



**House
Legislative
Analysis
Section**

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UNIFORM SECURITIES ACT AMENDMENTS

House Bill 5296 (Substitute H-~~RECEIVED~~)
First Analysis (2-27-90)

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Sponsor: Rep. Jo

hn Bennett

Committee: Corporations & Finance

Mich. State Law Library

THE APPARENT PROBLEM:

The Uniform Securities Act regulates those who deal in the issuance, sale, or purchase of securities in Michigan, and specifies the Corporations and Securities Bureau in the Department of Commerce as the administrator of the act. Public Act 408 of 1988 amended the act primarily to raise various fees for persons required to be registered under the act. These fees are scheduled to expire December 1, 1990, and the bureau has requested removing the sunset on fee increases to permanently establish the fees. In addition, the act currently exempts a number of different types of securities — for example, those traded on the New York and American Stock Exchanges — which are policed by federal regulators. Some people feel securities traded on the National Association of Securities Dealers Automated Quotation/National Market System (NASDAQ/NMS) should also be exempted from the act as investor protection for NMS securities (which also are regulated by the Securities and Exchange Commission) equals or exceeds that of securities traded on exchanges now exempt. Finally, the bureau periodically audits registrants and applicants under the act to ensure they are complying with, or are capable of meeting, the act's requirements. The cost of these audits is now paid by the bureau, though it feels it should be allowed to pass these costs on to those audited. The bill would address these and other concerns.

THE CONTENT OF THE BILL:

The bill would amend the Uniform Securities Act to exempt certain types of securities issuers from the act, to provide that persons licensed under the act (or who apply for registration) could be required to reimburse the Corporations and Securities Bureau — the act's administrator, within the Department of Commerce — for expenses related to an audit, and to permanently establish various fees scheduled to expire December 1, 1990.

Bureau Reimbursed for Audits. The act currently permits the bureau to examine periodically the records of licensees or persons applying for registration under the act. The bill specifies that expenses "reasonably attributable" to such an audit could be charged to the applicant or registrant who was involved in the examination. Funds received from such reimbursements would be deposited into the state treasury for use by the bureau in carrying out its duties under the act.

NASDAQ/NMS Exemptions. The act currently exempts a number of different securities from having to be registered under the act. The bill would also exempt 1) securities listed or approved for listing upon notice or issuance on the National Association of Securities Dealers Automated Quotation (NASDAQ)/National Market System (NMS) and any other similar security of senior or substantially equal rank, 2) securities called for by subscription rights or

warrants so listed or approved, or 3) a warrant or right to purchase or subscribe to either of these.

The Corporations and Securities Bureau could — after providing notice of hearing to all interested parties, opportunity for hearing, written findings of fact and conclusions of law, and a right to judicial appeal — do any of the following:

- deny or revoke the exemption by order for a specific securities issue;
- deny the exemption by rule or order to a category of securities when necessary in the public interest and for the protection of investors;
- decertify the system by order if the bureau determined the system's requirements were so changed from those listed in federal securities law (adopted December 28, 1988), or insufficiently applied so that public interest and investor protection contemplated by the requirements were no longer afforded.

Limits on "Manual Exemption" Securities Issuers. The act currently exempts as a transaction a nonissuer distribution of an outstanding security whose issuer and any predecessors have been continuously operating for at least 5 years if 1) a recognized securities manual contains the names of the issuer's officers and directors, an up-to-date balance sheet of the issuer, and a profit and loss statement for either the fiscal year preceding the issuer's balance sheet date or the most recent year of operations, or 2) the security has a fixed maturity or a fixed interest or dividend provision and there has been no default during the current fiscal year or within the 3 preceding fiscal years, or during the existence of the issuer and any predecessors if less than 3 years, in paying principal, interest, or dividends on the security.

The bill specifies that an issuer or predecessor would be considered in continuous operation only if it had gross operating revenue in each of the 5 years immediately preceding its claim of exemption and had gross operating revenue of at least \$500,000 in not less than 3 of those 5 years.

Secondary Trading of Securities. The bill would clarify that all outstanding securities of the same class as a registered security are considered to be registered for the purpose of a nonissuer transaction, providing the registration statement is effective or the issuer had a class of securities that were subject to the reporting requirements of the federal Securities Exchange Act of 1934 for at least 9 months before the transaction and all reports required under the federal act had been filed for that period.

