



Eric Milstead  
Director

# Legislative Services Office

## Idaho State Legislature

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### MEMORANDUM

**TO:** Rules Review Subcommittee of the Senate Commerce & Human Resources Committee and the House Business Committee

**FROM:** Division Manager - Mike Nugent

**DATE:** August 15, 2016

**SUBJECT:** Department of Finance

IDAPA 12.01.08 - Rules Pursuant to the Uniform Securities Act (2004) - (Fee Rule) Proposed Rule (Docket No. 12-0108-1601)

The Department of Finance is proposing to amend its rules relating to the uniform securities act of 2004. The proposed rules are in seven categories.

The first category is amendments associated with federal regulatory naming conventions and related references. The Department's rules reference various rules of federal regulatory bodies with whom the Department shares regulatory authority.

The second category relates to federal preemption of state authority. The Department indicates during 2015 and as a result of the federal Dodd-Frank legislation, the U.S. Securities and Exchange Commission (SEC) passed new rules governing federal Regulation A securities offerings. In part, these new rules preempted state authority to oversee and comment on the disclosures presented in certain securities offerings but partially retained state authority to require filings and collect fees. The proposed rule states the effect of this federal preemption and allows the Department to know who will be offering Regulation A securities to Idaho residents and to reduce its fee schedule accordingly.

The third category relates to multi-state uniform guidelines. The Department of Finance collaborates with fifty other state securities regulators, as well as Canadian and Mexican securities regulators through the North American Securities Administrators Association (NASAA). Many of these efforts are directed at providing a uniform regulatory framework for securities issuers across jurisdictions. The Department seeks to amend its existing incorporation of NASAA Statements of Policy to reflect changes in these uniform guidelines during the last ten years.

The fourth category relates to multi-state securities issuer filings. These proposed rules are intended to provide some regulatory relief for certain securities issuers that wish to sell securities in multiple jurisdictions. The Department piloted and allows the use of a national electronic filing depository (EFD) for the filing of certain documents. Acknowledgment of this optional issuer filing format will be provided for in these proposed rules.

Mike Nugent, Manager  
Research & Legislation

Cathy Holland-Smith, Manager  
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The fifth category relates to state/federal investment adviser books and records requirements. The Department indicates that there are two tiers of regulated investment advisers in the United States. Investment advisers with assets under management in excess of \$100 million are required to register only with the U.S. Securities and Exchange Commission, while those managing funds under \$100 million are required to register only with their state of domicile. Since advisers may, over time, experience variances in their “book of business”, they may migrate back and forth between federal and state oversight. In this proposed rule change the Department seeks to minimize the changes required of state registered advisers as they move between the two regulatory systems.

The sixth category relates to investment adviser and investment adviser representative registration platforms. The Department indicates that investment advisers and their representatives are required to use national registration platforms to license in the jurisdictions where they will conduct business. Presently, advisers use the “IAR” while their representatives use a corollary system known as the “CRD.” The proposed rules pertaining to these adviser and adviser representative registrations are being amended to provide which registration platform should be used based upon the registrant’s status as either an adviser or an adviser representative.

The seventh category relates to suitability standards where investment adviser are involved. Rule 104.04 proposes that investment advisers have a duty to provide suitable recommendations in connection with their advisory activities when advising clients to purchase or sell securities.

The eighth category relates to investment adviser financial statements. The Department indicates that as a condition of registration and ongoing compliance, investment advisers must demonstrate solvency by providing a balance sheet to the Department. Proposed Rule 89.01(e) is being amended to identify that balance sheets provided to the Department are prepared substantially in accordance with Generally Accepted Accounting Principles (GAAP).

