

FINAL STATEMENT OF REASONS
FOR RULE CHANGES UNDER THE
CORPORATE SECURITIES LAW OF 1968

As required by Section 11346.9 of the Government Code, the Commissioner of Corporations ("Commissioner") sets forth below the reasons for the amendments to Sections 260.211 and 260.211.1 of the California Code of Regulations (10 C.C.R. §§ 260.211 & 260.211.1).

Under the Corporate Securities Law of 1968 ("CSL"), the Commissioner is responsible for the regulation of certain broker-dealers and agents of broker-dealers. Pursuant to this authority, broker-dealers must obtain a license from the Commissioner, which includes providing an application and various additional documents and fees to the Commissioner. The Commissioner proposes to amend the rules outlining the procedures for applications and other filings by broker-dealers and agents to allow all applications, amendments, and fees to be filed directly with the Central Registration Depository ("CRD").

While most broker-dealers have been filing documents with CRD for years, the Department of Corporations ("Department") has never accepted applications through CRD, and has required applicants to send either a physical copy of Form BD (the national, uniform application form for broker-dealers) or the Department's "Application for License by Notification" and specified supporting documents to the Department. The amendments to Sections 260.211 and 260.211.1 set forth new procedures for broker-dealers filing with the Department through CRD, and implement the provisions of AB 1048 (Frommer-Chap. 264, Stats. 2001).

Section 260.211: The amendments to Section 260.211 amend the procedures for applicants neither filing through CRD nor filing by notification, and set forth new procedures for applicants filing with the Department entirely through CRD. Applicants not filing through CRD will no longer be required to amend the Form BD questions related to arrest records. AB 1048 amended the law to no longer prohibit the Commissioner from asking about arrest records, where such questions are part of a uniform, national application required for participation in CRD (i.e., Form BD), and therefore, amendments to the questions are no longer necessary.

The amendments to Section 260.211 also clarify that certain additional filings related to agents of broker-dealers are necessary for all applicants whose agent records are not on file with CRD, in addition to applicants not registered under the Securities Exchange Act of 1934. This amendment is necessary to ensure that the Department has access to agent information for all agents of broker-dealers.

The amendments to Section 260.211 further remove the provisions that set forth procedures for broker-dealers who previously relied upon Section 25205 of the

Corporations Code for an exemption from the licensure requirement to provide investment advisory services. AB 1048 amends the Corporations Code to delete Section 25205, and instead to provide an exemption for broker-dealers from the fees associated with licensure as an investment adviser. Broker-dealers who perform investment advisory services are to follow the same licensure procedures as investment advisers, and thus the separate instructions in Section 260.211 are unnecessary. These amendments are necessary to implement AB 1048.

The amendments to Section 260.211 additionally set forth procedures for applicants filing through CRD. The applicant is to file Form BD with CRD for transmission to the Commissioner, and to pay the required fee of \$300 directly to CRD. The amendments further provide that the Commissioner may require additional documents to be filed directly with the Commissioner, and may request additional documentation or detail pertaining to Form BD. The amendments provide that the filing is complete when the Commissioner approves the application and the approval is received through CRD. These amendments are necessary to set forth procedures for filing directly with CRD.

The amendments to Section 260.211 also set forth a provision providing that the annual minimum assessment of \$75 is to be filed with CRD in accordance with its procedures for transmission to the Commissioner, or paid directly to the Commissioner if the broker-dealer does not participate in CRD. This provision instructs broker-dealers on the procedure for the annual assessment under 25608(o) of the Corporations Code.

The added provision regarding successions instructs broker-dealers on the procedures to follow in the event of a succession. Broker-dealers are instructed to follow Rule 15b1-3 under the Securities Exchange Act of 1934 (12 C.F.R. § 240.15b1-3) for the filing of a Form BD, an amendment to Form BD, or Form BDW, as applicable. This amendment is necessary to instruct broker-dealers on how to proceed in the event of a succession.

Section 260.211.1: Section 260.211.1 sets forth the application for license by notification pursuant to Section 25211(b) of the Corporations Code. The amendments to Section 260.211.1 remove the application instructions for broker-dealers who also engage in business as an investment adviser. As noted above, AB 1048 removes the exemption from licensure as an investment adviser for licensed broker-dealers, and therefore broker-dealers are now to follow the same procedure for registering as an investment adviser as is set forth for all other investment advisers. These amendments are necessary to implement AB 1048.

The amendments further disqualify the National Association of Securities Dealers, Inc. ("NASD") and the Pacific Exchange, Inc. (referred to as the Pacific Stock Exchange in Corporations Code Section 25211) from the provisions of subdivision (b) of Section 25211 of the Corporations Code (i.e., licensure by notification), pursuant to the

authority provided by that section that permits the Commissioner to disqualify a self-regulatory organization by rule from the licensure by notification procedures. For members of the NASD, a separate application procedure for licensure by notification is no longer necessary, since the amendments to Section 260.211 set forth a procedure for electronic filing through CRD and all members of NASD already file with NASD through CRD. Therefore, these amendments are necessary to implement filing through CRD.

