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# THE BLUE SKY BUGLE

A Newsletter for Blue Sky Lawyers

Published by the ABA Committee on State Regulation of Securities

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## EVENTS CALENDAR

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The State Regulation of Securities Committee will meet in conjunction with the 2007 Spring Meeting of ABA Business Law Section to be held  
March 17, 2007 (10:30 AM to 12:00 PM)  
at the Renaissance Washington, DC Hotel

The Committee and its Subcommittees will meet in conjunction with the 2007 Annual Meeting of ABA Business Law Section to be held  
August 13-17, 2007  
San Francisco, CA

The Committee and its Subcommittees will meet at the 2007 Annual NASAA Fall Conference  
September 30 through October 3, 2007  
Westin Hotel, Seattle Washington

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## PLAN FOR THE FUTURE

The Committee and its Subcommittees will meet in conjunction with the 2008 Spring Meeting of ABA Business Law Section  
April 10 through April 13, 2008  
at the Hilton Anatole Hotel, Dallas Texas

The Committee and its Subcommittees will meet in conjunction with the 2008 Annual Meeting of ABA Business Law Section  
August 2008  
New York, New York

The Committee and its Subcommittees will meet at the 2008 Annual NASAA Fall Conference  
September 15 through September 18, 2008  
Las Vegas, Nevada

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## CLE PROGRAMS SPONSORED BY THE STATE REGULATION OF SECURITIES COMMITTEE

Hot Securities Law Issues for Small Business  
March 16, 2007, 10:30 a.m. to 12:30 p.m.  
Renaissance Washington, DC Hotel

Regulation of Variable Annuities  
Date and Time TBA  
and  
California Dreamin’ – Watch Out for Speed Bumps!  
Date and Time TBA

ABA Annual Meeting, August 13 to 17, 2007  
San Francisco, California

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## BLUE SKY BITS AND PIECES

*By Ellen Lieberman*

Debevoise & Plimpton LLP (New York)

It is with great sadness that we report the death on October 24 of our friend **Charles H.B. (Chick) Braisted**, whom we saw so recently at the meetings in San Diego. Chick had left his practice after 30 years at Davis, Polk & Wardwell but continued to be involved in state securities law from his home in Vermont. Our deepest sympathies go to his wife Gayl and family. He will be missed as an important member for so many decades of our blue sky community. I posted the sad news on our Committee's listserv on October 27 and received a flood of responses from practitioners and regulators alike. We hope Chick knew, and that his family is aware, of the great esteem and affection in which his colleagues held him—his efforts on the various renditions of the Uniform Securities Act, his insights into New York's Martin Act, his professional but always cordial manner, and his ever wise counsel, made him for many Mr. Blue Sky. Those who follow in his footsteps are honored to have known and worked with him.

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**Tung Chan** has been named as the new head of the Business Registration Division in the Hawaii Department of Commerce and Consumer Affairs effective September 5, 2006. She will oversee registration of new business and other corporate filings and enforce the state's securities laws. The new Hawaii securities commissioner was previously assistant general counsel for New York Life Insurance Co. in their New York City office and, prior to that, an associate at the firm of Cleary Gottlieb Steen & Hamilton, where she concentrated in securities offerings and financing transactions. She also served as a 1996 summer law clerk in Honolulu for U.S. District Court Judge David A. Ezra. Ms. Chan replaces Commissioner of Securities **Corinna Wong** who recently relocated from Hawaii.

Effective September 1, 2006, **Mary L. Schapiro** took office as NASD's Chairman and CEO. She joined the NASD in 1996 as President of NASD Regulation and was named Vice Chairman in 2002. She was appointed Chairman of the Federal Commodity Futures Trading Commission in 1994 by President Clinton and served as a Commissioner of the SEC from 1988 to 1994. She is a graduate of Franklin and Marshall College in Lancaster, Pa., and earned a Juris Doctor degree (with honors) from George Washington University

**F. Lee Liebolt, Jr.**, has recently opened his own law office in New York's historic Graybar Building at Grand Central Terminal. Lee says "I am quite excited about the possibilities." Lee, in addition to serving as our Committee's Liaison to NASAA's Ombudsman, has offered to act as our Committee's program chair for an MCLE panel at the Spring Meeting of the ABA Section of Business Law.

A Blue Sky Cube (one cubic foot of Kansas blue sky) was awarded at the September 2006 NASAA Annual Meeting to **Christine A. Bruenn**, formerly Maine's Securities Administrator and a past NASAA President, and now in private practice as a partner in the Portland, Maine, office of Bingham McCutchen LLP. This is the second such award she has received, this presentation spotlighting her leadership in making NASAA a strong voice for investor protection. A Blue Sky Cube was also awarded to Maryland Securities Commissioner **Melanie Senter Lubin** for her unparalleled passion for investor protection. She has served as Chair of NASAA's CRD/IARD Steering Committee.

The NASAA Corporate Finance Section presented its Annual Award to **Randall Schumann**, Legal Counsel for the Wisconsin Division of Securities, for his achievements on behalf of the Section.

**Joseph P. Borg**, Alabama's Securities Commissioner since 1994, took office at the NASAA Annual Meeting and became, for the second time in his career, President of NASAA having served previously in 2001-2002. He will work to further improve NASAA's close working relationship with the SEC, NASD, and New York Stock Exchange, and will work to increase coordination and cooperation with other regulators, including state and federal banking regulators and state insurance regulators. He succeeds Wisconsin Securities Administrator **Patricia D. Struck**. North Dakota Securities Commissioner **Karen Tyler** was named NASAA's President-elect., and NASAA's 2006-2007 Board of Directors includes Commissioner Tyler, Securities Administrator Struck, **Glenda Campbell**, Vice Chair of the Alberta Securities Commission; **Denise Voigt Crawford**, Texas Securities Commissioner; **Michael Johnson**, Arkansas Securities Commissioner; **Fred J. Joseph**, Colorado Securities Commissioner; **James O. Nelson II**, Mississippi Assistant Secretary of State, Business Regulation and Enforcement; and **James B. Ropp**, Delaware Securities Commissioner.

