

REVISIONS TO IOWA SECURITIES LAW

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*The views expressed in this outline and speech are my personal views and do not necessarily represent the official policy or positions of the Iowa Securities Bureau, or any other person or part of the Executive Branch.

I. Overview of Iowa Securities Regulation

A. History

The Iowa securities statute is known as the Iowa Uniform Securities Act, and may be found at Chapter 502 of the Iowa Code. The securities laws in Iowa are more than 80 years old, adopted as part of a large wave of populist legislation. The state laws became popularly known as Blue Sky Laws, since their purpose was to protect the public from fraudulent sales of securities involving "speculative schemes which have no more basis than so many feet of blue sky." Hall v. Geiger-Jones Co., 242 U.S. 53g (1917) (Upholding the constitutionality of the Ohio Act).

The purposes of securities laws are generally described as to provide investor protection, to preserve the integrity of the capital formation system, and to secure a climate where legitimate business can raise capital. As stated by the Iowa Supreme Court in Lolkus v. VanderWilt, 141N.W.2d 600 (1966), "It]he suppression of fraudulent practices and the protection of the public from their own gullibility are commonly accepted as the primary purposes of Blue Sky Laws." Overall, the Main Street retail investor is the primary customer for state securities agencies.

The question you may have is: Why do we need or want to protect investors in this manner? Unlike cattle, cars, or corn, securities are intangibles. Their value is dependent on the underlying business. An investor needs information about the business in order to make an informed decision on whether to purchase a security or not. Securities laws and regulation assure that flow of information. Securities laws change the standard of *caveat emptor* and place a duty of full disclosure onto the sellers of the securities. See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963). In debating the proposed federal securities statute, Representative Sam Rayburn put it succinctly:

The purpose of this bill is to place the owners of securities on a Parity, so far as is possible, with management of the corporations, And to place the buyer on the same plane so far as available' Information is concerned, with the seller.
77 Cong. Rec. 2918 (1933)

The applications of any securities act, and the resulting requirements, are all dependent upon whether a person is selling a "security". Stocks and bonds are easily identified as securities, but the important catchall is an "investment contract", that is, an investment of money in a common enterprise with profits to come solely from the efforts of others. They have included such diverse things as the sale of general partnership interests, earthworm marketing contracts, and the sale of silver invoices evidencing indebtedness with a repurchase guarantee. Substance will always control over form. The courts, and enforcement agencies,

construe the statute broadly so as to protect investors. In Midwest Management Corp. v. Stephens, 291N.W.2d 896 (Iowa 1980), the Court stated [T]hose laws should be liberally construed to effectuate their purpose. [citations omitted].

B. Securities Bureau Responsibilities

The responsibility for administering the Iowa Uniform Securities Act is vested in the Securities Bureau, which is headed by an administrator who is responsible to the Commissioner of Insurance. The current law grants the Commissioner of Insurance broad powers over the issuance and sale of securities in the state. That law is substantially equivalent to the Uniform Securities Act (1956), which is in effect in more than 35 states.

The Securities Bureau is divided into units. The Licensing Unit regulates brokerage firms, agents, investment advisers, and investment adviser reps. Through careful licensing and on-site audits, we protect investors from overreaching sales practices to outright fraud. Our close proximity to firms and investors allows us to be local cops on the beat. Agents and IA reps undergo an extensive registration review process. The Iowa staff closely reviews each applicant's disciplinary history so that persons with an egregious disciplinary history are not licensed, sometimes as a result of agency prosecuted administrative hearings to revoke or deny a license. The licensing scheme requires passage of exams (including a new competence exam for IA reps), sets standards for licensure, imposes record keeping and supervisory requirements and prohibits unethical business practices. The licensure of firms and individuals is handled electronically through one-stop national system. It can be characterized as a preventive device as compared to enforcement actions, which operate after a violation has occurred. We have an audit program that focuses on independent contractors and local branch offices of larger firms, and state-only licensed investment advisers. Close scrutiny is made for sales practice violations.

The Corporate Finance Unit is responsible for review of securities registration files, exemption questions, and most public inquiries. We primarily review regional and local offerings, checking to ensure that full disclosure is made, as well as compliance with certain substantive standards. We use the Small Company Offering Registration (SCOR) form, an intuitive, fill-in-the-blank form used by entrepreneurs to make required disclosures to investors. We participate in interstate use of the form as part of a Midwest Region, as well as working within the Coordinated Equity Review program designed to streamline the registration process for larger offerings. However, most of the capital raised in Iowa each year involves securities sold pursuant to one of several exemptions from registration, primarily the limited offering exemption. We provide small business assistance by counseling entrepreneurs and their counsel regarding the limited offering exemption and SCOR program.

Enforcement against fraud is a primary component of securities regulation. Recently, the Commissioner of Insurance merged the securities enforcement unit with the Division Consumer Affairs Bureau in order to increase the cooperation and consistency of these areas. The Securities Unit investigates complaints and has broad enforcement powers, including the ability to issue subpoenas, compel testimony, issue cease and desist orders, as well develop and assist in civil injunctive and criminal cases. State regulators are closest to the investing public and thus can identify new investment scams quickly, bring a large number of enforcement cases covering a wide variety of investment-related violations, and work closely with various law enforcement agencies and prosecutors. We historically have opened 100's of cases each year. Our assistance runs the gamut from explaining how to complain to your broker and firm, looking into problems about account transfers, to filing injunctions and seeking restitution of investor funds from fraudulent operators. The primary goal however, is to police the industry, not to get money back for consumers, although that sometimes occurs as a result of settlements or civil litigation.

