



JENNIFER M. GRANHOLM
GOVERNOR

STATE OF MICHIGAN
OFFICE OF FINANCIAL AND INSURANCE REGULATION
DEPARTMENT OF ENERGY, LABOR & ECONOMIC GROWTH
STANLEY "SKIP" PRUSS, DIRECTOR

KEN ROSS
COMMISSIONER

BILL ANALYSIS

BILL NUMBER: House Bill 6141(H-3)

TOPIC: Uniform Securities Act; Investment Adviser Representatives;
grandfathering of certain representatives

SPONSOR: Representative Meekhof

CO-SPONSORS: Reps. Rogers, Hildenbrand, Opsommer, Miller, Genetski, Denby,
Schuitmaker, Agema, Proos, Byrum, Hammel, LeBlanc, Schmidt
and Pearce

COMMITTEE: Insurance

DATE: May 19, 2010

POSITION

The Office of Financial and Insurance Regulation (OFIR) opposes this legislation.

PROBLEM/BACKGROUND

In December 2008, the Michigan Legislature enacted the Uniform Securities Act (USA), MCL 451.4101 *et seq.*, effective October 1, 2009. USA is based on the 2002 Uniform Securities Model Act (Model Act) drafted by the National Conference of Commissioners on Uniform State Laws (NCCUSL).

The USA was based on three themes:

Facilitate uniformity and cooperation among relevant state and federal governments and self-regulatory organizations;

Consistency with the NCCUSL;

Required updates to facilitate technological advancements intended to permit electronic filing in central information depositories.

Section 404 of the USA requires that Investment Adviser Representatives (IARs) conducting business in Michigan to be registered, unless otherwise exempt as provided by statute, rule, or order of the administrator.

Section 412(5) of the USA allows the Commissioner to establish a rule or order requiring that an examination, including an examination developed or approved by an organization of securities regulators, be successfully completed by a class of individuals. An order under this act may waive an examination as to an individual; a rule under this act may waive an examination to a class of individuals if the administrator determines that the examination is not necessary or appropriate in the public interest and for the protection of the investor.

On October 1, 2009, the new Michigan Uniform Securities Act, MCL 451.2101 et seq. (USA) took effect. Section 404(1) of USA, MCL 451.2404(1), required investment adviser representatives (IARs), for the first time, to submit an application to the Office of Financial and Insurance Regulation (OFIR) or its designee. Anticipating 7,500 – 10,000 IAR applications, Commissioner Ross, as the Administrator of USA issued four Transition Orders between September 1st, 2009 and March 11th, 2010, three of which specifically dealt with the registration of IARs.

The third Transition Order No.09-070-M, dated December 18th, 2009, clarified that if the IAR applicant had been registered as an IAR within two years immediately preceding the date of application, as determined from the Web CRD/IARD records, in a state that required the IAR applicant to take and pass either the S65 or the S66 and S7, the IAR applicant did not have to re-take the exam. It also exempted from the examination requirement certain professional designations.

DESCRIPTION OF BILL

HB 6141(H-3) seeks to exempt from the examination requirements various populations of persons who have never taken a core IAR examination, that being either the S 65 or the S 66 and S 7. This significantly broadens the examination exemption.

Section 404(1) applies to “an individual acting as an investment adviser representative in this state on the effective date of the 2010 amendatory act that amended this section is exempt from the requirement to sit for the examination in order to be registered if that individual has not filed for protection under any chapter of the Bankruptcy Code more than 1 time and...”

Section 404(1)(A): Has passed the S65 or S66 within the past 2 years. Section 404(2)(A): and submits his/her application by September 1, 2010;

Section 404(1)(B): Has been continuously employed by an Investment Adviser firm (IA) and has been performing investment adviser services without a 2 or more year break in service since he/she passed the S65 or S66 exam. Section 404(2)(A): and he/she submits his/her application by September 1, 2010;

Section 404(1)(C): Has been continuously employed by an IA and the IA firm takes responsibility for compliance and suitability and enforces the Securities Exchange Commission [sic] and Financial Industry Regulatory Authority standards; or

Section 404(1)(C): Was employed before 10-1-08 as an IA and has been performing IA services without a 2 year break in service since passing either: the Series 6 and Series 63 or - the Series 7 and Series 63

Section 404(2)(B) states that the applicant must submit an application by October 1, 2010 to be exempt from the requirement to sit for the S63, Series 6 or Series 7 examination.