**Mark Uyeda**, Chief Advisor to the California Corporations Commissioner, left the California Department of Corporations as of October 16, 2006,

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relocating to the U.S. Securities and Exchange Commission in Washington, D.C. where he will serve as counsel to SEC Commissioner Paul Atkins.

**Peter J. Anderson**, a partner at the Atlanta, Georgia office of Sutherland Asbill & Brennan LLP, has graciously agreed to serve as the Committee's Liaison on Variable Annuity Issues, and to serve as our Committee's program chair for an MCLE panel at the ABA Annual Meeting in August 2007 in San Francisco, California, on the regulation of variable annuities. Peter is a member of the Georgia and Pennsylvania bars and has represented brokerage firms, broker-dealers and individual brokers before the SEC, the NASD, the New York Stock Exchange, and state regulators on issues relating to supervision, suitability, sales practices and insider trading, and has represented officers and directors of public companies, accounting firms and auditors in SEC enforcement actions, Department of Justice investigations and civil litigation.

**Andrew Kandel**, First Vice President and Assistant General Counsel, Merrill Lynch, Pierce, Fenner & Smith Incorporated has accepted the position of Committee Liaison to NASAA's Enforcement Trends Project Group. We are delighted that he will be monitoring the work of the NASAA Group — informing us of their activities as well as bringing our concerns to their attention. Andrew was formerly Chief of the Investor Protection and Securities Bureau of the Office of the New York State Attorney General.

**Keith Paul Bishop** has agreed to serve as our new California liaison. Keith is currently Vice Chair, Legislation, of the Business Law Section of the State Bar of California. He is a Shareholder in the law firm of Buchalter Nemer Fields & Younger, practicing in Orange County. He is a former Commissioner of Corporations of the State of California. He has also previously served as Deputy Secretary and General Counsel to the California Business, Transportation & Housing Agency and as a member of the California Senate Commission on Corporate Governance, Shareholder Rights and Securities Transactions. His practice emphasizes federal and state securities laws, public and private offerings, corporate maintenance, investment advisers, mergers and acquisitions and California administrative law. We are fortunate to be able to share his insights into California law.

**Michael J. Halloran**, who was Senior Partner of the Corporate and Securities practice group of Pillsbury Winthrop Shaw Pittman LLP, has become Counselor to the Chairman and Deputy Chief of Staff at the Securities

and Exchange Commission. Among his many accomplishments, he was Group Executive Vice President and General Counsel for BankAmerica Corporation from 1990-96, and he founded and led Pillsbury's Washington DC office from 1979-83.

We are pleased that **David N. Jonson**, from the Raleigh, North Carolina, office of Kennedy Covington Lobdell & Hickman, L.L.P., will serve as Committee Liaison to the Securities Industry Conference on Arbitration. He will be the eyes and ears to that group for our Committee and its Enforcement Subcommittee. David concentrates his practice in the area of securities law, representing broker-dealers, investment advisers, and financial service providers in all aspects of federal and state securities compliance and defense matters. Previously he was Deputy Attorney General and Deputy Securities Commissioner for the State of South Carolina from 1997-2000, was a member of NASAA's Board of Directors from 1999-2001, and received NASAA's Outstanding Service Award in 2001. David will also be reporting to our Committee as Liaison to North Carolina, and we look forward to his service with great appreciation.

Ms. **Alex Sink** was elected on November 7, 2006, as Florida's new Chief Financial Officer (the cabinet office created in 2002 to combine the old offices of Comptroller and Insurance Commissioner). She will be the only woman and the only Democrat in the Florida Cabinet and, as head of the Department of Financial Services, the state's securities, banking, and insurance regulator. She replaces Tom Gallagher, a Republican and Florida's first CFO, who ran unsuccessfully for the gubernatorial nomination.

**R. Michael Underwood** of Squire, Sanders & Dempsey L.L.P. advises that the **Florida Division of Securities and Finance**, which is part of the Florida Department of Financial Services Office of Financial Regulation, is being reorganized to spin off "finance regulation," that is, mortgage brokerage, retail installment sales, small loan companies, money transmitters, collection agencies, "payday lenders" etc. into its own division. Regulation of securities issues, broker-dealers, investment advisers, and their associated persons will remain in the Division of Securities.

Taking a giant leap into the information age, **Don Rett**, Chair of our Subcommittee of Liaisons to States and NASD, has launched his own website produced by his daughter's marketing company. Although not handing out cigars, he is nevertheless justifiably proud and said—"when you get a chance, go to [www.donrett.com](http://www.donrett.com)."

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## FROM THE CHAIR — EVENTS AND INTERESTING DEVELOPMENTS

By *Ellen Lieberman*  
Debevoise & Plimpton LLP

San Diego Meeting. *Rule 701.* We had a sellout crowd at our Committee and subcommittee meetings in conjunction with NASAA's Annual Meeting in San Diego in September 2006. Our Committee meeting began with substantive presentations from California's new Corporations Commissioner, Preston DuFauchard, and Chief Advisor to the Commissioner, Mark Uyeda. With impeccable timing they had provided us only days before with a proposal to revise California's Rule 701 exemption to eliminate many of the nonuniform provisions, and a request for comments relating to the issue of broker-dealer registration for "finders." Mr. Uyeda also attended the meeting of our Subcommittee on Employee Plan and Other Exempt Securities, where there was further discussion, among other issues, of California's Rule 701 proposal.

Subsequent to the meetings, we learned that Mr. Uyeda will be leaving the California Department of Corporations and going to the Securities and Exchange Commission to serve as counsel to Commissioner Paul Atkins. We anticipate, however, that initiatives begun by Commissioner DuFauchard will move forward, and the Committee anticipates submitting a comment letter on the Rule 701 proposal prior to expiration of the comment period on December 18, 2006.