Investor education has become an increasingly critical function of state securities regulation. State regulators can serve as a source of objective information to our nation of shareholders. Since we all too often see the consequences of financial illiteracy, we are increasing advocacy for investor education. More directly, we provide written materials, issue warnings about current frauds and abuses, post information on our website, and have participated in packaged training of teachers through the Financial Literacy 2010 program.

The Regulated Industries Unit administers several statutes, the foremost of which deals with prearranged funeral plans and perpetual care cemeteries. This includes annual filing requirements, audits, complaint investigation, and enforcement, including receiverships. In the motor vehicle service contracts and residential service contacts areas, we take complaints, seek consumer solutions or refunds, and take enforcement actions.

II. Uniform Securities Act 2002 Overview

A. National Conference of Commissioners on Uniform State Laws process

The National Conference of Commissioners on Uniform State Laws worked four years to develop the new act. All major interest groups were represented as observers and commentators at the numerous drafting meetings. As a result, all major groups have endorsed the act:

- American Bar Association (ABA)
- ABA Business Law and Litigation Sections
- Investment Counsel Association of America (ICAA)

- National Association of Securities Dealers (NASD)
- New York Stock Exchange (NYSE)
- North American Securities Administrators Association (NASAA)
- Securities Industry Association (SIA)
- Certified Financial Planner Board of Standards

B. Progress to date

ENACTMENTS

- Missouri HB 380 (Bartle) SB 427 (Byrd) – Enacted 2003
- Oklahoma SB 724 (Cain) - Enacted 2003
- South Dakota – Enacted 2004
- Idaho – Enacted 2004
- Iowa – Enacted 2004
- Kansas - Enacted 2004

PENDING 2004

- U.S. Virgin Islands : Introduced as 25-0059 in 2003-04 - Passed Finance Committee
- Michigan: Introduced as HB 5746 - House Commerce

III. Iowa Process

A. ISBA Securities Regulation Committee

Under the leadership of NCCUSL Commissioner David Walker (also Chair of the Bar's Business Section), the Securities Regulation Committee thoroughly reviewed the USA (2002), comparing it with the current Iowa Act. The Committee met roughly 12 times during 2003, and agreed to retain several provisions in current Iowa law.

Virtually all of the recommended changes to the USA (2002) involved a decision to retain provisions from the current Iowa Uniform Securities Act, Chapter 502, Code of Iowa (hereinafter "IUSA"). What follows is a highlight of the substantive differences from the USA (2002). The Bar recommended version retained the

current IUSA fee structure and amounts, as well as the current amounts for civil penalties. One of the more prominent additions was the decision to retain the takeover sections from the current IUSA. This is a second generation takeover law that was originally drafted by the Iowa Bar, and integrated into the IUSA. In the adopted version, these provisions are found in Article 3A, sections 502.321A through 321I, plus fraudulent activities at §502.506A, and civil liability at §502.509(13B).

Additional changes to the USA (2002) include:

- §102(2A) – defines “agricultural cooperative association.
- §102(28) – adds to the definition of “security” as (C)(2) an exclusion for certain tax credits; adds as (E) current IUSA language regarding LLCs and LLPs that creates a rebuttable presumption they are securities; adds as (F) the term “viatical settlement investment contracts”, plus defines the term at §102(32), defines its “issuer” at §102(17(D), and adds an exemption for some of these at §201(14).
- §201(8A) &(8B) – keeps the current IUSA exemptions for cooperatives.
- §201(10) - keeps the current IUSA exemption chapter 496B corporations (economic development corporations).
- §201(11) - keeps the current IUSA exemption for the agricultural development authority.
- §201(12) - keeps the current IUSA exemption for membership campgrounds.
- §201(13) - keeps the current IUSA exemption fro time-shares filed under §557A.2.
- §202(13)(C) - keeps current IUSA explicit rulemaking authority to expand the institutional investor exemption to individuals.
- §202(14) – expands to 35 the number of purchasers in a limited offering exemption.
- §304(b)(19) – adds to registration by qualification the current IUSA ability to examine the business.
- §304A – retains current IUSA section for expedited registration by filing of small issuers.
- §306(a)(7) – adds current IUSA “financial condition of the issuer” as a review standard.
- §306(8) – adds current IUSA language regarding abandoned registrations.
- §409 – adds current IUSA regarding abandoned license applications.
- §412(f) – adds current IUSA language making §17A.18A inapplicable (public health, etc. standard for summary action vs. USA “for the protection of investors”.
- §501A – keeps current IUSA section that creates as a prohibited transaction sales by BDs and agents using manipulative devices or who make unsuitable recommendations.

- §504(c) - retains current IUSA section authorizing rules to bar false advertising.
- §509(g)(3) - retains current IUSA provision for aiding and abetting civil liability for all persons.
- §601(a) – inserts current administrative provisions.
- §601(e) – adds a \$200,000 cap on the investor education fund.
- §604A - retains current IUSA section that provides limited law enforcement authority for information sharing purposes.
- §607(b)(6) – modifies the expungement language.

B. 2004 General Assembly – HR 2557

HF 2557 passed both chambers unanimously. It was signed by the Governor, and will become effective January 1, 2005.