It appears that the proposed rules have been promulgated within the statutory authority granted to the Department of Finance.

cc: Department of Finance  
Michael Larsen

## PROPOSED RULE COST/BENEFIT ANALYSIS

Section 67-5223(3), Idaho Code, requires the preparation of an economic impact statement for all proposed rules imposing or increasing fees or charges. This cost/benefit analysis, which must be filed with the proposed rule, must include the reasonably estimated costs to the agency to implement the rule and the reasonably estimated costs to be borne by citizens, or the private sector, or both.

**Department or Agency:** Idaho Department of Finance/Securities Bureau

**Agency Contact:** James A. Burns **Phone:** 208-332-8080

**Date:** July 5, 2016

**IDAPA, Chapter and Title Number and Chapter Name:**

IDAPA 12 – DEPARTMENT OF FINANCE - 12.01.08 - RULES PURSUANT TO THE UNIFORM  
SECURITIES ACT

**Fee Rule Status:**  **Proposed**  **Temporary**

**Rulemaking Docket Number:** 12-0108-1601

### STATEMENT OF ECONOMIC IMPACT:

The proposed rules changes DO NOT impose any additional reporting requirements or fees upon industry.

## INCORPORATION BY REFERENCE SYNOPSIS

In compliance with Section 67-5223(4), Idaho Code, the following is a synopsis of the differences between the materials previously incorporated by reference in this rule that are currently in full force and effect and newly revised or amended versions of these same materials that are being proposed for incorporation by reference under this rulemaking.

The following agency of the state of Idaho has prepared this synopsis as part of the proposed rulemaking for the chapter cited here under the docket number specified:

### IDAPA 12 – DEPARTMENT OF FINANCE

#### 12.01.08 - RULES PURSUANT TO THE UNIFORM SECURITIES ACT

##### DOCKET NO. 12-0108-1601

Securities issuers that wish to publicly offer securities generally must file their registration materials with the U.S. Securities & Exchange Commission (SEC) AND with each state in which they intend to offer securities. Securities Issuers must address deficiencies in their registration application and offering materials noted by the SEC and by each state jurisdictions where the offering was filed.

In order to speed the multi-state registration review process, the North American Securities Regulators Association (NASAA)<sup>[1]</sup>, through its state and provincial members, developed a set of uniform standards for registered securities offerings known as NASAA Statements of Policy. These uniform standards assist issuers by providing a uniform approach to various elements of the securities disclosure document. The Department of Finance has incorporated several NASAA Statements of Policy (SOP) in prior rulemakings. The proposed rules changes reflect the adoption of NASAA Policy Statements and guidelines updated since the Rules Pursuant to the Idaho Uniform Securities Act were last updated.

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**01. Incorporated Documents.** IDAPA 12.01.08, “Rules Pursuant to the Uniform Securities Act (2004),” adopts and incorporates by reference the full text of the following Statements of Policy and guidelines adopted by the North American Securities Administrators Association (NASAA): (3-24-05)

**a. “Loans and Other Material Affiliated Transactions,” as adopted with amendments through ~~November 18, 1997~~ March 31, 2008;**

*Synopsis of Changes:*

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<sup>[1]</sup> Organized in 1919, the North American Securities Administrators Association is the oldest international organization devoted to investor protection. NASAA is a voluntary association whose membership consists of 67 state, provincial, and territorial securities administrators in the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada, and Mexico.

*Adopted April 27, 1997; Amended March 31, 2008*

- 1. The SOP has non-material edits to correct grammar and sentence structure, for example, the editor changed “passive voice” sentence structure to “active voice.” Also the phrase “the offering of securities may be disallowed by the administrator” was changed to “the administrator may deny the offer or sale” to better align with the language of the Uniform Securities Act.*
- 2. The introduction was amended to remove language reminding the state administrator that nothing prevented the state from applying different standards from the SOP.*
- 3. A reference to the specific terms used in this SOP that are defined in the SOP for Corporate Securities Definitions was added. The earlier version merely referenced the SOP for Corporate Securities Definitions.*

*The organization of the SOP’s outline structure was edited to provide better readability, but there were no material content changes from the earlier version.*

