

Fiscal Note & Local Impact Statement

122nd General Assembly of Ohio

BILL: Sub. H.B. 695 DATE: May 21, 1998

STATUS: As Reported by House Financial Institutions SPONSOR: Rep. Stapleton

LOCAL IMPACT STATEMENT REQUIRED: No — Minimal cost

CONTENTS: Makes various changes to the Securities Law and establishes the regulation of investment advisors and investment advisor representatives

State Fiscal Highlights

STATE FUND	FY 1998	FY 1999	FUTURE YEARS
General Revenue Fund			
Revenues	- 0 -	- 0 -	- 0 -
Expenditures	- 0 -	Potential minimal increase	Potential minimal increase
Fund 550, Securities			
Revenues	- 0 -	\$850,000 gain plus likely additional gain	\$850,000 gain plus likely additional gain
Expenditures	- 0 -	Increase, but likely less than revenue gain	Increase, but likely less than revenue gain

- The bill increases penalties for violations of state securities laws and removes certain inequities in the existing penalty statutes. Depending on the value of the funds or securities involved in the offense, fines can range from \$500 to \$20,000; offenders may also be found guilty of felonies ranging from the fifth to the first degree. The state would pay incarceration costs and share expenses with counties for indigent defense. The number of cases affected would probably be small.
- The licensure and regulation of investment advisors and investment advisor representatives will generate new revenue and expenses for the Division of Securities in the Department of Commerce. An estimated \$850,000 in new annual license fees will make up the majority of the revenue increase. Additional revenue is possible from a late license fee penalty, fees for the transfer of investment advisor and investment advisor representative licenses, and fees for changes to an investment advisor's business form, re-incorporation, merger or other similar change. During the course of regulating investment advisors and investment advisor representatives, the Division will incur regulatory costs. Although regulatory activity could include examining an investment advisor or an investment advisor representative, a significant portion of the Division's administrative costs will likely reside with licensure activities, such as renewal.



Local Fiscal Highlights

LOCAL GOVERNMENT	FY 1998	FY 1999	FUTURE YEARS
Counties			
Revenues	Potential minimal gain	Potential minimal gain	Potential minimal gain
Expenditures	Potential minimal increase	Potential minimal increase	Potential minimal increase

- Under the bill, the Director of the Department of Commerce may seek an injunction against any investment advisor or investment advisor representative for failure to comply with a subpoena or other request by the Department. The additional work placed upon common pleas courts by this new language will likely be minimal. Costs could go up a small amount. Counties pay the operating costs for common pleas courts, so they are the only local government affected.
- The bill increases penalties for violations of state securities laws and removes certain inequities in the existing penalty statutes. Depending on the value of the funds or securities involved in the offense, fines can range from \$500 to \$20,000; offenders may also be found guilty of felonies ranging from the fifth to the first degree. The county could receive fine revenue and local court revenues. The county would share potential expenses with the state for indigent defense. In both cases, any change in financial position should be relatively small.

Detailed Fiscal Analysis

This bill extends authority for regulating investment advisors (IA) and investment advisor representatives (IAR) to the Division of Securities within the Department of Commerce. Current law defines an investment advisor as a person who directly or indirectly advises others about investing in, purchasing, or selling securities or issuing reports about securities (section 1707.01(X)). No definition for an investment advisor representative currently exists. Under section 1707.01(II) of the bill, however, an IAR means a person supervised by an IA or a "supervised" person that only provides non-specific investment advisory services. Throughout the bill, the regulation of IAs and IARs closely parallel Securities Law regulations. The bill also makes other changes to the Securities Law.

State Fiscal Effect

Revenues

Under this bill, the Division of Securities will regulate certain investment advisors and investment advisor representatives. For those IAs and IARs that the Division licenses new revenue will be generated. The following table estimates the amount of new revenue according to the Division.

Table 1

Bill Section	Description	Fee	Number	Est. Annual Revenue
1707.17(B)(3)	IA license fee	\$200	800	\$160,000
1707.17(B)(4)	IA notice filing fee	\$200	200 in-state 1,000 out-of-state	\$40,000 \$200,000
1707.17(B)(5)	IAR license fee	\$50	9,000	\$450,000
Total				\$850,000

The \$200 IA license fee that the Division will collect comes from those investment advisors that have less than \$25 million in assets under their management. Federal legislation enacted in 1996 called the National Securities Markets Improvement Act divided the regulation of investment advisors between the states and the Securities Exchange Commission (SEC). This law essentially eliminated duplicative federal and state regulation of IAs. Due to the federal legislation, states must regulate these "small" IAs. Although the SEC would pursue IAs for fraudulent activity if no state regulation was implemented, the downside would be that a "fraudulent activity" is an ex post facto method of regulating IAs. So, this bill will allow the state to license and regulate from the beginning those IAs with assets less than \$25 million. The SEC will regulate those with assets under management greater than \$25 million.