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The bill may be found at:

<http://coolice.legis.state.ia.us/Cool-ICE/default.asp?Category=billinfo&Service=Billbook&hbill=HF2557>

IV. Key Provisions

The drafting committee for the uniform commissioners made a decision early in their process to recommend a new act that would be revenue neutral. The act does not suggest any fee amounts, but rather places these in brackets to be filled in by each state considering the act. The draft submitted (after review by the Bar's Securities Committee), and as adopted, retained the fee structure and amounts that are currently in Chapter 502. As such, the annual revenues can expect to stay at roughly \$9 million.

Securities registration fees remain at .1% of the proposed sales price, with a minimum of \$50 and a maximum of \$1,000; §502.305(2). Investment company notice filers for indefinite amounts pay fees of the current amount of \$1,000. Fixed fee filers also keep the same fee structure, paying an initial \$250, and an additional amount based on either sales if they don't file sales reports, a flat \$1,250; §502.302(1)(a). Licensed persons retain the same fees, set at \$30 for individuals (agents or investment adviser representatives) and for firms, amounts of \$200 for broker-dealers and \$100 for investment advisers; §502.410. One minor change is that fees for federal private placements (\$100) are now set in the statute, whereas in the past these have been set by rule; §502.302(3).

The criminal penalties were copied from the current act as well. A willful violation of the act is a class "D" felony. However, if the violation involves fraud and results in a loss of more than \$10,000, it becomes a class "C" felony. The formal

Fiscal Note states that "House file 2409 will have no significant correctional impact."

There are several references to civil penalties, but they all keep the current thresholds of a maximum of \$5,000 for a single violation or \$500,000 for more than one violation. Civil penalties may be assessed to licensees for certain misconduct [§502.412(3)], by a court for failure to comply with a subpoena [§502.602(3)], by a court as part of an injunctive action [§502.603(2)(b)(3)], and as part of an administrative cease and desist action [§502.604(4)]. Civil penalties are directed to an Investor Education Fund, a change from the current act; §502.601(5). The Fund is capped at \$200,000. In a typical year, the amount of civil penalties is less than \$50,000, or .5%.

Additionally, the proposed new law does not result in any changes in FTEs or staffing.

502.102(4). "**Broker-dealer**" means a person engaged in the business of effecting transactions in securities for the account of others or for the person's own account. The term does not include any of the following:

- a. An agent.
- b. An issuer.
- c. A bank or savings institution if its activities as a broker-dealer are limited to those specified in section 3(a)(4)(B)(i) through (vi), section 3(a)(4)(B)(vii) if the offer and sale of private securities offerings are limited to nonconsumer transactions that are not primarily for personal, family, or household purposes, section 3(a)(4)(B)(viii) through (x), or section 3(a)(4)(B)(xi) if limited to unsolicited transactions all as provided in the Securities Exchange Act of 1934, 15 U.S.C. } 78c(a)(4); in section 3(a)(5)(B), and 3(a)(5)(C) of the Securities Exchange Act of 1934, 15 U.S.C. } 78c(a)(4) and (5); or a bank that satisfies the conditions described in section 3(a)(4)(E) of the Securities Exchange Act of 1934, 15 U.S.C. } 78c(a)(4).
- d. An international banking institution.
- e. A person excluded by rule adopted or order issued under this chapter.

502.102(11). "**Institutional investor**" means any of the following, whether acting for itself or for others in a fiduciary capacity:

- a. A depository institution or international banking institution.
- b. An insurance company.
- c. A separate account of an insurance company.
- d. An investment company as defined in the Investment Company Act of 1940.
- e. A broker-dealer registered under the Securities Exchange Act of 1934.
- f. An employee pension, profit-sharing, or benefit plan if the plan has total assets in excess of five million dollars or its investment decisions are made by a named fiduciary, as defined in the Employee Retirement Income Security Act of 1974,

that is a broker-dealer registered under the Securities Exchange Act of 1934, an investment adviser registered or exempt from registration under the Investment Advisers Act of 1940, an investment adviser registered under this chapter, a depository institution, or an insurance company.

g. A plan established and maintained by a state, a political subdivision of a state, or an agency or instrumentality of a state or a political subdivision of a state for the benefit of its employees, if the plan has total assets in excess of five million dollars or its investment decisions are made by a duly designated public official or by a named fiduciary, as defined in the Employee Retirement Income Security Act of 1974, that is a broker-dealer registered under the Securities Exchange Act of 1934, an investment adviser registered or exempt from registration under the Investment Advisers Act of 1940, an investment adviser registered under this chapter, a depository institution, or an insurance company.

h. A trust, if it has total assets in excess of five million dollars, its trustee is a depository institution, and its participants are exclusively plans of the types identified in paragraph "f" or "g", regardless of the size of their assets, except a trust that includes as participants self-directed individual retirement accounts or similar self-directed plans.

i. An organization described in section 501(c)(3) of the Internal Revenue Code, 26 U.S.C. } 501(c)(3), corporation, Massachusetts trust or similar business trust, limited liability company, or partnership, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of five million dollars.

j. A small business investment company licensed by the small business administration under section 301(c) of the Small Business Investment Act of 1958, 15 U.S.C. } 681(c), with total assets in excess of five million dollars.

k. A private business development company as defined in section 202(a)(22) of the Investment Advisers Act of 1940, 15 U.S.C. } 80b-2(a)(22), with total assets in excess of five million dollars.

l. A federal covered investment adviser acting for its own account.

m. A "qualified institutional buyer" as defined in Rule 144A(a)(1), other than Rule 144A(a)(1)(i)(H), adopted by the securities and exchange commission under the Securities Act of 1933, 17 C.F.R. } 230.144A.

n. A "major U.S. institutional investor" as defined in Rule 15a-6(b)(4)(i) adopted by the securities and exchange commission under the Securities Exchange Act of 1934, 17 C.F.R. } 240.15a-6.

o. Any other person, other than an individual, of institutional character with total assets in excess of five million dollars not organized for the specific purpose of evading this chapter.

p. Any other person specified by rule adopted or order issued under this chapter.