**b. “Options and Warrants,” as adopted with amendments through ~~September 28, 1999~~ March 31, 2008;**

*Synopsis of Changes:*

*Amended November 17, 1997; September 28, 1999 & March 31, 2008*

- 1. The SOP has non-material edits to correct grammar and sentence structure, for example, the editor changed “passive voice” sentence structure to “active voice.”*
- 2. The introduction was amended to remove language reminding the state administrator that nothing prevented the state from applying different standards from the SOP. Language clarifying that the policy applies to all applications to register by coordination or by qualification has been added.*
- 3. Several definitions contained in the NASAA Statement of Policy Regarding Corporate Securities Definitions are incorporated by reference including: Administrator, Disclosure Document, Lock-In Agreement, Person, Promoter, Unaffiliated Institutional Investor, Underwriter.*
- 4. The SOP was reorganized with new headings to more logically structure the policies, for example headings were added to highlight permissible grants of options/warrants, general prohibitions, and disclosure requirements. The SOP has non-material edits relating to permissible grants to unaffiliated institutional investors and persons.*
- 5. The prohibition relating to a limitation on exercise price was revised to require the issuer to demonstrate the underlying shares’ fair market value to the Administrator’s satisfaction. Pursuant to the revision, the Administrator may require the issuer to provide a concurrent appraisal of the shares’ fair market value from a qualified independent appraiser. The previous SOP only required the issuer to consider the advisability of obtaining an appraisal.*

*The prior SOP prohibited certain options/warrants from being exercisable more than five (5) years from the date of the public offering; this prohibition has been eliminated.*

**c. “Corporate Securities Definitions,” as adopted with amendments through ~~September 28, 1999~~ March 31, 2008;**

*Synopsis of Changes:*

*Adopted April 27, 1997; Amended September 28, 1999 & March 31, 2008*

- 1. The SOP has non-material edits to correct grammar and sentence structure, for example, the editor changed “passive voice” sentence structure to “active voice.”*
- 2. The introduction was amended to remove language reminding the state administrator that nothing prevented the state from applying different standards from the SOP.*
- 3. Several SOPs have moved definitions to this central SOP and have incorporated these definitions by reference. Definitions moved include: “Administrator”, “Selling Expenses”, and “Underwriting Expenses.” The definition of “Underwriting Expenses” was modified by deleting the formula for valuing the underwriter’s warrants.*
- 4. Definitions added include: “Disclosure Document” and “A Person is Insolvent if.” A disclosure document means a prospectus, information statement, offering circular or other offering document. “A Person is Insolvent if” means it 1) has an accumulated deficit; 2) has negative shareholder equity; 3) is unable to satisfy current obligations as they come due; 4) has negative cash flow; or 5) has financial statements that include a footnote or explanatory paragraph in the auditor’s report regarding the issuer’s ability to continue as a going concern.*
- 5. The definition of “escrow agent” was revised to permit Canadian financial institutions to act as an “escrow agent.” The definition has previously been limited to U.S. based financial institutions. Both institutions cannot be affiliated with the issuer, its promoters or associates.*
- 6. The definition of an “impoundment agent” was revised to include a Canadian based entity provided it is a depository institution as defined in Section 102(5) of the Uniform Securities Act of 2002. The definition has previously been limited to U.S. based entities. The requirement for the depository’s deposits to be insured by the FDIC was eliminated.*
- 7. The definition of an “independent director” was revised to include the requirement that an independent director cannot currently (or within the last two years) receive, other than in his/her capacity as a member of the board of directors/committee, any consulting, advisory or other compensatory fee from the issuer, its subsidiaries, or their affiliates or associates.*
- 8. The definition of a “lock-in agreement” was revised and simplified to state that a person would not dispose of or otherwise transfer equity securities that the person had received/been granted from the issuer. Duplicative language relating to disposal methods such as to sell, pledge, hypothecate, assign... was eliminated.*
- 9. The definition of a “person” was amended to have the same meaning as the definition in the Uniform Securities Act of 2002.*