Even though Ohio will not regulate IAs larger than \$25 million that operate in Ohio, the state will require those IAs to file a notice of operation. Along with the notice the bill imposes a \$200 notice filing fee. Both in-state and out-of-state IAs will pay the same fee to operate in Ohio. The table above indicates the number of in-state versus out-of-state IA's for the purpose of showing that most of the IAs paying this fee will not be based in Ohio.

Under section 1707.17(B)(5), a \$50 investment advisor representative fee is imposed. According to the Division of Securities, they estimate that 9,000 IARs will be licensed, generating \$450,000 in annual revenue.

In addition to the license fees listed in the table above, Fund 550, Securities, could receive other new revenue. Section 1707.18(A)(2) of the bill imposes a \$50 fee on an IA who wants to transfer their license. Like most other IA provisions, this provision models Securities Law language and fees for securities dealers and salespersons. The amount of revenue generated by this fee will depend upon the number of transfers. It is likely that annual revenue will be in the thousands of dollars. For IAR transfers, the fee is \$10 per IAR. It is also likely that this fee will generate several thousand dollars each year in revenue. Under section 1707.18(B)(2), the bill also imposes an identical fee schedule for an IA to change their business form, re-incorporate, merge or perform some other similar activity. Revenue in this case, while not as likely to top the transfer revenue, may enter into the thousands of dollars per year. Finally, section 1707.17(A)(1) establishes a late penalty for securities dealers and salespersons license renewals, as well as, a late penalty for IAs and IARs. In each case, the late fee is one-half of the license fee. For example, an IA who normally pays a \$200 license fee would owe \$300 if his/her license renewal were late. It is probably realistic to assume that only marginal additional revenue will be generated as a result of this change.

Two sections of the bill appear to establish new fees. However, sections 1707.03(Y)(10) and 1707.092(A)(1)(b) actually only represent a change where these revenues are collected. Section 1707.03(Y)(10) requires an issuer to file a notice of offering with the Division and pay a \$100 filing fee. According to the Division, sections 1707.03(Q), 1707.03(W), and 1707.03(X) currently collect these fees. The addition of 1707.03(Y)(10) will essentially redirect any revenues that would have been collected under the latter sections. Likewise, section 1707.092(A)(1)(b) will reallocate revenue from existing sections 1707.09 and 1707.091.

Expenditures

The Division of Securities will incur costs related to licensing and regulating investment advisors and investment advisor representatives. The costs for these activities should not exceed the projected revenue increase, but will likely be in the tens of thousands of dollars. The bill under section 1707.161 allows the Division to require an IAR license applicant to reimburse them for the actual expenses of investigating an applicant. In the event that the Division follows through with this action, Division expenditures will be lower than anticipated. The bill does not provide for the same reimbursement provision for IAs as it does for IARs. Under section 1707.151 the Division may require an IA applicant to advance sufficient funds for any investigation costs that occur outside of Ohio. This provision would more likely affect those IAs based outside of Ohio than those located in Ohio. Like the IAR, this provision would have the affect of moderating any anticipated licensing expenditures.

The bill increases penalties for violations of state securities laws and removes certain inequities in the existing penalty statutes. Depending on the value of the funds or securities involved in the offense, fines can range from \$500 to \$20,000; offenders may also be found guilty of felonies ranging from the fifth to the first degree. The state would pay incarceration costs and share expenses with counties for indigent defense. Any change in financial position should be relatively small.

Local Fiscal Effects

Section 1707.25 of the bill extends the authority of the Director of Commerce to seek injunctive relief against those people who violate Chapter 1707 to investment advisors and investment advisor representatives. The injunction would be sought in any common pleas court. Because counties pay the operating costs of common pleas courts, counties could experience an increase in costs. Any revenue generated by an injunction would go back to the county in which the order was made.

The bill increases penalties for violations of state securities laws and removes certain inequities in the existing penalty statutes. Depending on the value of the funds or securities involved in the offense, fines can range from \$500 to \$20,000; offenders may also be found guilty of felonies ranging from the fifth to the first degree. The county could receive fine revenue and local court revenues. The county would share expenses with the state for indigent defense. In both cases, any change in financial position should be relatively small.

□ *LBO staff: Sharon Hanrahan, Budget/Policy Analyst
Rick Graycarek, Budget/Policy Analyst*

H:\FN122\HB0695HR.DOC