502.102(15). **"Investment adviser"** means a person that, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or the advisability of investing in, purchasing, or selling securities or that, for compensation and as a part of a regular business, issues or promulgates analyses or reports concerning

securities. The term includes a financial planner or other person that, as an integral component of other financially related services, provides investment advice to others for compensation as part of a business or that holds itself out as providing investment advice to others for compensation. The term does not include any of the following:

- a. An investment adviser representative.
- b. A lawyer, accountant, engineer, or teacher whose performance of investment advice is solely incidental to the practice of the person's profession.
- c. A broker-dealer or its agents whose performance of investment advice is solely incidental to the conduct of business as a broker-dealer and who does not receive special compensation for the investment advice.
- d. A publisher of a bona fide newspaper, news magazine, or business or financial publication of general and regular circulation.
- e. A federal covered investment adviser.
- f. A bank or savings institution.
- g. Any other person that is excluded by the Investment Advisers Act of 1940 from the definition of investment adviser.
- h. Any other person excluded by rule adopted or order issued under this chapter.

502.102(28). **"Security"** means a note; stock; treasury stock; security future; bond; debenture; evidence of indebtedness; certificate of interest or participation in a profit-sharing agreement; collateral trust certificate; preorganization certificate or subscription; transferable share; investment contract; voting trust certificate; certificate of deposit for a security; fractional undivided interest in oil, gas, or other mineral rights; put, call, straddle, option, or privilege on a security, certificate of deposit, or group or index of securities, including an interest therein or based on the value thereof; put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency; or, in general, an interest or instrument commonly known as a "security"; or a certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. All of the following shall apply to the term:

- a. It includes both a certificated and an uncertificated security.
- b. It does not include an insurance or endowment policy or annuity contract under which an insurance company promises to pay a fixed or variable sum of money either in a lump sum or periodically for life or other specified period.
- c. It does not include any of the following:
 - (1) An interest in a contributory or noncontributory pension or welfare plan subject to the Employee Retirement Income Security Act of 1974.
 - (2) A certificate or tax credit issued or transferred pursuant to chapter 15E, division VII.
- d. It includes an investment in a common enterprise with the expectation of profits to be derived primarily from the efforts of a person other than the investor and a "common enterprise" means an enterprise in which the fortunes of the

investor are interwoven with those of either the person offering the investment, a third party, or other investors.

e. It includes as a security an interest in a limited liability company or in a limited liability partnership or any class or series of such interest, including any fractional or other interest in such interest, provided "security" does not include an interest in a limited liability company or a limited liability partnership if the person claiming that such an interest is not a security proves that all of the members of the limited liability company or limited liability partnership are actively engaged in the management of the limited liability company or limited liability partnership; provided that the evidence that members vote or have the right to vote, or the right to information concerning the business and affairs of the limited liability company or limited liability partnership, or the right to participate in management, shall not establish, without more, that all members are actively engaged in the management of the limited liability company or limited liability partnership.

f. It includes a viatical settlement investment contract.

502.201(7). NONPROFIT SECURITIES. A security issued by a person organized and operated exclusively for religious, educational, benevolent, fraternal, charitable, social, athletic, or reformatory purposes, or as a chamber of commerce, and not for pecuniary profit, no part of the net earnings of which inures to the benefit of a private stockholder or other person, or a security of a company that is excluded from the definition of an investment company under section 3(c)(10)(B) of the Investment Company Act of 1940, 15 U.S.C. } 80a-3(c)(10)(B); except that with respect to the offer or sale of a note, bond, debenture, or other evidence of indebtedness issued by such a person, a rule may be adopted under this chapter limiting the availability of this exemption by classifying securities, persons, and transactions, imposing different requirements for different classes, specifying with respect to paragraph "b" the scope of the exemption and the grounds for denial or suspension, and requiring an issuer to do any of the following:

a. File a notice specifying the material terms of the proposed offer or sale and copies of any proposed sales and advertising literature to be used and provide that the exemption becomes effective if the administrator does not disallow the exemption within the period established by the rule.

b. File a request for exemption authorization for which a rule under this chapter may specify the scope of the exemption, the requirement of an offering statement, the filing of sales and advertising literature, the filing of consent to service of process complying with section 502.611, and grounds for denial or suspension of the exemption.

c. Register under section 502.304.

502.202(14). **LIMITED OFFERING TRANSACTIONS.** A sale or an offer to sell securities by or on behalf of an issuer, if the transaction is part of a single issue in which all of the following apply:

- a. Not more than thirty-five purchasers are present in this state during any twelve consecutive months, other than those designated in subsection 13.
- b. A general solicitation or general advertising is not made in connection with the offer to sell or sale of the securities.
- c. A commission or other remuneration is not paid or given, directly or indirectly, to a person other than a broker-dealer registered under this chapter or an agent registered under this chapter for soliciting a prospective purchaser in this state.
- d. The issuer reasonably believes that all the purchasers in this state, other than those designated in subsection 13, are purchasing for investment.