SUMMARY OF ARGUMENTS

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HB 6141(H-3) does not exempt a person who is acting as an investment adviser representative (IAR) from the examination requirement if they have filed Bankruptcy more than one time.

Con

Some of the enhancements inherent in the new Michigan USA, 2008 PA 551, are specifically designed for the protection of Michigan investors. The Michigan USA requires individuals representing investment advisor firms to have the requisite knowledge for recommending financial products to potential investors by taking and passing specific examinations. HB 6141 (H-3) goes against those consumer protection mechanisms by exempting certain individuals from the IAR examination requirements set forth by the Commissioner.

The exam requirements established by the Commissioner under the new USA were specifically designed to test IARs on the core proficiencies and fiduciary duties that are tantamount to operating as an IAR. This legislation significantly broadens the examination exemption for IARs, based in part on taking examinations that do not address the ethical and legal duties that are the essence of an IARs day-to-day operation. By expanding the examination exemption in this manner, this legislation diminishes essential consumer protections that were put in place specifically to ensure IAR competency in these core areas.

Section 404(1)(C) states that an IAR who is employed by an IA firm that takes responsibility for compliance and suitability and “enforces those standards that are governed by the Securities Exchange Commission [sic] and the Financial Industry Regulatory Authority” should not have to take a Series 65 or Series 66 and Series 7 exam.

OFIR does not know to what “compliance and suitability standards” (H-3) is referring. Further, this section does not acknowledge OFIR as the primary regulatory authority for state registered IA firms and IARs.

Additionally, IARs are not held to a suitability standard; by law, they are the fiduciaries for their clients, which is a higher standard of care than mere suitability.

Given Michigan's economic climate and a population of early retirees, OFIR has a vested interest in insuring that its residents are afforded IAR services by individuals who understand the high level of care and the legal duty owed by an IAR to his/her client.

(H-3) uses the terms IAR and IA incorrectly. For example, Section 404(1)(C) of (H-3) seeks to exempt an IA firm from the S 65 or S 66 and S 7 examination requirements, instead of seeking an exemption for an IAR who is an individual. (H-3) suffers from this same technical error throughout the draft bill.

(H-3) contradicts itself. In Section 404(1)(C), an individual acting as an IAR is who was employed as an IA without a break in service does not have to take the S 65 or S66 and S 7 if he or she has passed the Series 6 and Series 63 or the Series 7 and Series 63. However, in Section 404(2)(B), (H-3) says that an applicant is eligible for the exemption "from the requirement to sit for the (S63), Series 6 or Series 7 examination as described in subsection (1)(C)". There is no exemption in Section 404(1)(C) that exempts an applicant from taking the S 63, S6 or S7.

Sections 404(2)(A) and (B) refer to applications that are "postmarked". IARs submit their U-4 applications electronically through Web CRD/IARD, so there is nothing to be "postmarked". Section 404(4) allows an IAR whose application has not been approved to continue to conduct business in this state until January 1, 2011. If applications are submitted by the September 1, 2010 deadline OFIR currently imposes in the Fourth Transition Order, this section is not necessary, as applications will be processed by the end of November. Applications cannot be processed in December because FINRA Web CRD/IARD closes between Christmas and New Year's. This is why OFIR imposed the September 1, 2010 deadline for IAR applicants.

FISCAL/ECONOMIC IMPACT

OFIR has identified the following revenue or budgetary implications in this bill:

(a) To the Office of Financial and Insurance Regulation: Indeterminate

Budgetary:

Revenue:

Comments:

(b) To the Department of Energy, Labor & Economic Growth: None

Budgetary:

Revenue:

Comments:

(c) To the State of Michigan: None

Budgetary:

Revenue:

Comments:

(d) To Local Governments within this State: None

Comments:

OTHER STATE DEPARTMENTS

None.

ANY OTHER PERTINENT INFORMATION

None.

ADMINISTRATIVE RULES IMPACT

The proposed legislation would amend 2008 PA 551, the Uniform Securities Act (2002). OFIR has general rulemaking authority under this act.



Ken Ross
Commissioner

5/20/10

Date