10. *The definition of a “promotional or development stage company” was amended to include language which covers an issuer not authorized or listed on various exchanges (i.e. New York, American, Nasdaq Global Market). The definition was revised to include a securities exchange that the Securities and Exchange Commission determines under Section 18(b)(1) of the Securities Act of 1933 has substantially similar listing standards.*
11. *The definition of “promotional shares” was revised to mean equity securities that a promotional or development stage company has issued within five (5) years before the filing of the registration statement or will issue to its Promoters for cash or other consideration (i.e. services, copyrights, other intangibles.) The previous version did not have the 5 year time frame.*

*The definition of an “unaffiliated institutional investor” was amended to mean: an institutional investor as defined in Section 102(11) of the Uniform Securities Act of 2002; and a business development company as defined in Section 2(a)(48) of the Investment Company Act of 1940. This change is mainly a consolidation of terms as many of the eliminated terms are contained within the amended definition. The unaffiliated Qualified Purchaser term as defined by NSMIA has been eliminated, as the Act’s definition contains a higher asset threshold of \$10 million vs. the previous \$5 million requirement.*

**d. “Impoundment of Proceeds,” as adopted with amendments through ~~September 29, 1999~~ March 31, 2008;**

*Synopsis of Changes:*

*Amended April 27, 1997, September 28, 1999, and March 31, 2008*

1. *The SOP has non-material edits to correct grammar and sentence structure, for example, the editor changed “passive voice” sentence structure to “active voice.”*
2. *The SOP was reorganized with new headings to more logically structure the policies, for example, the execution requirement associated with the impoundment agreement was broken out into its own section.*
3. *The introduction was amended to remove language reminding the state administrator that nothing prevented the state from applying different standards from the SOP. Language clarifying that the policy applies to all applications to register by coordination or by qualification has been added.*
4. *The use of definitions set forth in the NASAA Statement of Policy Regarding Corporate Securities Definitions has been applied to this SOP.*
5. *Language permitting the administrator to deny the registration has been added in the event the issuer fails to impound the proceeds associated with a non-firmly underwritten offering. If denied, the recipient of the offering proceeds is required to deposit the proceeds in an interest bearing escrow/trust account with an impoundment agent.*
6. *Eligibility restrictions relating to who may act in the capacity of an impoundment agent have been added to include any affiliate of the following: the issuer, its officers/directors, the underwriter, or promoter.*

7. *The requirements of an impoundment agreement have been amended to incorporate the duties of an impoundment agent previously specified in Section IV, including:*
  - a. *To require that the administrator be notified in writing when the agent releases the proceeds.*

*To specify that the impoundment agent return the proceeds (including pro-rata interest earned) directly to the investors, in the event that the minimum requirements are not met within the time set out in the agreement. The impounded agent is not permitted to deduct any expenses from funds returned to investors, including fees of the impoundment agent.*

**e. “Preferred Stock,” as adopted with amendments through ~~April 27, 1999~~ March 31, 2008;**

Synopsis of Changes:

*Adopted April 27, 1997; Amended March 31, 2008*

1. *The SOP has non-material edits to correct grammar and sentence structure, for example, the editor changed “passive voice” sentence structure to “active voice.” Also the phrase “the offering of securities may be disallowed by the administrator” was changed to “the administrator may deny the offer or sale” to better align with the language of the Uniform Securities Act.*
2. *The introduction was amended to remove language reminding the state administrator that nothing prevented the state from applying different standards from the SOP.*
3. *A reference to the specific terms used in this SOP that are defined in the SOP for Corporate Securities Definitions was added. The earlier version merely referenced the SOP for Corporate Securities Definitions.*

*The organization of the SOP’s outline structure was edited to provide better readability, but there were no material content changes from the earlier version.*