As discussed at the meetings, the Subcommittee on Employee Plan and Other Exempt Securities, which is chaired by Michele A. Kulerman, Hogan & Hartson L.L.P., and Peter Danias, Kaye Scholer LLP, hopes to discuss with NASAA, other states' nonuniform Rule 701 provisions, including, for example, state provisions that do not permit compensatory contracts but only compensatory plans, that do not permit offers and sales to advisors and consultants for noncapital-raising purposes, that do not encompass employees of all majority owned subsidiaries and certain other affiliated or sister entities of the issuer, all as permitted under federal Rule 701.

In addition the Subcommittee on Employee Plan and Other Exempt Securities is concerned that exemptive language in state laws, regulations and orders provide an exemption for the offer and sale of options, warrants and rights for securities listed on the various Nasdaq Stock Market tiers, as Nasdaq switches from a national securities association to a national securities exchange

and additional tiers receive "covered" security status under Section 18 of the Securities Act of 1933, as amended. California has already begun to address this issue, according to California Commissioner DuFauchard. Subsequent to the San Diego meeting, I requested that NASAA's Corporate Finance Section review this question and, if appropriate, urge states to take remedial action.

*Finders.* Commissioner DuFauchard also circulated during the week of our meeting a request for comments regarding actions, if any, that California might take to regulate "finders." On this subject, there is a diversity of opinion within the Committee, the blue sky bar, the regulatory community and industry. The Committee urges individual practitioners and industry groups to submit their own comments to California on this subject, the comment period will end on December 28.

Stimulated by the Report of the Task Force on Private Placement Broker-Dealers, regulators in a number of states are discussing the issue of "finder" regulation.

Michigan, which has regulated finders for decades, requires investment adviser registration of certain finders, which are persons who may engage only in locating, introducing and referring potential buyers or sellers, may not have custody of client funds and must make appropriate disclosure as to compensation.

Texas, effective September 2006, crafted a form of broker-dealer registration (with limited recordkeeping and no examination requirement) for certain finders, who are natural persons who cannot conduct negotiations, engage in due diligence on behalf of potential buyers or sellers, provide advice or have custody of client funds, may act as finder only for accredited investors and must make appropriate disclosure of any conflict of interest and that compensation will be paid.

South Dakota has proposed an exemption for certain finders from the definitions of broker-dealer and agent, for natural persons who locate, introduce and refer persons to an issuer but who cannot conduct negotiations, provide advice or have custody of client funds, must disclose the amount of compensation that will be paid, and cannot be compensated on the basis of the amount of any investment.

Minnesota added a non-uniform provision to its Uniform Securities Act, which will become effective on August 2007, creating a statutory exemption from agent registration for an individual representing one or more

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issuers in exempt transactions who is not subject to “bad boy” disqualifying provisions, does not have custody of client funds and makes an annual filing of a notice and consent to service.

On the federal level, the Private Placement Broker-Dealer Task Force has been drafting proposed federal rules to implement the Task Force proposals and to facilitate discussion with the SEC and the NASD.

Because of the variety of views and because it is obvious that the states amongst themselves and *vis à vis* federal regulators have not yet adopted a uniform approach to this issue, again we urge individual practitioners and industry groups to make their own views known by submitting comments to the California Corporations Commission and/or other appropriate authorities.

*Other Issues.* Just a few other tidbits from the NASAA Meeting that are on the horizon—

NASAA’s Corporate Finance Section continues to be concerned about whether stock exchanges (particularly as they move to become for-profit entities) appropriately police the listing requirements of members.

The SEC is working on the electronic Form D project as well as possible changes to Rule 506 of Regulation D. Included on their radar screen are possible changes to the definition of “accredited investor” as set forth in Rule 501, and a possible definition of “qualified purchaser,” sales to whom would be a category of “covered” security under Section 18(b)(3) of the Securities Act of 1933, as amended.

Our Subcommittee on NSMIA and Limited Offering Exemptions, co-chaired by Mike Liles Jr., Karr Tuttle Campbell, and Kathleen G. Duggan, Cahill Gordon & Reindel LLP, with the assistance of Hugh H. Makens, Warner Norcross & Judd LLP, will examine possible changes to Rule 505 with the hope of resuscitating that exemption and making it into a useful tool. Those who were able to attend the Subcommittee’s meeting in San Diego were in stitches with Hugh’s rendition of the saga of Rule 505 comparing it to Dorothy’s journey in the Land of Oz—with your Committee Chair apparently assigned the role of one of the Good Witches.

Rick A. Fleming, General Counsel to the Kansas Securities Commission, is working on a NASAA project intended to encourage more uniformity among the jurisdictions in no-action letters and interpretive opinions.

California is considering providing for electronic filing of its Rule 701 exemption under Section 25102(o) and gamely accepted and will consider some of the critiques offered on the current electronic filing regime for its limited offering exemption under Rule 25102(f).

Our Subcommittee on International Securities Laws chaired by Ellen M. Creede, Cleary Gottlieb Steen & Hamilton, and Paul G Findlay, Borden Ladner Gervais LLP, may ask NASAA to assist in having its membership adopt exemptions that coordinate with federal Rules 801 and 802. NASAA previously approved, as a 2000 amendment to the Uniform Securities Act of 1956, a transactional exemption from securities registration for the offer or sale of securities which are exempt from registration under Rule 801 or 802 (rights offerings and exchange offers or business combinations for the securities of foreign private issuers).

Susana M. Namnun, Curtis, Mallet-Prevost, Colt & Mosle LLP, working under the guidance of our Subcommittee on Employee Plan and Other Exempt Securities is also starting a research project for the Committee on state merger exemptions.

New Liaisons. We are delighted to welcome to the ranks of Committee leadership Peter J. Anderson of Sutherland Asbill & Brennan LLP who has graciously agreed to serve as our Committee Liaison on Variable Annuity Issues. Peter has also agreed to act as our Committee’s Program Chair for a program to be held in San Francisco next summer at the ABA Annual Meeting focusing on variable annuity regulatory and compliance issues. We anticipate the program will also be cosponsored by other relevant Section of Business Law Committees.