Removal of Sunset on Fees. Public Act 408 of 1988 increased various registration fees in the act and provided a sunset date for these increases of December 1, 1990; after this date, the fees that were changed will revert to what they were before the increase. The bill would remove the sunset date for the fee increases and, thus, would

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permanently establish these fees in the act. The minimum filing fee under the act would remain \$100 and the maximum, \$1,250 (instead of reverting to \$50/\$500). Other registrant annual fees would remain as follows:

- for a broker-dealer, \$250;
- for a commodity issuer, \$250;
- for a principal, \$30 (scheduled to revert to \$25);
- for an agent, \$30 (instead of \$15); and
- for an investment advisor, \$150 (instead of \$100).

MCL 451.602 et al.

FISCAL IMPLICATIONS:

According to the Corporations and Securities Bureau, the bill would have budgetary implications for the state and the commerce department. Granting an exemption from registration for NASDAQ security dealers could decrease the bureau's operating revenues anywhere from \$100,000 to \$500,000 annually depending on future market activity in NASDAQ-traded securities; an exact projection of revenue loss from the exemption could not be determined. Also, removing the sunset on fees would prevent a revenue loss to the bureau of approximately \$1.9 to \$2.3 million annually; this amount, again, would be subject to variables related to the market and the financial condition of registrants under the act. (2-21-90)

ARGUMENTS:

For:

The bill would correct the following problems within the Uniform Securities Act:

- NMS securities traded under NASDAQ would be exempted from the act and, thus, would be granted parity with securities traded under similar exchanges. NMS securities were not originally exempted under the federal Uniform Securities Act — the basis for state securities law — when it was drafted in the 1950s since NASDAQ did not yet exist. Now, NASDAQ oversees its markets closely and requires that companies provide their shareholders with protections equal to or greater than those required by other exchanges. Since 1985, 26 states have exempted these transactions from their securities laws.
- Non-routine audits performed by the bureau on registrants and applicants are necessary to ensure investor protection and compliance with the act; these audits are time-consuming and costly. The bill would permit the bureau to charge persons audited for reasonable expenses related to an audit.
- The definition of "manual exemption" securities, which are exempt from the act due to their being listed in recognized securities manuals, would be modified in order to prevent abuse by some companies. Apparently, companies with little or no financial history in securities are able to get their securities listed in recognized manuals, thereby meeting the act's technical requirements for the exemption. Also, dealers in so-called "penny stocks" — which are low-grade, high risk securities with little value on paper but sold for huge profits — use the exemption to skirt registration under the act. The bill would provide that a securities issuer or predecessor company could only gain the exemption if it met the minimum requirements for length of time in operation and gross operating revenue.
- Various fees that were increased two years ago are scheduled to revert back to what they were before the increase took effect. Apparently, the increases were

used to help the bureau better regulate the securities industry in Michigan, but also to help offset a higher operating budget which the legislature adopted for the bureau's 1988-89 fiscal year. The fee increases, in fact, brought Michigan in line with what a number of other states charge for securities licensing. Even so, a December 1, 1990 sunset was included so that the legislature could assess after two years whether to continue with the fees. A spokesperson for the Corporations and Securities Bureau testified before the House Corporations and Finance committee that no complaints had been made to the bureau regarding the fees. In addition, the revenue loss the bureau would sustain from the NASDAQ/NMS exemption would be further compounded if the fees are allowed to sunset.

Against:

While the fees may seem appropriate in light of what other states charge for registration, any questions regarding the fees should first consider the cost of operating the bureau effectively. Some people suspect the current fees are bringing in more revenue than what the bureau needs to operate satisfactorily. If this is true, the fees should be adjusted to reflect the bureau's actual operating costs.

POSITIONS:

The Corporations and Securities Bureau, within the Department of Commerce, supports the bill. (2-21-90)

The National Association of Securities Dealers Automated Quotation (NASDAQ) supports the provision that would exempt its securities dealers from the act. (2-21-90)

Warner, Norcross, and Judd, a Grand Rapids-based law firm, supports the bill. (2-21-9)