For members of the Pacific Exchange, Inc., licensure as a broker-dealer is no longer necessary, since the members were recently exempted from licensure by Section 260.204.11 of these rules. Therefore, the licensure by notification procedures for these members are being removed.

The amendments to Section 260.211.1 also add a provision to the application for license by notification to require broker-dealers who are sole proprietors to include a Statement of Citizenship, Alienage, and Immigration Status Form pursuant to Section 250.31 of the rules. This provision is necessary to comply with Section 250.31 of the rules.

The amendments further require applicants to submit a completed Form BD and the accompanying schedules to the Commissioner. This requirement was recently amended out of the application procedure for licensure by notification, because the Department had access to the completed forms through CRD. However, the Department has learned that the information on CRD may not be current for members of the New York Stock Exchange ("NYSE") or the American Stock Exchange ("AMEX") that do not file directly with CRD like members of NASD. Therefore, the amendments to require NYSE and AMEX members to file Form BD are necessary to ensure that the Department has access to the current form for all broker-dealers it is issuing licenses to.

ECONOMIC IMPACT GOVERNMENT CODE SECTION 11346.2(b)(4)

The Department has made an initial determination that the proposed regulations will not have a significant adverse economic impact on business.

The amendments set forth procedures for broker-dealers who are members of NASD to make filings with the Department through CRD for transmission to the Commissioner, rather than the current procedure of either filing the hard copy with the Commissioner, or filing a separate "application by notification" with the Commissioner. Since the amendments are intended to reduce the regulatory burden on applicants for licensure as a broker-dealer, the Department has determined that the amendments will not have a significant adverse economic impact on business.

The amendments additionally implement the provisions of AB 1048. The Department has determined that these amendments will not have a significant adverse impact on business.

ALTERNATIVES CONSIDERED

No alternative considered by the Department or that otherwise has 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 or would be as effective and less burdensome to affected private persons, or would lessen any adverse impact on small businesses.

FISCAL IMPACT

Cost to Local Agencies and School Districts required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of the Government Code: None.

No other nondiscretionary cost or savings are imposed on local agencies.

DETERMINATIONS

The Commissioner has determined that the proposed regulatory action does not impose a mandate on local agencies or school districts, which require reimbursement pursuant to Part 7 (commencing with Section 17500) of Division 4 of the Government Code.

ADDENDUM REGARDING PUBLIC COMMENTS

No request for hearing was received during the 45-day public comment period which ended on April 2, 2002. No public hearing was scheduled or heard.

COMMENTS RECEIVED DURING THE 45-DAY COMMENT PERIOD

COMMENTOR: Keith Bishop, by e-mail dated 4/1/02

COMMENT 1: The commentor states that Section 260.211(a)(1)(B) violates the non-duplication requirement of Government Code Section 11349(f), suggesting that proposed Section 260.211(a)(1)(B) restates Corporations Code Section 25211(a). The commentor further indicates that if the Commissioner has internal guidelines for information requests, consideration should be given as to whether such guidelines constitute illegal "underground regulations" under the Administrative Procedure Act (the "APA").

RESPONSE: Corporations Code Section 25211(a) provides that the application for a certificate as a broker-dealer is to contain such information as the Commissioner

requires by rule. The purpose of proposed Section 260.211(a)(1)(B) is to inform the applicant that, after reviewing the application submitted by the applicant, the Commissioner may require additional detail or information. The section does not “duplicate” existing law, but instead provides notice to the applicant that additional documentation may be necessary for the Department to evaluate the applicant’s answers to the questions on Form BD. Additionally, Government Code Section 11349(f) states that the “non-duplication” standard is not intended to prohibit overlapping or duplicating regulation when it is necessary to satisfy the clarity standard in Government Code Section 11349.1(a)(3). Thus, the language in the rule provides clarity to the application process.

The language is intended to provide the Commissioner with the ability to seek additional information from applicants if the answers are incomplete or require further inquiry for the protection of investors, and the Commissioner does not have an “internal guideline for information requests” other than that set forth by this rule. Thus, no “illegal” underground regulation exists. Nevertheless, if the Department finds it is continuously requesting certain information from all applicants, it will adopt a rule pursuant to the APA.

COMMENT 2: The commentor states that Section 260.211(a)(2) violates the consistency requirement of Government Code Section 11349(d). The commentor notes that the Commissioner has an obligation, in accordance with Corporations Code Section 25608.3, to reduce any fee under Corporations Code Section 25608 and 25608.1 for the 2002-2003 fiscal year in a “reasonable and prudent manner.” The commentor further suggests amendments to the Initial Statement of Reasons are necessary to reflect the Commissioner’s findings with respect to the fixing of the filing fee. In this regard, the commentor notes that the setting of reduced fees constitutes rulemaking and is subject to the rulemaking provisions of the Administrative Procedure Act.

