

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

As required by Section 11346.7 of the Government Code, the Commissioner of Corporations ("Commissioner") sets forth below the reasons for the proposed amendments to Rule 260.236 of Title 10, California Code of Regulations (10 C.C.R. Secs. 260.236).

Necessity for Rule Changes

Most states require securities professionals to pass certain examinations before being registered or licensed. In order to promote uniformity among the states, the North American Securities Administrators Association ("NASAA") in cooperation with representatives of the securities industry associations, created a series of uniform examinations. These examinations are intended to provide a basis for state securities administrators to determine an applicant's knowledge and understanding of state and federal laws and regulations. The Series 63/Uniform Securities Agent State Law Examination ("Series 63 Examination") tests prospective broker-dealer agents on their knowledge of state securities laws. The Series 65/Uniform Investment Adviser Law Examination ("Series 65 Examination") tests prospective investment adviser representatives on their knowledge of federal and state securities laws and regulations. The Series 66/Uniform Combined State Law Examination ("Series 66 Examination") was created for individuals who are required or elect to take both the Series 63 and Series 65 Examinations. The Series 66 Examination tests an applicant on their knowledge of federal and state securities laws and regulations. The National Association of Securities Dealers Regulation ("NASDR") administers all three examinations.

In 1996, NASAA began a comprehensive review and modification of the Series 65 Examination, the examination to qualify candidates as investment adviser representatives. The goals of this review were to develop a uniform set of standards and qualifications to be applied universally from jurisdiction to jurisdiction. As a result of this review, the Series 65 and the Series 66 Examination were modified.

The current Series 65 Examination is a 75 question competency examination that covers the principles of state securities regulation as reflected in the Uniform Securities Act (with the amendments adopted by NASAA as of April 1997) and federal securities laws and regulations applicable to investment advisers, including unethical business practices.

The new Series 65 Examination contains 130 questions and combines competency and compliance questions into one examination. The new examination covers four primary subject areas: economics and analysis, investment vehicles, investment recommendations and strategies, and ethics and legal guidelines.

In order for individuals to engage in both investment adviser and broker-dealer activities in California, they are required to take and pass the Series 66 Examination. This examination covers the principles of state securities regulation reflected in the Uniform Securities Act (with the amendments adopted by NASAA as of April 1997) and federal securities laws and regulations applicable to investment advisers, including unethical business practices. The Series 66 Examination question bank consists of questions from both the Series 63 Examination and the Series 65 Examination and meets the separate state examination requirements for each activity. Individuals that successfully pass the Series

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66 Examination will be able to comply with the broker-dealer and investment adviser state law examination requirements.

When changes are made to either the Series 63 Examination or Series 65 Examination question banks, corresponding changes are made concurrently to the Series 66 Examination question bank. As a result of the modification of the Series 65 Examination, the Series 66 Examination was revised to include questions relating to investment vehicles and economics. The new Series 66 Examination will only be given to those who have passed the NASD's Series 7 /General Securities Representative Examination ("Series 7 Examination").

The current Series 65 and Series 66 Examinations will be retired on December 31, 1999. On January 1, 2000, only the new Series 65 and Series 66 Examinations will be administered.

### NASAA's Sample Rule

During its Spring Conference, NASAA introduced the new Series 65 and Series 66 Examinations and a sample rule for all states to consider. The NASAA sample rule has three components: (1) examination requirements, (2) grandfathering and (3) waivers. Below is a brief description of NASAA's sample rule:

Section (A) requires an individual applying to be registered as an investment adviser or investment adviser representative to pass: (1) the Series 65 Examination, or (2) the Series 7 Examination and the Series 66 Examination.

Section (B) provides a grandfather exemption for: (1) individuals who are registered as an investment adviser or investment adviser representative, in any jurisdiction of the United States, as of the effective date of this rule, and (2) requires an individual who has not been registered in any jurisdiction for a period of two years to comply with the requirements of this rule.

Section (C) waives the examination requirements for those persons holding current Chartered Financial Analyst ("CFA"), Chartered Financial Consultant ("ChFC"), Certified Financial Planner ("CFP"), Chartered Investment Counselor ("CIC"), or Personal Financial Specialist ("PFS") designations or any other designation as the Commissioner may by rule or order recognize.

In order to promote uniformity, NASAA recommends that, by January 1, 2000, all states adopt or revise their regulations to:

1. adopt the new Series 65 Examination,
2. adopt the new Series 66 Examination with the requirement that only applicants who have passed the Series 7 Examination may sit for it,
3. rescind all other exams for investment adviser representatives,
4. exempt any person licensed or registered as an investment adviser representative as of December 31, 1999 from the examination requirements, except an investment adviser representative who has not been in business for the last two years must take the examinations for re-entry into the industry, and

5. waive the examination requirements for those persons holding current Chartered Financial Analyst (“CFA”), Chartered Financial Consultant (“ChFC”), Certified Financial Planner (“CFP”), Chartered Investment Counselor (“CIC”), or Personal Financial Specialist (“PFS”) designations.