It is worth noting that the Uniform Securities Act (2002) and the 1956 version of the Uniform Securities Act allowed state by state determination as to whether variable annuity contracts issued by insurance companies (which are securities under federal law) should be excluded from the definition of “security.” In most instances, variable annuities are issued by separate accounts of insurance companies, which are federally registered as investment companies, and thus would be “covered securities” under NSMIA and preempted from state securities registration requirements. Defining “security” under state law to include variable annuities, however, would have the effect of making those who sell them subject to broker and agent registration, and the sale subject to state antifraud provisions and state notice filing requirements.

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We are also pleased that Andrew Kandel, First Vice President and Assistant General Counsel, Merrill Lynch, Pierce, Fenner & Smith Incorporated will be our Committee's Liaison to NASAA's Enforcement Trends Project Group, informing us of their activities and speaking on our behalf to members of the Project Group.

We welcome Keith Paul Bishop as our new California liaison. Keith is currently Vice Chair, Legislation, of the Business Law Section of the State Bar of California. He is a Shareholder in the law firm of Buchalter Nemer Fields & Younger, practicing in Orange County. He is a former Commissioner of Corporations of the State of California, and we are delighted to have the benefit of his insights into California law.

Washington, DC Meeting. The next regularly scheduled meeting of the Committee will be held Saturday March 17, 2007 at the Renaissance Washington, DC Hotel 10.30 a.m.-12 noon. Because I am hoping for another sellout crowd, I've asked the ABA to provide us with a bigger room—so I'm hoping to see all of you there. Securities regulators and our Committee liaisons from Washington, D.C. and Virginia will be invited to attend.

The Committee will also be sponsoring a program on Friday, March 16 from 10.30 a.m.-12.30 a.m. on Hot Securities Law Issues for Small Business, and F. Lee Liebolt, Jr., who has recently opened his own law office in the historic Graybar Building in New York, has agreed to serve as Program Chair. The program will be cosponsored by the Committees and Federal Regulation of Securities and Small Business.

San Francisco Meeting. The Committee will meet again in conjunction with the ABA Annual Meeting August 10-14, 2007, in San Francisco, California—details to follow. During the Annual Meeting, the Committee hopes to sponsor with other Section of Business Law Committees two MCLE panels. One program on variable annuity issues will be organized on our Committee's behalf by Peter J. Anderson of Sutherland Asbill & Brennan LLP. A second program that relates to issues unique to doing business in California has a working title of "California Dreamin' - Watch Out for the Speed Bumps!" We will provide additional information when available, and we hope to see you all there.

ABA Committee Luncheon Meeting. The second in our continuing series of luncheon meetings was held in person and by telephone conference call on November 27, 2006, with Joseph P. Borg, President of NASAA and Alabama's Securities Commissioner and Rex Staples,

General Counsel of NASAA, as our guest speakers. Lee Liebolt, who also serves as our Liaison to the NASAA Ombudsman, helped to organize the event. Ben Nager and David Katz of Sidley Austin LLP graciously agreed to host the meeting. The luncheon provided an opportunity for NASAA officials to air concerns involving, *inter alia*, Regulation D enforcement issues, the future of broker-dealer regulation, hedge funds and variable annuities, and for practitioners to put on the table such issues as finder regulation and nonuniform rule 701 exemptions. There were some glitches in the conference call mechanism and apologize to those who were unable to join the discussion. We hope to host more of these periodic luncheon meetings during the year in addition to our regularly scheduled meetings in March, August and September/October in conjunction with the ABA/NASAA meetings.

Committee Comment Letters. Andrew D. Brooks, of Seltzer Caplan McMahon Vitek, with our Subcommittee on Employee Plan and Other Exempt Securities, is working as an ad hoc drafting task force for a Committee comment letter in response to California's Rule 701 proposal. Alan M. Parness of Cadwalader, Wickersham & Taft LLP, working with Judith Fryer of Greenberg Traurig, LLP, has just submitted a Committee comment letter on recent proposals by NASAA's Direct Participation Programs Policy Project Group. Members who would like to participate in drafting comment letters should feel free to contact members of the drafting committees or other Committee leaders.

As a Committee of the ABA Section of Business Law, we are in a position to submit comment letters to agencies of states or the federal government. Although it can be a somewhat cumbersome process, Alan Parness, our Committee's Vice Chair, having jumped through the hoops with our initial letters, should now be well versed in ABA bureaucracy and can guide the rest of us as we tackle new issues. If there are in fact issues on the state or federal level that you believe we should address as a group, let us know and then pitch in and help with the drafting process.

Communicate. The more information you share, the more your colleagues will reciprocate, so we can all know what's happening in the blue sky world. We welcome dialogue and feedback and urge you to also become more active on Committee and subcommittee projects. Share your expertise and interests, and let us know what information would be really helpful to you. Contribute to the listserv, the Blue Sky Bugle, at

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meetings. This is YOUR Committee and we want you (and your firm) to be duly recognized.

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## NASAA'S HOT TOPICS FOR 2007

*By Joseph P. Borg*  
President, NASAA  
Director, Alabama Securities Commission

On the NASAA agenda for the upcoming year, the States are concentrating on the increasing problems in the 506 Reg D arena. Complaints are significantly up and filings by somewhat less than reputable promoters are significant. The issues center on lack of any "gatekeeper" functionality — the States are preempted by NSMIA from any relevant action effectively until after the fraud has been detected (usually by complaint). A review of problem 506 offerings is underway and may result in a sweep to determine the extent of the problem. Details of the issues were recently discussed at the ABA securities committee meeting in New York on November 27th.

The NASAA Broker-Dealer section has published its finding on a recent BD sweep (results are available at [www.NASAA.org](http://www.NASAA.org) (<http://www.nasaa.org/content/Files/BDExams06.ppt>)) where 228 examinations were conducted between May 1, 2006 and June 30, 2006. 85% of the exams involved small branch offices and 15% involved larger offices. Overall, the examinations found 654 deficiencies in five compliance areas. The greatest number of deficiencies (49 percent) identified in the examinations involved books and records, followed by supervision (22 percent), sales practices (16 percent), registration and licensing (7 percent), and operations (6 percent). The three most common deficiencies involved maintenance of customer account information, suitability, and failure to follow written procedures. The three most common books and records deficiencies involved maintenance of customer new account information, seminar advertising and sales literature, and outgoing/incoming correspondence. In the area of supervision, the most common deficiencies concerned the failure to follow written supervisory procedures, internal audits, and written supervisory procedures not maintained as current. The most common deficiencies found in the area of sales practices involved suitability, outside business activity and selling away, and variable product suitability. The top problems in the registration and licensing area involved Form U-4 information, qualifications/licensing and special or heightened supervision. Operational deficiencies include issues

related to sales seminars, handling of money and securities, and commission agreements and statements.