**f. “Promotional Shares” as adopted with amendments through ~~September 28, 1999~~ March 31, 2008;**

Synopsis of Changes:

*Amended November 17, 1997, September 28, 1999, and March 31, 2008*

1. *The SOP has non-material edits to correct grammar and sentence structure, for example, the editor changed “passive voice” sentence structure to “active voice.”*
2. *The introduction was amended to remove language reminding the state administrator that nothing prevented the state from applying different standards from the SOP.*
3. *A reference to the specific terms used in this SOP that are defined in the SOP for Corporate Securities Definitions was added. The earlier version merely referenced the SOP for Corporate Securities Definitions.*
4. *Certain definitional information was removed that duplicated information in the SOP for Corporate Securities Definitions. For example, information about acceptable “selling*



*expenses” was removed as “selling expenses” are defined in the SOP for Corporate Securities Definitions.*

5. *A more detailed formula illustration was added to show how to calculate the number of promotional shares required to be deposited in escrow.*
6. *A more detailed formula illustration was added to show how to calculate the number of promotional shares that could be periodically released from escrow after registration of the offering.*
7. *A requirement was added requiring the release of all promotional shares held in escrow if the securities become “covered securities” as defined in federal law.*
8. *The restrictions on the transfers of promotional shares was amended to indicate that the restrictions were non-exclusive to the SOP and were condensed to state that no interest in promotional shares held in escrow could be transferred by the depositor except for gift to a family member. Information about the transfer of escrowed shares by operation of law was eliminated.*

*Specific requirements for the terms of the escrow agreement were eliminated.*

**g. “Promoters’ Equity Investment,” as adopted with amendments through ~~April 27, 1997~~ March 31, 2008;**

*Synopsis of changes:*

*Amended April 27, 1997 and March 31, 2008*

1. *The SOP has non-material edits to correct grammar and sentence structure, for example, the editor changed “passive voice” sentence structure to “active voice.” Also the phrase “the offering of securities may be disallowed by the administrator” was changed to “the administrator may deny the offer or sale” to better align with the language of the Uniform Securities Act.*
2. *The introduction was amended to remove language reminding the state administrator that nothing prevented the state from applying different standards from the SOP.*

*A reference to the SOP for Corporate Securities Definitions was added for specific words used in the SOP.*

**h. “Specificity in Use of Proceeds,” as adopted with amendments through ~~September 28, 1999~~ March 31, 2008;**

*Synopsis of changes:*

*Amended April 27, 1997, September 28, 1999, and March 31, 2008*

1. *The SOP has non-material edits to correct grammar and sentence structure, for example, the editor changed “passive voice” sentence structure to “active voice.”*
2. *The introduction was amended to remove language reminding the state administrator that nothing prevented the state from applying different standards from the SOP.*

*Language clarifying that the policy applies to all applications to register by coordination or by qualification has been added.*

3. *Definitions contained in the NASAA Statement of Policy Regarding Corporate Securities Definitions are incorporated by reference including: Disclosure Document and Promoter.*
4. *The SOP was revised to clarify that the issuer must disclose the “estimated” amount of proceeds to be used for each purpose.*
5. *The SOP was revised to require the disclosure document to identify potential other sources of funds to be raised to achieve the issuer’s purpose. If these sources are contingent, an explanation of the contingency is required.*
6. *The SOP was revised to require the disclosure document to include information on potential property acquisitions and/or a not yet identified business. The revision also requires disclosure relating to the type of property/business to be acquired and potential impact to issuer’s core business to be included in the disclosure document.*
7. *Revisions relating to disclosure involving debt repayment were made. The revisions set forth the disclosure that is required if the issuer plans to use any material part of the proceeds to discharge indebtedness. The nature (i.e. whether indebtedness includes unpaid salaries) and terms of indebtedness are required to be disclosed as well as how the issuer used the proceeds of any indebtedness incurred during the current or previous fiscal year.*
8. *The flexibility in use of proceeds was amended to indicate that the issuer must not reserve more than 15% of the proceeds for working capital or general corporate purposes/other unspecified use).*