Current Requirements:

Under the Corporate Securities Law of 1968 (the “CSL”) (specifically Corporations Code Section 25236), the Commissioner is authorized to adopt standards regarding the training, experience, and other qualifications for investment advisers and their investment adviser representative or associated persons. The Commissioner adopted Rule 260.236 to set forth the qualification requirements of investment advisers, investment adviser representatives and associated persons.

Current Rule 260.236 requires an investment adviser, each investment adviser representative or associated person to:

- (1) pass the Series 65 Examination or the Series 66 Examination and either:
  - (A) pass the Series 7 Examination or
  - (B) hold a current CFA, ChFC, CFP, CIC, or PFS designation; and

(2) have been continually and actively engaged in the securities business as a broker-dealer, investment adviser, or an investment adviser representative or associated person since passing the qualifying examination.

Subsection (b) “grandfathers” any individual who has passed the SECO/NASD Non Member General Securities Examination or "Series 2 Examination" before January 1, 1998 or any investment adviser representative or associated person who was engaged by an investment adviser before January 1, 1998. These individuals are not required to satisfy the examination requirements based on their current status.

Subsection (c) provided an exemption from the examination requirements for any investment adviser applicant, or investment adviser representative or associated person who has been actively and continuously engaged as a portfolio manager or securities analyst for three or more years of the five year period prior to filing an application for certificate as an investment adviser, or investment adviser representative or associated person; or for any investment adviser representative or associated person who was employed by an investment adviser to only offer or negotiate for the sale of investment advisory services of the investment adviser.

Subsection (d) provides definitions for “securities analyst” and “portfolio manager”.

Proposed Revisions to Rule 260.236

In light of the modifications to the Series 65 and Series 66 Examinations, the Commissioner has reviewed current Rule 260.236 and NASAA’s sample rule. To promote uniformity of the examinations throughout the United States, the Commissioner proposes to amend Rule 260.236 to adopt NASAA’s sample language with modifications to reflect the grandfather and waiver provisions contained in the existing rule. The changes to Rule 260.236, which are based on NASAA’s sample rule, are necessary

to protect the general public. It is essential that investment advisers, investment adviser representatives, and associated persons have a basic understanding of the investment products available, as well as the laws and regulations governing the industry. The examination requirements under Rule 260.236 will ensure that investment advisers, investment adviser representatives and associated persons can competently and effectively render investment advisory services to their clients.

Subsection (a) is being amended to require any investment adviser, investment adviser representative or associated person to pass, at least two years before filing the application for an investment adviser certificate or becoming engaged as an investment adviser representative or associated person pass either:

- (1) The Series 65 Examination, or
- (2) The Series 7 Examination and the Series 66 Examination.

Subsection (b) provides for the “grandfathering” or waiving of certain individuals based on their experience or current registration. Subsection (b) conforms to NASAA’s sample rule and specifically waives those individuals who have previously satisfied other qualifying examinations, that have been continuously engaged in the business, without substantial interruption. These individuals will not be required to satisfy the examination requirement anew, as these new examination requirements are prospective. This subsection is necessary to ensure that those already holding an investment adviser certificate are not unduly burdened by the new examination requirements.

Subsection (b)(1) waives the examination requirements for those investment advisers, investment adviser representatives or associated persons who are currently registered in any state as of December 31, 1999.

Subsection (b)(2) is former subsections (a) and (b) of Rule 260.236. This subsection clarifies that investment advisers and investment adviser representatives or associated persons who are qualified pursuant to former Rule 260.236 will not be required to take the new Series 65 and Series 66 Examinations.

The Commissioner is amending subsection (c) to incorporate NASAA’s proposal. This subsection is necessary to ensure that those already holding an investment adviser certificate are not unduly burdened by the new examination requirements.

Subsection (c)(1) incorporates NASAA’s sample rule to exempt any person who is currently registered as an investment adviser, investment adviser representative or associated person in any state for at least two years prior to filing an application for certification or notice in California.

Subsection (c)(2) is former subsection (a)(2). This subsection provides an exemption for individuals who have been actively and continuously engaged in the securities business as a broker-dealer, investment adviser, investment adviser representative or associated person for two years since passing a qualifying examination.

Subsection (c)(3) is former subsection (c)(2). This subsection exempts solicitors or other individuals who are engaged by an investment adviser solely to offer or negotiate the sale of investment advisory services of the employing investment advisor from the examination requirements based on their

limited activity. These individuals are precluded from delivering any investment advice.

Subsection (c)(4) exempts any individual who currently holds one of the following professional designations: Chartered Financial Analyst, Chartered Financial Consultant, Certified Financial Planner, Chartered Investment Counselor, or Personal Financial Specialist, because these individuals have been determined by NASAA to meet the qualification requirements.

Current subsection (d) is being repealed as it defines “securities analyst” and “portfolio manager”. As these terms are no longer used in the rules, the definitions are unnecessary. The Commissioner is adopting new subsection (d) in accordance with NASAA's Sample Rule, to clarify that an individual who has not been registered in any jurisdiction in the United States for a period of two years must comply with the qualification requirements of subsection (a) of this rule. This provision does not apply to an individual using an exemption in subsection (c)(2), (c)(3), and (c)(4).