Variable Annuities continue to plague state regulators as complaints from seniors continue to increase. Results of a NASAA survey, measuring senior investment fraud, show that 45 percent of all investor complaints received by state securities regulators come from seniors. In addition, the survey found that one-third of enforcement actions taken by state securities regulators involve senior investment fraud. Not surprising, the threats facing senior investors are more pronounced in states with large retirement populations. In Florida, around 75 percent of all investor complaints are made by seniors. The NASAA survey also found that unregistered securities, variable annuities and equity-indexed annuities are the most pervasive financial product involved in senior investment fraud. In California, 75 percent of the state's senior investment fraud cases involve unregistered securities. Cases involving variable or equity-indexed annuities were 65 percent of the caseload in Massachusetts, 60 percent of the caseload in Hawaii and Mississippi.

The NASAA Direct Participation Programs Policy Project Group (the "Project Group") recently proposed revisions to update and enhance the suitability standards in the NASAA Guidelines for Direct Participation Programs. The focus of the updates and revisions is on three main sections: (1) a revision of the definition of the term Net Worth of the investor to exclude retirement assets, (2) a diversification standard to limit excessive concentrations of an investor's assets in an issuer, and (3) an increase to the net income and net worth amounts.

The Project Group solicited comments regarding the proposed revisions, the official submission period expiring November 27, 2006. NASAA has received a significant number of comments in response to its solicitation and is currently reviewing and categorizing each response in anticipation of a secondary review of the proposed revisions.

NASAA continues to monitor the hedge fund landscape, post-Goldstein. We are actively engaged in dialogue with industry representatives, as well as the Commission, so that we might help shape the future regulatory environment. Some of the particular topics we have been discussing and gathering information on are the content and conduct of field examinations of fund advisors, the adequacy of examiner training, the nature and extent of hedge fund misconduct, modifications to the definition of Accredited Investor, the extent of

“retailization”, and the role of hedge funds as activist shareholders.

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## **NEW FLORIDA INSURANCE AGENCY LAW GIVES FINANCIAL SERVICES INDUSTRY FITS**

*By R. Michael Underwood and Joseph M. Thompson  
Squire, Sanders & Dempsey L.L.P.*

October 1, 2006, was the effective date of a Florida insurance agency law that appears to have caught many national brokerage firms off guard.<sup>1</sup> Enacted in 2005, the new law requires that every business location of an insurance agent licensed in Florida, whether in or out of the state, must be licensed as an “insurance agency” with the Florida Department of Financial Services (“DFS”). Section 626.112(7)(a), Florida Statutes (2006), known as the Agency Act, requires each such business location to apply for and obtain a license or registration from DFS when that location engages in activity that may be performed only by a licensed insurance agent. The Agency Act states:

Effective October 1, 2006, no individual, firm, partnership, corporation, association, or any other entity shall act in its own name or under a trade name, directly or indirectly, as an insurance agency, unless it complies with s. 626.172 with respect to possessing an insurance agency license for each place of business at which it engages in activity which may be performed only by a licensed insurance agent.

“Insurance agency” is defined in § 626.015(8), Florida Statutes (2006) as:

[A] business location at which an individual, firm, partnership, corporation, association, or other entity, other than an employee of the individual, firm, partnership, corporation, association, or other entity and other than an insurer as defined by s. 624.03 or an adjuster as defined by subsection (1), engages in any activity or employs individuals to engage in any activity which by law may be performed only by a licensed insurance agent.

Activities that may be performed only by a licensed insurance agent focus on solicitation of insurance. Section 626.112(1)(b), Florida Statutes (2006) requires a license for an insurance agent to engage in the solicitation of insurance.<sup>2</sup> “Solicitation of insurance” is described as:

[T]he attempt to persuade any person to purchase an insurance product by:

1. Describing the benefits or terms of insurance coverage, including premiums or rates of return;
2. Distributing an invitation to contract to prospective purchasers;
3. Making general or specific recommendations as to insurance products;
4. Completing orders or applications for insurance products;
5. Comparing insurance products, advising as to insurance matters, or interpreting policies or coverages; or
6. Offering or attempting to negotiate on behalf of another person a viatical settlement contract as defined in s. 626.9911.

An exception to the requirement for an agency license, which must be renewed every three years, is provided by the new law for agencies that qualify for a one-time-only “registration.” Section 626.112(7)(a), Florida Statutes (2006) also provides:

Each agency engaged in business in this state before January 1, 2003, which is wholly owned by insurance agents currently licensed and appointed under this chapter, each incorporated agency

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<sup>2</sup> Section 626.112(6), Florida Statutes (2006) delineates one narrow exception:

An individual employed by a life or health insurer as an officer or other salaried representative may solicit and effect contracts of life insurance or annuities or of health insurance, without being licensed as an agent, when and only when he or she is accompanied by and solicits for and on the behalf of a licensed and appointed agent.

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<sup>1</sup> See “New Florida Licensing Law Challenges Insurance Industry,” [InvestmentNews.com](http://InvestmentNews.com), October 9, 2006.

whose voting shares are traded on a securities exchange, and each agency whose primary function is offering insurance as a service or member benefit to members of a nonprofit corporation may file an application for registration in lieu of licensure in accordance with s. 626.172(3).

The impetus for passing the Agency Act seems to have come from language in the Gramm-Leach-Bliley Financial Services Modernization Act of 1999,<sup>3</sup> which encourages states either to adopt model rules with regard to insurance agent and agency licensing or face the possibility of federal control of those processes. A second justification for the Agency Act was the view that Florida was unique among states in not requiring insurance agencies to be licensed. Problems had reportedly arisen because Florida-based agencies could not avail themselves of licensing reciprocity with other states, since Florida-based agencies could not produce a certified copy of an agency license to other states' regulators. Justification for licensing an agent's physical location instead of the agent's employer seems to have been DFS' fear that an agent's license might be leveraged to operate multiple insurance offices.