502.304A EXPEDITED REGISTRATION BY FILING FOR SMALL ISSUERS.

502.509 CIVIL LIABILITY.

502.601(4). **INVESTOR EDUCATION.** The administrator may develop and implement investor education initiatives to inform the public about investing in securities, with particular emphasis on the prevention and detection of securities fraud. In developing and implementing these initiatives, the administrator may collaborate with public and nonprofit organizations with an interest in investor education. The administrator may accept a grant or donation from a person that is not affiliated with the securities industry or from a nonprofit organization, regardless of whether the organization is affiliated with the securities industry, to develop and implement investor education initiatives. This subsection does not authorize the administrator to require participation or monetary contributions of a registrant in an investor education program.

502.601(5). THE SECURITIES INVESTOR EDUCATION AND TRAINING FUND

A securities investor education and training fund is created in the state treasury under the control of the administrator to provide moneys for the purposes specified in subsection 4. All moneys received by the state by reason of civil penalties pursuant to this chapter shall be deposited in the securities investor education and training fund. Notwithstanding section 12C.7, interest or earnings on moneys deposited into the fund shall be credited to the fund. Notwithstanding section 8.33, unencumbered or unobligated moneys remaining in the fund shall not revert but shall be available for expenditure for the following fiscal year. However, if, on June 30, unencumbered or unobligated moneys remaining in the fund exceed two hundred thousand dollars, moneys in excess of that amount shall revert to the general fund of the state in the same manner as provided in section 8.33.

V. Section by Section Explanation

Article I General Provisions

Section 1. §502.102 Definitions

This section contains the definitions needed to administer the act. Key terms include (4) Broker-dealer – follows the current law, but has an exclusion for certain bank activities; (11) Institutional investor – expands the list of persons to whom sales may be made without the need to register; (15) Investment adviser – provides a functional definition to establish who is must be licensed; (28) Security – keystone since a “security” is required before jurisdiction is available under the act; paragraph (d) is derived from a leading US Supreme Court case that sets a functional test that covers certain exotic securities; paragraphs (e) and (f) are retained from current chapter 502.

Section 2. §502.103 References to federal statutes

This section includes a list of the many other laws that are referred to in this act.

Section 3. §502.104 References to federal agencies

Makes clear that references to federal agencies includes successor agencies.

Section 4. §502.105 Electronic records and signatures

The purpose of this section is to permit the filing of electronic signatures and electronic records.

Article 2 Exemptions from Registration of Securities

Section 5. §502.201 Exempt securities

Both this section that includes exempt securities and Section 202 that includes exempt transactions provide they are exempt from the securities registration requirements, the notice filing requirement of Section 302, and the filing of sales literature of Section 504 of this Act. However, neither Section 201 nor Section 202 provides an exemption from the Act’s antifraud provisions in Article 5, nor the broker-dealer, agent, investment adviser, or investment adviser registration requirements in Article 4.

Subsection (1) – Exempts United States government and municipal securities.

Subsection (2) Exempts foreign government securities.

Subsection (3) Exempts depository institution and international banking institution securities.

Subsection (4) Exempts insurance company securities.

Subsection (5) Exempts common carrier and public utility securities.

Subsection (6) Exempts certain options and rights.

Subsection (7) Exempts nonprofit securities.

Subsection (8A) Exempts cooperative associations.

Subsection (8B) Exempts agricultural cooperative associations.

Subsection (9) Exempts equipment trust certificates.

Subsection (9A) Exempts economic development corporations.

Subsection (9B) Exempts agricultural development authority.

Subsection (9C) Exempts membership campgrounds.

Subsection (9D) Exempts time-shares.

Subsection (9E) Exempts viatical settlement contracts.

Section 6. §502.202 Exempt transactions

Subsection (1) Exempts isolated nonissuer transactions.

Subsection (2) Exempts nonissuer transactions in specified outstanding securities.

Subsection (3) Exempts nonissuer transactions in specified foreign transactions.

Subsection (4) Exempts nonissuer transactions in securities subject to Securities Exchange Act reporting.

Subsection (5) Exempts nonissuer transactions in specified fixed income securities.

Subsection (6) Exempts unsolicited brokerage transactions.

Subsection (7) Exempts nonissuer transactions by pledgees.

Subsection (8) Exempts nonissuer transactions with federal covered investment advisers.

Subsection (9) Exempts specified exchange transactions.

Subsection (10) Exempts underwriter transactions.

Subsection (11) Exempts unit secured transactions.

Subsection (12) Exempts bankruptcy, guardian, or conservator transactions.

Subsection (13) Exempts transactions with specified investors.

Subsection (14) Exempts limited offering transactions.

Subsection (15) Exempts transactions with existing security holders.

Subsection (16) Exempts offerings registered under this chapter and the Securities Act of 1933.

Subsection (17) Exempts offerings when registration has been filed, but is not effective under this chapter and exempt from the Securities Act of 1933.

Subsection (18) Exempts control transactions.

Subsection (19) Exempts rescission offers.

Subsection (20) Exempts out-of-state offers or sales.

Subsection (21) Exempts employee benefit plans.

Subsection (22) Exempts specified dividends and tender offers and judicially recognized reorganizations.

Subsection (23) Exempts nonissuer transactions involving specified foreign issuer securities traded on designated securities exchanges.