RESPONSE: The proposed rule does not violate the consistency requirement of Government Code Section 11349(d). Corporations Code Section 25608.3 provides the Commissioner with the authority to reduce fees, as set forth in that provision. The fee in the proposed rule is not one that the Commissioner is reducing. The Department does not agree that Section 25608.3 requires the fee in the proposed rule be reduced. If the Commissioner reduces the fee in the proposed rule in the future, this rule will be amended as necessary.

The Department does not agree that Section 25608.3 requires the Department to amend its Statement of Reasons to provide a reason for maintaining the statutory fee for broker-dealers.

Comments with respect to adopting a rule under Corporations Code Section 25608.3 are outside the scope of this rulemaking action. However, the Department will consider the suggestions for future rulemaking actions.

COMMENT 3: The commentor suggests amendments to Section 260.211(a)(3) to conform to the requirements of the Permit Reform Act, noting that this section violates the Permit Reform Act because Section 260.211(a)(3) does not specify the time period within which the Commissioner must notify the applicant in writing that the application is complete. The commentor further notes that Section 250.51 does not currently distinguish between the procedures set forth in Section 260.211 and Section 260.211.1. The commentor recommends that the Commissioner amend Section 250.51 to distinguish between applications submitted in accordance with Corporations Code Section 25211(a) and (b). Furthermore, the commentor suggests that Section 250.51 does not accurately reflect the time period set forth in Section 25211(c).

RESPONSE: Proposed Section 260.211(a)(3) does not violate the Permit Reform Act. The time period for notification to applicants is set forth in Section 250.51, in conformance with the Permit Reform Act. While the Department appreciates the suggestion to amend Section 250.51, the comment is outside the scope of this rulemaking action. The Department will consider the suggestion for a future rulemaking action.

COMMENT 4: The commentor notes that Form BD does not include disclosures regarding the appeals process required by Government Code Section 15378(b). In this regard, the commentor notes that Section 15378(b) requires these disclosures to appear in permit application forms.

RESPONSE: The Department provides additional instructions for completing Form BD, and any additional state law requirements for applications that differ from those in the uniform application are set forth and incorporated through the Department's instructions.

COMMENT 5: With respect to Section 260.211(b)(1)(B)(iii), the commentor asks why the Citizenship, Alienage and Immigration Status Form is required only for sole proprietorship broker-dealers that do not participate in the CRD.

RESPONSE: The form is required of all sole proprietor applicants (see Section 250.61), but the method for submitting the document to the Department differs between those who do and do not participate in the CRD. The method is set forth in instructions provided by the Department for CRD participants. Nevertheless, the Department notes

that the form was inadvertently not included in the list in subparagraph (A) of Section 260.211(a)(1), and the section has been amended accordingly.

COMMENT 6: Citing previously stated reasons, the commentor suggests that Section 260.211(b)(1)(E) violates the non-duplication requirement of Government Code Section 11349(f).

RESPONSE: The Department disagrees that the section violates the non-duplication requirement, for the reasons set forth in the response to Comment 1.

COMMENT 7: Again, citing previously stated reasons, the commentor suggests that Section 260.211(b)(2) violates the consistency requirement of Government Code Section 11349(d).

RESPONSE: The Department disagrees that the section violates the “consistency” requirement of Government Code Section 11349(d) for the reasons set forth in the response to Comment 2.

COMMENT 8: The commentor suggests that Section 260.211(b)(3) violates the Permit Reform Act.

RESPONSE: The Department disagrees that the section violates the Permit Reform Act for the reasons set forth in the response to Comment 3.

COMMENT 9: The commentor asks whether the Commissioner has determined that the Form BD includes the disclosures mandated under the Information Practices Act, including Civil Code Section 1798.17. Also, the commentor asks whether the Commissioner has determined that the Department will be in compliance with the agency requirements of the Information Practices Act.

RESPONSE: As indicated in the response to Comment 4, The Department provides additional instructions for completing Form BD, and any additional state law requirements for applications that differ from those in the uniform application are set forth and incorporated through the Department’s instructions. The Department has not identified any provision of the Information Practices Act that it would not be in compliance with solely as a result of this rulemaking action.

COMMENT 10: The commentor asks whether the Commissioner has determined that the CRD will transmit all fees and charges collected under Corporations Code Section 25608(o) to the Treasurer at least weekly as required by Corporations Code Section 25608(a).

RESPONSE: This comment appears to be outside the scope of this rulemaking action. Nevertheless, the Department is not aware of any fee collection and transmission procedures that are not in compliance with Corporations Code Section 25608(a).

No written comments were received during the 15-day public comment period when ended on August 23, 2002.

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