The practical effect of the Agency Act as now written is that for most businesses a license must be obtained for each physical location of that business from which insurance products are offered or sold to Florida residents.<sup>4</sup> The license requirement applies to the home of an insurance agent, if the agent's home is a location where activity occurs that only a licensed agent may perform, such as solicitation of insurance.<sup>5</sup> Out-of-state business locations that conduct any activity that only a Florida-licensed insurance agent may perform must also be licensed or registered.<sup>6</sup> A maximum fine of \$10,000

may be imposed against each "agency" that fails to file for licensure or registration.<sup>7</sup> The application process must be conducted online through the DFS website ([www.fldfs.com](http://www.fldfs.com)).<sup>8</sup>

While there is no application or license fee associated with the application for agency licensure or registration, a fingerprint-processing fee of \$64<sup>9</sup> is required to accompany the application for licensure. Fingerprints are not required from agencies that qualify for registration. The fee must be submitted along with fingerprints for each of the persons listed in § 627.172(2)(f), Florida Statutes (2006).<sup>10</sup> This fingerprint

only be performed by a licensed insurance agent, the business location must comply with the Agency Act).

<sup>7</sup> See § 626.112(7)(a)1., Fla. Stat. (2006). A business location that is eligible for registration but fails to file the pertinent application may be subject to a maximum fine of \$5,000. See *id.* at subsection 7(a)2. See also *2005 Legislative Changes* at 11 (stating that "[e]ach place of business where an individual engages in any activity that may be performed only by a licensed insurance agent must be registered or licensed," and noting imposition of maximum fine of \$10,000.00 for failure to obtain license). Subsection (9) of § 626.112 provides that:

Any person who knowingly transacts insurance or otherwise engages in insurance activities in this state without a license in violation of this section commits a felony of the third degree, punishable as provided in s. 775.082, s. 775.083, or s. 775.084.

A possible interpretation of subsection (9) is that one or more individuals associated with a business location that conducts activity only a licensed insurance agent may perform is subject to criminal liability for failing to secure a license or registration for the business location. The Agency Act does not authorize a civil cause of action for rescission of an insurance contract processed by an unlicensed insurance agency, nor does it specifically authorize any civil cause of action by an individual or class.

<sup>8</sup> See *2005 Legislative Changes* at 10.

<sup>9</sup> See Fla. Admin. Code R. 69B-211.005(1)(a).

<sup>10</sup> The statute requires fingerprints to be submitted from each of the following, with respect to a business location that is defined as an agency:

1. A sole proprietor;
  2. Each partner;
  3. Each owner of an unincorporated agency;
  4. Each owner who directs or participates in the management or control of an incorporated agency whose shares are not traded on a securities exchange;
  5. The president, senior vice presidents, treasurer, secretary, and directors of the agency;
- and

<sup>3</sup> 15 U.S.C. § 6801 et seq.

<sup>4</sup> See "Important Information Regarding the New Insurance Agency Licensing Law in Florida," Florida Department of Financial Services website ([www.fldfs.com](http://www.fldfs.com)), (stating that "Every agency location must be licensed or registered with the department. You may not obtain one license in order to cover multiple agency locations.") DFS has not issued formal administrative rules to implement the Agency Act.

<sup>5</sup> See *2005 Legislative Changes for CS for CS for SB 1912 Relating to Agent and Agency Licensing/Registration*, Florida Department of Financial Services, Division of Agent and Agency Services, at 11 (stating that an "insurance agent [who] sells insurance from his/her home" is required to obtain an agency license (or registration, if pertinent)). The language of subsections (1)(b) and (7)(a) of § 626.112 also supports this conclusion.

<sup>6</sup> See *2005 Legislative Changes* at 10 (noting that if a business location outside of Florida engages in activity in Florida that may

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requirement could be quite financially and logistically burdensome on major corporations with anyone in corporate headquarters or elsewhere who “directs or participates in the management or control of the agency, whether through the ownership of voting securities, by contract, or otherwise.” § 627.172(2)(f)6., Fla. Stat. (2006). The literal language of this subsection could be construed to require the repeated submission of fingerprints and the \$64 fee for each person enumerated in the statute for each and every “agency” operated by the company. DFS is construing the fingerprint requirement, however, in a “relaxed way.” For instance, although all officers and directors, including “senior vice presidents,” are required to submit fingerprint cards by § 626.172(2)(f), Fla. Stat. (2006), only those corporate officials, other than the President, Secretary and Treasurer, who direct or participate in the management or control of a specific agency are being required to submit fingerprints and no one is required to submit fingerprints more than once.<sup>11</sup> Fortunately, any individual described in § 627.172(2)(f) who is “also licensed and appointed as an insurance agent at the time the agency application is submitted is exempt from the requirement to file fingerprints.”<sup>12</sup>

The option in the Agency Act that allows for registration instead of licensure when the agency’s voting shares are traded on a securities exchange appears to be a glitch. As written, it encompasses the very narrow situation in which a business location is incorporated and engages in insurance-related activity as referenced above by §§ 626.015(8) and 626.112(1)(b) of the Florida Statutes, and its voting shares are traded on a securities exchange. For this registration option to be available, it is the shares of the specific business location that must be traded on a securities exchange. It is not enough to qualify for registration if a business location is operated by a subsidiary of a publicly traded company or if it markets the insurance products of another corporation whose shares are traded on a securities exchange.<sup>13</sup>

Each business location that is subject to licensure must list on the licensure application “[t]he name of each

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6. Any other person who directs or participates in the management or control of the agency, whether through the ownership of voting securities, by contract, or otherwise.

§ 626.172(2)(f), Fla. Stat. (2006).

<sup>11</sup> “Agency Licensing & Registration Frequently Asked Questions (“FAQ”)” at Question 37, [www.fldfs.com](http://www.fldfs.com), Oct. 13, 2006.