Section 7. §502.203 Additional exemptions and waivers

Empowers the administrator to add exemptions. Under this type of authority, 50 of 53 jurisdictions through September 2002 had adopted the Uniform Limited Offering Exemption (ULOE). It also authorizes the administrator to adopt by rule or order new exemptions as circumstances warrant for new technologies such as the Internet.

Section 8. §502.204 Denial, suspension, revocation, condition, or limitation of exemptions.

This section provides the administrator with the authority to correct abusive use of certain exemptions. The courts have given a securities administrator's decision to deny or revoke an exemption substantial deference when there was compliance with applicable due process and statutory requirements.

Article 3 Registration of securities and notice filing of federal covered securities.

Section 9. §502.301 Securities registration requirement.

This section makes the sale of securities unlawful unless they are registered, exempt, or a federal covered security.

Section 10. §502.302 Notice filing.

Congress has preempted state regulation of certain securities (e.g. mutual funds), but has allowed for notice filings and fees to be paid. This section implements that authorization.

Section 11. §502.303 Securities registration by coordination.

This section provides for coordination with federal requirements for a class of securities that is registered on both levels. As such, it streamlines the content of the registration statement and the procedure by which a registration statement becomes effective, but not the substantive standards governing the effectiveness of a registration statement.

Section 12. §502.304 Securities registration by qualification.

This section sets out the process for registration for those securities that generally are only registered with the state. The section provides a laundry list of the types of information that should be provided and the timeframes for processing the filing.

Section 13. §502.304A Expedited registration by filing for small issuers.

This section is retained from current chapter 502, and provides a unique system for fast track simplified registration in Iowa by small businesses.

Section 14. §502.305 Securities registration filings.

This is an overarching section that applies to sections 303, 304, and 304A. It sets out certain processes and restrictions, the filing fees, reporting requirements, and the method to amend a filing.

Section 15. §502.306 Denial, suspension, and revocation of securities registration.

This section applies to sections 303, 304, and 304A. It establishes the standards for reviewing filings and the authority of and the process by which the administrator may deny a registration.

Section 16. §502.307 Waiver and modification.

This section empowers the administrator to waive or modify any of the requirements of 302, 303, 304(b), or the requirement of any information or record in a registration statement.

Article 3A Takeover provisions

This Article is preserved from current chapter 502. The Iowa bar worked with the Division in 1986-87 to develop a takeover disclosure law that would be constitutional. This article was adopted by the General Assembly in 1987 and incorporated as part of chapter 502.

Section 17. §502.321A Special definitions.

These definitions apply only to the takeover article. A “takeover offer” per subsection (8) includes a tender offer for equity securities made to an Iowa resident if the offeror would ultimately own more than 10% of the shares. A “target company” under subsection (9) is an issuer of securities by a public company that has at least 20% of its equity securities held by Iowans.

Section 18. §502.321B Registration requirements – Hearing.

A takeover offer must be filed with the Administrator, and becomes effective upon filing. It may be suspended if the filing does not make full disclosure, after which a hearing must be held.

Section 19. §502.321C Filing of solicitation materials.

This section requires all advertising to be filed.

Section 20. §502.321D Fraudulent, Deceptive, or manipulative acts and practices prohibited.

This section lists prohibited acts, including false statements, disclosure of offers with differing payments, and delivery requirements.

Section 21. §502.321E **Section 17.** §502.321A Limitations on offers and offerors.

This section requires the same terms for instate as out of state offerees, sets out what happens if the offering terms change, and sets restrictions on after purchase transactions.

Section 22. §502.321F Administration – rules and orders.

This section allows the administrator to adopt exemptions and provides that the procedures in this article control if in conflict with chapter 17A (this is needed because of the concerns with unconstitutionality if they do not coordinate with federal requirements).

Section 23. §502.321G Fees.

This section sets the filing fee at \$250.

Section 24. §502.321H Nonapplication of corporate takeover law.

This section makes the article inapplicable to tender offers involving utilities or banks (subject to their own regulation).

Section 25. §502.321I Application of securities law.

This is a savings clause.

Article 4 Broker-dealers, Agents, Investment Advisers, Investment Adviser Representatives, and Federal Covered Investment Advisers

Section 26. §502.401 Broker-dealer registration requirement and exemptions.

This section makes unlawful acting as a broker-dealer unless the person is registered or exempt. Firms are also prohibited from employing agents who have been revoked. Exemptions are created for broker-dealers with no place of business in the state who transact business with institutional investors, with preexisting customers or on a deminimus basis. The administrator is authorized by rule to recognize the licensing system of Canada or other foreign jurisdictions.

Section 27. §502.402 Agent registration requirement and exemptions.

This section parallels with §401. It also limits an agent from being affiliated with more than one broker-dealer.

Section 28. §502.403 Investment adviser registration requirement and exemptions.

This section makes unlawful acting as an investment adviser unless the person is registered or exempt. Firms are also prohibited from employing investment adviser representatives who have been revoked. Exemptions are created for investment advisers with no place of business in the state who transact business with institutional investors, with preexisting customers or on a deminimus basis.

Section 29. §502.404 Investment adviser representative registration requirement and exemptions.

This section parallels with §403. It allows an investment adviser representative to be licensed with only one firm if the activity is limited to receiving referral fees from a second firm.

Section 30. §502.405 Federal covered investment adviser notice filing requirement.

This section is intended to coordinate with the Investment Advisers Act of 1940 (federal statute) that allows a notice filing to be made with the state administrator.