#### ALTERNATIVES CONSIDERED

No alternative considered by the Department of Corporations would be more effective in carrying out the purpose for that the regulation is proposed, would be as effective and less burdensome to affected private persons, or would lessen any adverse impact on small businesses.

#### COST IMPACT

The potential cost impact of the proposed action on private persons or businesses directly affected is expected to be insignificant. The Commissioner has determined that the proposed action will not have a significant adverse economic impact on businesses within the meaning of Chapter 1083, Statutes 1982, and Chapter 1306, Statutes 1992. The proposed regulation changes provide uniformity of examination requirements for persons wishing to become an investment adviser. More than 60 industry experts participated in the review of the Series 65 and Series 66 Examinations and the development of NASAA's sample rule, ensuring be no adverse economic impact on business.

#### 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.

#### CHANGES MADE TO CONFORM TEXT TO EMERGENCY REGULATION

The Finding of Emergency and the Notice of Proposed Text were both filed with the Office of Administrative Law on December 17, 1999. The Notice of Proposed Text and the Text of Proposed Changes had already been prepared for mailing by the end of OAL's review of the Finding of Emergency. Therefore, the Text of Proposed Changes did not contain the changes made to the emergency regulation. The following changes to the Text of Proposed Changes are being made to correspond to changes made to the emergency order.

Subsections (a), (c)(1) and (c)(2), "association" person has been changed to "associated" person.

Subsection (c)(1) the term "notification" has been changed to "notice pursuant to Corporations Code Section 25230.1(b)".

Other grammatical, punctuation changes were made.

The Department did not receive any comment during the 45-day comment period with respect to these minor inconsistencies.

#### ADDENDUM REGARDING PUBLIC COMMENT PERIOD

The public comment period ended on February 18, 2000. The Department did not receive any request for hearing, and no public hearing was scheduled or heard. One comment letter was received during the 45-day comment period.

COMMENTOR: Michael C. Herndon, Manager, Government Relations, Certified Financial Planner Board of Standards, letter dated January 25, 2000.

COMMENT: In general, the commentor supports the proposed changes to Rule 260.236, and suggests that the reference to Certified Financial Planner be amended to "Certified Financial Planner ("CFP") awarded by the Certified Financial Planner Board of Standards, Inc.;".

The commentor also provides information on how the Department's staff can verify the status of an applicant claiming an examination exemption because he or she is a Certified Financial Planner.

RESPONSE: The Commissioner agrees with this suggestion and makes this change. In addition, the Department proposes amending the references to Chartered Financial Analyst ("CFA"), Chartered Financial Consultant ("ChFC"), Chartered Investment Counselor ("CIC") and Personal Financial Specialist ("PFS") to include the names of the issuing organizations. These changes provide clarifies the designations by including the names of the issuing organizations, and provides greater conformity to NASAA's Sample Rule, upon which the proposed rule changes are based. NASAA's Sample Rule also lists the designations and the issuing organization.

#### ADDITIONAL CHANGES

Subsection (b)(2) or Rule 260.236 is further amended to insert "qualified" before the word "examination(s)". This change is need to clarify the meaning of examination, and provide consistency within the rule.

Subsection (c)(1) is amended to replace the reference to Corporations Code Section 25230.1(b) with Section 25230(b) or 25230.1(c). Corporations Code Section 25230.1(b) applies to an investment adviser registered under Section 203 of the Investment Advisers Act of 1940. Because these federally registered investment advisers are exempt from the registration requirements, Corporations Code Section 25230.1(b) does not apply in this situation and is being replaced by Section 25230(b) and 25230.1(c).

Corporations Code Section 25230(b) requires any person who conducts business on behalf of a licensed investment adviser to first comply with the qualification and employment requirements of an

investment adviser. Corporations Code Section 25230.1(c) requires any investment adviser representative conducts business on behalf of a licensed investment adviser to first comply with the qualification and employment requirements of an investment adviser representative.

#### OTHER COMMENTS

The Department received a letter from George R. Monte, an investment adviser, dated January 3, 2000. In his letter, Mr. Monte expressed his concern over the proposed rule change believing it would have a negative affect on the business he was in the process of establishing. He requested an interpretation of "actively and continuously engaged in the securities business" and an explanation of how the proposed rule change would affect his business.

The Department contacted Mr. Monte on February 11, 2000 to explain that Mr. Monte is considered to be 'actively and continuously engaged in the securities business' as he has been registered as an investment adviser with the Department has since 1997.

No other comments were received during the 45-day comment period.

### ADDITIONAL 15-DAY COMMENT PERIOD

Based on the comment letter received from the Certified Financial Planner Board of Standards and the additional changes, the Department, issued a Notice of Proposed Final Text and the Proposed Final Text for an additional 15-day comment period. This additional comment period began on March 28, 2000 through April 14, 2000. No comments were received as a result of this additional comment period.