<sup>12</sup> FAQ at Question 36.

<sup>13</sup> FAQ at Question 4.

agent to be in full-time charge of an agency office and specification of which office.” § 626.172(2)(3), Fla. Stat. (2006). The Agent in Charge must be licensed and appointed in Florida and may be in charge of only one business location.<sup>14</sup> Identification of an Agent in Charge has caused many logistical and personnel concerns for businesses that sell annuities and other insurance products to Florida residents. The practice of many bank brokerage and insurance subsidiaries of having a single agent work from a circuit of multiple locations is impossible under the new law unless the business has the same number of locations and Florida-licensed insurance agents. Because working from an agent’s home requires that location be licensed, no agent can be Agent in Charge for both a home and business office. Moreover, in the case of broker-dealers, the Agent in Charge requirement may do violence to a firm’s supervisory structure unless the branch manager happens to be a Florida-licensed and appointed agent who does not conduct insurance activity from home or another business location. DFS has stated that the Agent in Charge need not be “an officer or director of the agency.”<sup>15</sup> In fact, DFS has stated that an Agent in Charge need not be “in charge” of anything.<sup>16</sup> In the absence of formal administrative rules on the subject of the Agent in Charge, however, the ultimate impact of the statute cannot be known.

Privately, DFS legal staff does not feel it has authority from the Florida Legislature to construe the Agency Act by rule. In a statement issued on the eve of the October 1 deadline, DFS stated that while it did not have authority to delay the effective date of the new law, it would exercise its discretion to “forego the imposition of administrative fines until November 1, 2006.”<sup>17</sup> This action appears to have been necessitated by the huge

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<sup>14</sup> See “Important Information,” *supra* (stating (with emphasis in original): EVERY LOCATION MUST HAVE A LICENSED AND APPOINTED AGENT IN FULL-TIME CHARGE OF THAT AGENCY. An agent MAY NOT be the Agent in Charge of multiple locations at the same time.); see also *2005 Legislative Changes* at 11 (noting that the former statutory requirement to file “primary agent” form has been repealed, listing the requirement for identification of an Agent in Charge, and stating that “[t]he full-time agent may not be in charge of more than one location”). DFS has relaxed this requirement only where two agencies share the same location such as where separate agencies are set up at the same location to sell life and casualty insurance. FAQ at Question 25.

<sup>15</sup> *2005 Legislative Changes* at 11.

<sup>16</sup> FAQ at Question 24.

<sup>17</sup> “Informational Notice Concerning Insurance Agency Licensing and Registration,” Florida Department of Financial Services website ([www.fldfs.com](http://www.fldfs.com)), Sept. 29, 2006.

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volume of traffic into the online application process and call center, which caused the DFS website to fail. A future session of the Florida Legislature is certainly going to have to revisit Florida's insurance agency licensing program. While repeal may be most desirable to the industry, revision to bring Florida's requirements more in line with other states or at least authorize rulemaking would be a great improvement.

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## FROM THE OTHER SIDE OF THE DESK

*By Sue Noble, Paralegal Specialist — Blue Sky/Securities  
Bingham McCutchen LLP*

*From ghoulies and ghosties  
And long-leggedy beasties  
And things that go bump in the night,  
Good Lord, deliver us!  
— Old Scottish Prayer*

The Halloween publication deadline for this issue of the Bugle gives rise to all sorts of dire thoughts, beginning with ghoulies, ghosties, long-leggedy beasties and things that go bump in the night. One need not be of Scottish descent to wish deliverance from these terrors, and one need not be a member of the bar to be frightened by them. Being a blue sky practitioner of any stripe is quite sufficient. As a blue sky paraprofessional, I have conjured up my own pet list of scary things, all of which have no doubt already haunted readers of the Blue Sky Bugle. Here are a few, with some suggested penalties (sorry, no treats for these tricks):

*What do you mean, when was the first sale? We haven't closed the transaction yet.*

This one goes bump in the night. Or even several nights. It may be an arguable (even reasonable) position, but Release 33-6455 says the first sale occurs on the earlier of receipt of a subscription agreement or the receipt of money, even when the funds are being put into escrow. It's my job to tell you that, and your job, as a member of the bar, to decide what position is appropriate for your client in your particular circumstances. Should you turn out to be wrong, your penalty is to write a memo to the file (and perhaps a supervising partner) on why timely filings were not made.

*This hedge fund is an institutional buyer (the original long-leggedy beastie).*

Well, maybe. It depends on what state you're talking about. You can breathe a sigh of relief for those jurisdictions that include all accredited investors in the list of institutions (if you have a hedge fund that's not accredited, you are likely to have all sorts of other problems), but what, on the other hand, are you going to do about Virginia? Or a QIB in a state which doesn't include QIBs in the institutional investor definition? If you are wrong, well, that may be more than a bump in the night. The appropriate penalty is six months' hard service as a trainee for an undisputedly institutional investor, such as a bank or an insurance company.

*It's a tax-compliant employee benefit plan, how can there be any securities issues?*

Probably first and foremost because the plan is offering and selling securities, and there is no universal exemption for such transactions. Then you're going to have to establish that in all the states where employees live, local exemption(s) are satisfied. And if you want to combine exemptions, relying partly on de minimis exemptions, partly on Rule 701 and partly on Rule 506, you had better be sure that you calculate Rule 506 compliance and Rule 701 limitations correctly. Any uncertainty requires a careful re-analysis of Ralston Purina, as well as a minutely detailed study of Google's problems. An error could haunt you for years to come. It's a VERY long-leggedy beastie.