Section 31. §502.406 Registration by broker-dealer, agent, investment adviser, and investment adviser representative.

This section establishes the process for registration and amendments, and sets the time frames for review of applications.

Section 32. §502.407 Succession and change in registration of broker-dealer or investment adviser.

This section is intended to avoid unnecessary interruptions of business by specifying procedures for a successor broker-dealer or investment adviser. A broker-dealer or investment adviser may maintain its registration if it changes its form of organization or name, or in accordance with a rule or order adopted under this Act, there is a change of control of a broker-dealer or investment adviser.

Section 33. §502.408 Termination of employment or association of agent and investment adviser representative and transfer of employment or association.

Subsection (1) specifies a procedure to inform the administrator of a notice of termination. To expedite transfer to a new broker-dealer or investment adviser, subsection (2) provides a procedure by which agents or investment adviser representative registration will be effective immediately as of the date of new employment when there is no new or added disciplinary disclosure. Subsections

(3) and (4) are intended to ensure that the administrator has the authority to prevent immediate effectiveness in appropriate cases.

Section 34. §502.409 Withdrawal of registration of broker-dealer, agent, investment adviser, and investment adviser representative.

This section does not affect any applicant's privilege of withdrawal of an application from registration before the registration becomes effective. It is simply designed to prevent withdrawal of an effective registration under fire. The last sentence preserves the ability of the administrator to initiate an action under Section 412 when the administrator does not know of a reason to object to withdrawal until after withdrawal has become effective. Subsection 1A covers the situations when a filing is abandoned or the firm ceases to do business.

Section 35. §502.410 Filing fees.

This section sets the filing fees. It retains the current fee structure, so is revenue neutral.

Section 36. §502.411 Post-registration requirements.

This section authorizes the administrator to establish financial requirements, financial reporting, and recordkeeping. It authorizes audits or inspections of licensed persons. It permits the administrator to require a bond if the firm has custody of customer funds. It permits the administrator to require an investment adviser to furnish disclosure information to prospective customers. It authorizes continuing education requirements.

Section 37. §502.412 Denial, revocation, suspension, withdrawal, restriction, condition, or limitation of registration.

This section enables the administrator to seek a sanction based on the seriousness of the misconduct. Paragraph 4 enumerates the laundry list of grounds, which include false statements, violations of the act, felony convictions, injunctions or orders from federal or other financial regulators, failure to supervise, and dishonest or unethical practices. The administrator may require an individual to pass an exam. Procedural requirements are set, including allowing summary orders. Control person liability is also recognized.

Article 5 Fraud and Liabilities

Section 38. §502.501 General fraud.

This section makes unlawful schemes to defraud, untrue statements or omissions of material fact, or acts that operate as a fraud or deceit.

Section 39. §502.501A Prohibited transactions of broker-dealers and agents.

This section prohibits manipulative devices and fictitious quotes, and also requires that recommended securities be suitable for the customer.

Section 40. §502.502 Prohibited conduct in providing investment advice.

This section makes unlawful schemes to defraud or acts that operate as a fraud or deceit when providing investment advice. It authorizes rules to define fraudulent, deceptive, or manipulative practices, and to specify the contents of an investment advisory contract.

Section 41. §502.503 Evidentiary burden.

In subsection (a), in a civil or administrative action, the person claiming an exemption, exception, preemption, or exclusion has the burden of persuasion. In contrast, in a criminal action under subsection (b), the prosecutor is required to prove each element of a crime “beyond a reasonable doubt.” The defendant only has the burden of producing evidence of an exemption, exception, preemption, or exclusion.

Section 42. §502.504 Filing of sales and advertising literature.

This section authorizes rules that require filing of advertising. False or misleading ads may be defined by rule.

Section 43. §502.505 Misleading filings.

This makes unlawful filings made pursuant to the act that are misleading or false.

Section 44. §502.506 Misrepresentations concerning registration or exemption.

This section provides that a misrepresentation concerning registration or an exemption is unlawful. A state employee may not endorse or recommend securities.

Section 45. §502.506A Misstatements in publicity prohibited.

This section makes unlawful false or misleading statements in connection with a tender offer.

Section 46. §502.507 Qualified immunity.

Broker-dealers and investment advisers are required to report violations made by the individuals that work for them. This section provides for qualified immunity from defamation suits filed due to the information they provide to regulators as part of that process.

Section 47. §502.508 Criminal penalties.

This section keeps the current levels of penalties for securities act violations. It provides that prosecutors may file criminal actions with or without a referral from the administrator.

Section 48. §502.509 Civil liability.

This section generally tracks with current Iowa law. Under Section 509 violations of two or more sections can be proven, but the remedy is limited either to rescission or actual damages. Actual damages mean compensatory damages. Punitive or “double” damages are not provided by this section. Subsections (5) and (6) establish civil liability for individuals who willfully violate Section 102 dealing with fraudulent practices pertaining to advisory activities. Subsection (7) provides a control person liability provision. Part of that subsection contains the defense of lack of knowledge. Partners, officers, and directors are liable, subject to the defense afforded by that subsection, if they aided in the fraudulent sale. The section retains current law of aiding and abetting liability for all persons. The “reasonable attorneys’ fees” specified in Section 509 are permissive, not mandatory. The contribution provision in Section 509(8) is a safeguard to avoid the common law principle that prohibited contribution among joint tortfeasors. The statute of limitations is bifurcated. There is a one year (shortened from 2 years) limit for registration violations. Section 509(10)(b), in contrast, generally follows the federal securities law model (the recently enacted the Sarbanes-Oxley Act). An action must be brought within the earlier of two years after discovery or five years after the violation. The rationale for replicating the basic federal statute of limitations in this Act is to discourage forum shopping. Subsection 13A includes a precatory provision requiring an informational filing with the administrator. Subsection 13B provides civil liability for takeover violations.

