting the person designated below.

Inna Swickard
Legal Secretary
1515 K Street, Suite 200
Sacramento, California 95814
Telephone: (916) 322-3553
e-mail: Inna.Swickard@dbo.ca.gov

The notice, initial statement of reasons and proposed text are also available on the Department's website at www.dbo.ca.gov. To access the documents from the Department's website, click on the "Laws & Regs" tab at the top of the home page, click on the "Rulemaking" link under "Division of Corporations", and then click on the "Corporate Securities Law of 1968" link.

As required by the Administrative Procedure Act, the Legal Division maintains the rulemaking file. The rulemaking file is available for public inspection and copying throughout the rulemaking process at the Department of Business Oversight, Legal Division, 1515 K Street, Suite 200, Sacramento, California 95814.

AVAILABILITY OF CHANGED OR MODIFIED TEXT [Government Code Section 11346.5, Subdivision (a)(18)]

If the Department makes changes which are sufficiently related to the originally proposed text, it will make the modified text (with changes clearly indicated) available to the public for at least 15 days before the Department adopts, amends or repeals the regulations as revised. A request for a copy of any modified regulation(s) should be addressed to the contact person designated below. The Department will accept written

comments on the modified regulations for at least 15 days after the date on which they are made available.

AVAILABILITY OF FINAL STATEMENT OF REASONS [Government Code Section 11346.5, Subdivision (a)(19)]

Upon its completion, the Final Statement of Reasons will be available and copies may be requested from the contact person named below or may be accessed on the Department's website listed above.

CONTACT PERSON [Government Code Section 11346.5, Subdivision (a)(14)]

Inquiries regarding the substance of the proposed regulations may be directed to:

Peggy Fairman
Senior Counsel
1515 K Street, Suite 200
Sacramento, California 95814
Telephone: (916) 324-5217
e-mail: Peggy.Fairman@dbo.ca.gov

Nonsubstantive inquiries concerning this action, such as requests for copies of the proposed regulation or questions regarding the timelines or rulemaking status, may be directed to the backup contact person:

Inna Swickard
Legal Secretary
1515 K Street, Suite 200
Sacramento, California 95814
Telephone: (916) 322-3553
e-mail: Inna.Swickard@dbo.ca.gov

Dated: May 17, 2016
Sacramento, California