*But we've always done it this way.*

This one is a ghoulie when asserted by a regulator, and the result of a ghostie when espoused by a practitioner. It makes one's heart go bump in the night, although I'm not at all certain that internal bumps are what the original Scottish prayer is concerned with. On the regulatory side, it results in efforts to impose requirements in excess of those permitted by NSMIA for Rule 506 transactions, causing excessive time to be spent on otherwise straightforward filings. On the practitioner side, it often results in voluntary compliance with requirements in excess of those permitted by NSMIA, sometimes with truly bewildering results, such as checking off no ULOE disqualifications on the Appendix to Form D. Or filing a Form M-11 when a Form 99 would do (or, in the view of a number of respectable practitioners, making no New York filing at all for Rule 506 or 4(2) transactions). Regardless of whether an offender is a regulator or a practitioner, the appropriate penalty for this trick is for the offender to

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write a plain English treatise, not exceeding 10 pages in length in at least 12-point type, on the legislative history and impact of NSMIA.

*There's a filing requirement? Doesn't NSMIA cover everything?*

Ghoulish snarl. Ghost of Christmas past. NSMIA has long legs, but they aren't THAT long! They will not enable you to stride past state filing requirements for Rule 506 transactions, and they don't confer covered security status on securities sold in Rule 504, Rule 505 (speaking of ghosties), or Rule 701 transactions. What's that you say? Your client is traded on the OTCBB and is a reporting company? Its securities may be covered for purposes of secondary trading but not for purposes of any non-Rule 506 issuer transaction. If you find the distinctions tricky, just try treating yourself to, say, all of the research and blue sky work for a 50-state registration by coordination.

*We can combine this isolated sale exemption and the benefit plan exemption in order to avoid a filing in this state.*

You know what? That associate was right, despite my insistence that there simply weren't any self-executing exemptions in the jurisdiction in question. Now that's a truly SCARY thought. Exorcism, anyone?

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## **FLORIDA SUPREME COURT HOLDS THAT ARBITRATORS, NOT COURTS, DECIDE STATUTE OF LIMITATIONS QUESTIONS**

*By Donald Rett*  
Law Office of Donald Rett

In this October, 2006, decision, the Florida Supreme Court had been called upon to resolve a conflict between Florida's Fifth District Court of Appeals ("DCA") and the Fourth DCA.

The conflict issue was whether under the Florida Arbitration Code, a statute of limitations defense is subject to arbitration when the arbitration agreement provides that claims, disputes or other matters arising out of or relating to are to be decided by arbitration, but also provides that a demand for arbitration cannot be made when institution of legal or equitable proceedings

based on the underlying claim would be barred by the applicable statute of limitations.

The Florida Supreme Court held that under the Florida Arbitration Code, a broad agreement to arbitrate (such as they found present in the instant case) includes the determination of the statute of limitation defenses. O'Keefe Architects, Inc. v. CED Construction Partners, Ltd. et al. #SC05-1417, October 19, 2006.

Members of the Florida Bar have noted that this decision is most likely inapplicable to securities arbitration matters if "interstate commerce" is present, citing Wachovia Securities LLC v. Vogel, 918 So.2d 1104, 1007 (FL 2nd D.C.A.) 2006.

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## **EDITORIAL**

*By Martin A. Hewitt*  
Cadwalader, Wickersham & Taft LLP

Recently, Alan M. Parness, as Vice Chair of the ABA Committee on State Regulation of Securities (the "Committee"), prepared a draft comment letter (the "Letter") on behalf of the Committee in response to a Notice of Request for Public Comments by the North American Securities Administrators Association Direct Participation Programs Policy Project Group (the "NASAA DPP Group"), relating to proposed revisions to certain of NASAA's Direct Participation Programs Guidelines and Statements of Policy (the "Request for Comment"). The Letter was submitted for approval by the Business Law Section's officers. Unfortunately the Committee's request to provide comments to the NASAA DPP Group was denied due to a policy of the ABA Board of Governors that the ABA only has the authority to submit technical comments to federal and state agencies (e.g., the SEC, PCAOB and individual state securities regulatory agencies, but not NASAA, the NASD or any other self-regulatory organization). In anticipation of this response, Alan stated in his cover email to the Section's officers that "[w]hile NASAA is technically not a governmental agency itself, it operates in a quasi-governmental" capacity by "representing its member agencies before Congress, state legislatures, the SEC, other federal and state administrative agencies, and federal and state courts." It is worth noting that NASAA's membership consists solely of governmental agencies and its statements of policy and guidelines are often adopted by its member agencies as written. Often times such statements of policy and guidelines are adopted informally, without any rulemaking procedures or separate public notice or opportunity to comment on

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the individual state level (purportedly in the interest of uniformity).

The ABA's position raises several important policy and practical issues. First, the Request for Comment comes from the NASAA DPP Group, not the 50 states, the District of Columbia, Puerto Rico and the Virgin Islands. Query for the ABA, how does one respond to a comment letter but by responding to those requesting comment? Second, while the ABA continually strives to make the legal community at large more involved in ABA matters, it also creates unnecessary hurdles which undermine the goal of encouraging more activist attorneys – why? Third, the ABA's decision regarding the Letter reflects a rigidity of thinking that is clearly inefficient. If one were to follow the logic of the ABA, the Committee would have to wait and submit letters to each of the 53 NASAA member agencies at considerable time and expense, in order to reach the same audience which can be reached in one letter to the NASAA DPP Group, which is comprised of the individuals who actually drafted the Request for Comment and are charged with shepherding their proposals through NASAA. Fourth, why would the ABA take a position that benefits no one? Only one thing is accomplished by the ABA's refusal to permit the Committee to submit a comment

letter directly to the NASAA DPP Group – the effective blocking of the most efficient avenue of communication between regulators and practitioners. Fifth, what is the policy argument for the ABA's decision? This may be the most important point I can make in this editorial. What ABA policy could possibly exist that would explain a rush to inefficiency and a denial of the Committee's ability to effectively communicate? I can see no justification to impose form over substance, especially when both parties – the Committee and the NASAA DPP Group – are particularly well positioned to engage in a meaningful dialogue that could result in effectively updating statements of policy and guidelines (and possibly preventing NASAA from adopting inappropriate revisions before the individual states consider the proposals).

While there is not enough time for the ABA to reconsider its position before the deadline for the Request For Comment, it is my hope that the ABA will take from this experience the understanding that it is unwise to prohibit those with the most experience on both the practitioner's and regulators side to engage in open and efficient discussions whenever such opportunities arise.

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