Section 49. §502.510 Rescission offers.

This section provides for a rescission offer process so that civil liability under Section 509 may be extinguished. Subsection 5 provides for a filing if the allegations involve fraud.

Article 6 Administration and Judicial Review

Section 50. §502.601 Administration.

Subsection 1 keeps the current act language that makes the insurance commissioner the administrator and provides for a deputy. Subsection 2 makes unlawful the use of nonpublic information for personal benefit. Subsections (4)

and (5) recognize the importance of investor education. An increasing number of jurisdictions are earmarking specific funds for this purpose. The lack of financial acumen among public investors, seniors, and students continues to be demonstrated in recent industry and regulatory studies. The importance of investor financial literacy is increasingly crucial given the decades long shift from defined benefit retirement plans toward defined contribution plans where employees are left to direct their own retirement accounts.

Section 51. §502.602 Investigations and subpoenas.

This section provides investigation and subpoena powers. Standards for issuance of subpoenas have been generally established in federal and state securities law. The scope of subpoena enforcement in each state is a general matter for judicial determination. An individual can be subpoenaed and compelled to attend. Once in attendance an individual can assert an evidentiary privilege or exemption, including the Fifth Amendment privilege against self-incrimination. The section allows the administrator to apply to the appropriate court to compel testimony under the “use immunity” provision barring the record compelled or other evidence obtained from being used in a criminal case. A court may quash a subpoena for good cause. The section provides for reciprocal enforcement by the administrator of subpoenas issued by another State.

Section 52. §502.603 Civil enforcement.

This section empowers the administrator to file a civil action to enjoin violations of the act. It lists a broad range of potential sanctions to enable administrators to better tailor appropriate sanctions to particular misconduct.

Section 53. §502.604 Administrative Enforcement.

This provides cease and desist authority for violations of the act. The administrator may also seek costs and civil penalties as part of the administrative action. A summary process is allowed. Enforcement of the order by application to court may be made.

Section 54. §502.604A Limited law enforcement authority.

This section was recently added to current chapter 502 to enable better information sharing with federal agencies with which the agency is working or to which the agency has referred a case for criminal prosecution.

Section 55. §502.605 Rules, forms, orders, interpretative opinions, and hearings.

This section authorizes rulemaking. It is anticipated that the administrator will propose amendments or make to remain coordinate with relevant federal law,

and to achieve uniformity among the States. Uniform forms such as Form B-D, U-4, U-5, and NF are today common in the securities industry and are authorized by this section.

Section 56. §502.606 Administrative files and opinions.

This requires certain records to be maintained for public review, and allows a fee for copies.

Section 57. §502.607 Public records – confidentiality.

This section sets a presumption that records are public. Subsection 2 lists the records that are not public, including investigatory files, audit files, trade secrets, nonpublic files provided by other law enforcement or regulatory agencies, personal identifying information (SS#s), and records expunged by a designee (NASD's CRD system pursuant to court order).

Section 58. §502.608 Uniformity and cooperation with other agencies.

Since uniformity of regulation among the states and coordination with the Securities and Exchange Commission is a principal objective of this Act, this section is intended to encourage such cooperation to the maximum extent appropriate. It lists some joint or coordinated efforts which might be undertaken.

Section 59. §502.609 Judicial review of orders.

This section makes orders subject to review per chapter 17A.

Section 60. §502.610 Jurisdiction.

This section defines the application of the Act to interstate or international transactions when only some of the elements of a violation occur in this State. This Section applies to all types of proceedings specified by the Act, whether administrative, civil, and criminal. The law is now settled that a person may violate the law of a particular state without ever being within the state or performing each act necessary to violate the law within that state. This follows current law but has been modernized to reflect the development of the Internet and other electronic communications.

Section 61. §502.611 Service of process.

Section 611 requires a signed consent to service of process in subsection (1), a substituted service of process in subsection (2), and process and opportunity to defend in subsections (3) through (5).

Section 62. §502.612 Severability clause.

This provides that if a provision is held to be invalid, other provisions keep the force of law.

Section 63.

This section repeals those current code section numbers that are not used in the new act.

Division II Transition Provisions

Section 64. Application of act to existing proceeding and existing rights and duties.

Prior law governs all suits, actions, prosecutions, or proceedings which are pending or may be initiated on the basis of facts or circumstances occurring before the effective date of this act.

Division III Conforming Changes

Section 65. §22.7

Strikes a former reference to chapter 502 and inserts a new reference to the non-public records listed in §502.607(b).

Section 66. §507B.14

Changes a former reference to the felonies listed in chapter 502 to a specific delineation in chapter 507B for criminal penalties. These are similar to the former penalties listed in chapter 502 and track with the penalties in other proposed Insurance Division legislation.

Section 67. §536A.22

This retains the current exemption for certain thrift certificates, but eliminates a reference to an exemption in current chapter 502 that is not carried over in the new act.

Division IV Effective Date

Section 68.

This makes the new act effective on January 1, 2005. This will allow time to do necessary rulemaking.

