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BILL ANALYSIS

Senate Fiscal Agency

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House Bill 5296 (Substitute S-2 as reported)
Sponsor: Representative John Bennett
House Committee: Corporations and Finance
Senate Committee: Commerce and Technology

Date Completed: 5-21-90

RATIONALE

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. In 1988 the Act was amended 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 the removal of the sunset on the fee increases to establish the fees permanently.

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--that are policed by Federal regulators. Some people feel securities traded on the National Association of Securities Dealers Automated Quotation/National Market System (NASDAQ/NMS) also should be exempted from the Act since investor protection for NMS securities (which also are regulated by the Securities and Exchange Commission) reportedly equals or exceeds that of securities traded on exchanges that are now exempt.

Finally, the Bureau periodically audits registrants and applicants under the Act to ensure that 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 on these costs to those audited.

CONTENT

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

The bill would take effect November 30, 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 also would exempt 1) securities listed or approved for listing upon notice or issuance on the National Association of Securities Dealers Automated Quotation/National Market System and any other similar security of senior or substantially

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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.

In regard to the additional exempt securities, the Corporations and Securities Bureau--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--could 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 that the system's requirements were so changed from those listed in Federal securities law (adopted December 28, 1988), or insufficiently applied so that the 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 five 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 three preceding fiscal years, or during the existence of the issuer and any predecessors if less than three years, in paying principal, interest, or dividends on the security. The bill would delete the phrase "or during the existence of the issuer and any predecessors if less than three years".

Further, 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 five years immediately preceding its claim of exemption and had gross operating revenue of at least \$500,000 in not less than three of those five years. The bill also would exempt any transaction by a "personal representative". The bill would delete language that exempts a nonissuer transaction effected by or through a broker dealer in any outstanding security of the same class as that which was registered for general public sale under the Act or a predecessor act before January 1, 1978.

Secondary Trading of Securities

The bill provides that all outstanding securities of the same class as a registered security would be considered to be registered for the purpose of a nonissuer transaction, providing the registration statement was 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 nine months before the transaction and all reports required under the Federal Act had been filed for that period. Currently, the Act specifies that the securities are to be considered registered as long as the registration statement is effective and "between the thirtieth day after the entry of any stop order suspending or revoking the effectiveness of the registration statement under Section 306, if the registration statement did not relate in whole or in part to a nonissuer distribution, and one year from the effective date of the registration statement". The bill would replace that language.

Public Access to Documents

The Act currently specifies that any information contained in or filed with any registration statement, application, or report could be made available to the public. Further, upon request, the Bureau must provide to any person photostatic or other copies of documents that are a matter of public record. The bill provides that the information could be retained and stored by the Bureau in the document's original form or by photostatic, micrographic, photographic, or optical disc media, and that reproductions or copies of any registration statement, application or report could be made available to the public. Further, upon request,

the Bureau would be required to provide to any person micrographic, photographic and optical disc media reproductions of public documents.

Removal of Sunset on Fees

The Act was amended in 1988 to increase various registration fees until 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 permanently establish the current fees in the Act. The minimum filing fee under the Act, therefore, would remain at \$100 and the maximum fee would remain at \$1,250, instead of reverting to a minimum fee of \$50 and a maximum fee of \$500 after December 1, 1990. Other annual registration fees would remain as follows:

- For a broker-dealer, \$250 (which did not change in 1988).
- For a commodity issuer, \$250 (which did not change).
- For a principal, \$30 (scheduled to revert to \$25).
- For an agent, \$30 (instead of \$15).
- For an investment advisor, \$150 (instead of \$100).
- For a successor, \$100 (instead of \$50).

MCL 451.602 et al.

SENATE COMMITTEE ACTION

The Senate Committee adopted a substitute that would allow information pertaining to registration statements, applications, and reports to be stored by photostatic, micrographic, photographic or optical disc media and to be made available to the public in these various forms, and that specifies an effective date of November 30, 1990.

FISCAL IMPACT

The bill would have a net annual fiscal impact on the State of between \$1,675,600 and \$1,975,600 in additional revenue and no fiscal impact on local government. The bill would remove the sunset on various fee increases that were established by Public Act 408 of 1988. The additional revenue generated by these increased fees would be between \$1,900,000

and \$2,100,000 per year. Also, the bill would exempt certain securities from having to be registered under the Act. The decrease in annual revenue to the State due to the exemptions would be between \$200,000 and \$300,000. In addition, the bill would allow the Corporations and Securities Bureau in the Department of Commerce to charge for its audit expenses. Assuming the Bureau charged annually \$42/hour for 1,800 hours, the Bureau would receive \$75,600 in additional annual revenues.

ARGUMENTS

Supporting Argument

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 the companies to provide their shareholders with protection equal to or greater than that required by other exchanges. Since 1985, 26 states have exempted these transactions from their securities laws.

Supporting Argument

Nonroutine audits performed by the Bureau on registrants and applicants are necessary to ensure investor protection and compliance with the Act; these audits, however, are time-consuming and costly. The bill would permit the Bureau to charge persons audited for reasonable expenses related to an audit.

Supporting Argument

The definition of "manual exemption" securities, which are exempt from the Act because they are 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 provides that a securities issuer or predecessor

company could gain the exemption only if it met the minimum requirements for length of time in operation and gross operating revenue.

Supporting Argument

Various fees that were increased two years ago are scheduled to revert to what they were before the increase took effect. Apparently, the increases were used not only to help the Bureau better regulate the securities industry in Michigan, but also to help offset a higher operating budget that 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. Reportedly, 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 compounded further if the fee increases were allowed to expire.

Opposing Argument

While the fees may seem appropriate in light of what other states charge for registration, any decisions 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.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.