*The impound requirement for the minimum proceeds of a non-firmly underwritten offering has been modified and moved to the SOP Regarding the Impoundment of Proceeds.*

**i. “Underwriting Expenses, Underwriter’s Warrants, Selling Expenses, and Selling Securities Holders,” as adopted with amendments through ~~September 28, 1999~~ March 31, 2008;**

Synopsis of changes:

*Adopted on April 27, 1997; Amended on September 28, 1999 and March 31, 2008*

1. *The SOP has extensive, non-material edits to correct grammar and sentence structure, for example, the editor changed “passive voice” sentence structure to “active voice.” Also the phrase “the offering of securities may be disallowed by the administrator” was changed to “the administrator may deny the offer or sale” to better align with the language of the Uniform Securities Act.*
2. *The introduction was amended to remove language reminding the state administrator that nothing prevented the state from applying different standards from the SOP.*

3. *A reference to the SOP for Corporate Securities Definitions was added for specific words used in the SOP.*
4. *The SOP was reorganized with new headings to more logically structure the policies, for example, a heading was added to highlight conditions for which an administrator can deny an application for registration.*
5. *Certain definitional information was removed that duplicated information in the SOP for Corporate Securities Definitions. For example, information about acceptable “selling expenses” was removed as “selling expenses” are defined in the SOP for Corporate Securities Definitions.*
6. *The previous version of the SOP outlined specific selling and underwriting expenses that were acceptable, in addition to identifying circumstances under which the administrator could disallow an offering. The updated SOP structure now simply identifies situations that permit the administrator to deny a registration, but does not attempt to list acceptable selling and underwriting expenses.*

*A detailed illustration was added to show an example of how to calculate the value of a warrant.*

**j. “Unsound Financial Condition,” as adopted with amendments through September 28, 1999 March 31, 2008;**

Synopsis of changes:

*Adopted on April 27, 1997; Amended September 28, 1999 and March 31, 2008*

1. *The SOP has non-material edits to correct grammar and sentence structure, for example, the editor changed “passive voice” sentence structure to “active voice.”*
2. *The introduction was amended to remove language reminding the state administrator that nothing prevented the state from applying different standards from the SOP.*
3. *A reference to the SOP for Corporate Securities Definitions was added for specific words used in the SOP.*
4. *The amended version of this SOP eliminated the description of when a company may be deemed to be in unsound financial condition. The amended SOP permits the administrator to deny the registration if the issuer is insolvent.*
5. *The amended version of this SOP clarifies that the administrator may register the offering of an insolvent issuer demonstrates that the offering proceeds and long-term business plan will improve the issuer’s financial condition.*

*In the amended version of this SOP, the editor increased the suitability standards for investors. Investor must either have (A) a minimum gross income of \$70,000 and net worth of \$70,000 (previously \$65,000 each) or (b) a net worth of \$250,000 (previously \$150,000).*

**k. “Unequal Voting Rights,” as adopted with amendments through September 28, 1999 March 31, 2008;**

Synopsis of changes:

Adopted October 24, 1991; Amended March 31, 2008

1. *The SOP has non-material edits to correct grammar and sentence structure, for example, the editor changed “passive voice” sentence structure to “active voice.”*
2. *The introduction was amended to remove language reminding the state administrator that nothing prevented the state from applying different standards from the SOP.*
3. *A reference to the SOP for Corporate Securities Definitions was added for specific words used in the SOP.*

*The amended version of this SOP clarifies an offering of securities with less than equal voting rights for the same class of securities of the issuer that are currently authorized or outstanding is inconsistent with the public interest. The previous version indicated that the administrator could “deem” such an offering to not be in the public interest.*

DATED this 11th day of August, 2016.

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