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DEPARTMENT OF BANKING
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COMMISSIONER

HOWARD B. BROWN
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BANKING COMMISSIONER'S COMMENTS

Change in the financial services industry continues to confront us. As banks, brokerage firms and insurers offer more services and products, the question of supervisory responsibility becomes more prominent. This edition of the Securities Bulletin contains an article addressing the question of supervisory responsiblity. I believe this article will clarify many points raised regarding the responsibility of broker-dealers and investment advisers to supervise those who offer services and products to the investing public. In short, we expect proper supervision of securities personnel.

Another article addresses the presently unregulated government securities market which recently experienced some notable failures. Because the collapse of a few government securities firms resulted in unforseen consequences, I think that it is time to consider adequate regulation of these institutions. We support the efforts of the Legislation Committee of the North American Securities Administrators Association (NASAA) to develop a policy in this area.

This issue of the Securities Bulletin also highlights the increased attention which the Department of Banking is giving to various arrangements under which Individual Retirement Accounts are marketed to the investing public. An Investor Alert outlines questions to ask in choosing a financial planner. This edition also contains information to help the brokerage industry to comply with state securities laws, including the notification and transfer procedures to be followed by registrants ceasing to do business. Also included is information on the procedure to be followed by registrants requesting an extension of time to file their annual financial statements.

A continuing concern of state securities administrators is the imposition of appropriate sanctions for documented violations of the "blue sky" laws. An article in this edition points up the need for greater statutory flexibility in disposing of securities violations and sheds further light on the administrative process before this agency.

During my tenure as Banking Commissioner, the responsibilities of the Securities and Business Investments Division have grown considerably. I envision that both federal and state securities regulators will encounter new challenges in properly regulating dynamic, complex and swiftly changing markets. It has been my experience that adherence to a policy that mandates full disclosure of relevant information enhances investor protection. I also believe that a functional approach in regulating the financial services industry is sensible, practical and provides a durable solution to many existing regulatory problems. In the future, I think investor education and a balanced, coherent and orderly implementation of the state securities laws should be the overriding concerns of this state, NASAA and other jurisdictions.

This edition of the Securities Bulletin will be published during my last week as Banking Commissioner, since I have resigned my office effective September 12, 1985. The publication of the Bulletin was an important objective of mine when I first took office. I felt it was important to keep the industry well informed of Connecticut's laws, policies and procedures. I sincerely hope that you have found and will continue to find the Bulletin useful.

The Securities and Business Investments Division of the Department of Banking has undergone some substantial and positive changes in the past few years under the very capable leadership of my appointee, Division Director Caleb Nichols. To the staff of the Securities and Business Investments Division and the industry, I sincerely hope that my tenure has contributed to the success of the Division and has provided for the kind of positive relationship that ought to exist between the regulator and the regulated industry.

BRIAN J. WOOLF
BANKING COMMISSIONER

ANNOUNCEMENTS

Banking Commissioner Resigns

Commissioner Brian J. Woolf resigned his position with the Department of Banking effective September 12, 1985. During his 3 1/2 year tenure as Banking Commissioner, he initiated several changes in state supervision of the banking and securities industry. He will assume new employment as Senior Vice-President of The Richard Roberts Group, Inc. of Avon, Connecticut on October 1, 1985.

From January 1978 to December 1981, Commissioner Woolf served as Executive Assistant/Counsel to the Banking Commissioner. During this period, he was substantially involved in administering the Connecticut Uniform Securities Act, the Connecticut Business Opportunity Investment Act, the Connecticut Tender Offer Act and the state credit union laws.

The staff of the Securities and Business and Investments Division takes pride in the leadership exercised by Commissioner Woolf and wishes him well in his future endeavors.

Tom Dolan and William Olesky were promoted from the position of Examiner I to Examiner II on September 13, 1985.

Appointments to the Banking Commissioner's Advisory Committee on Securities

On May 29, 1985, Commissioner Woolf appointed Stephen H. Solomson, Esq. of the law firm of Danaher, O'Connell, Attmore Tedford & Flaherty, P.C. of Hartford and Robert Googins, Executive Vice-President of Connecticut Mutual Life Insurance of Hartford, to the Advisory Committee to the Banking Commissioner on the Connecticut Uniform Securities Act.

Mr. Solomson is a graduate of the University of Connecticut Law School, and holds a B.A. in history from Providence College. Over the years, he has held the positions of Assistant Prosecuting Attorney in Windsor, Connecticut, Assistant State's Attorney, Economic Crime Unit, Connecticut Division of Criminal Justice, Wallingford; and National Manager, Special Investigative Unit, for Commercial Union Insurance Companies of Boston, Massachusetts. Mr. Solomson is also a member of the American, Connecticut and Hartford County Bar Associations, Connecticut Defense Lawyers Association, Defense Research Association and Board of Directors, Chrysalis Center, Inc.

Mr. Googins holds a B.S. and J.D. from the University of Connecticut, an MBA from the University of Hartford and a CLU from the American College of Life Underwriters. Over the years, he has held the positions of Member, Securities and Exchange Commission Advisory Committee; Governor-at-Large, Board of Governors, National Association of Securities Dealers, Inc.; Member, Board of Governors, Association of Life Insurance Counsel; Chairman, National Association of Insurance Commissioners. Industry Advisory Committee to the Agents; Chairman, Legal Section, American Council of Life Insurance; and Director, Legal Aid Society.

ADVISORY INTERPRETATION ISSUED ON SECURITY STATUS OF INDIVIDUAL RETIREMENT ACCOUNT PROGRAM

Text of Advisory Interpretation

The Department of Banking has received your letters, with enclosures, concerning the above captioned matter. The information contained in your correspondence is incorporated by reference herein.

As I understand them, the pertinent facts are as follows. In 1980, you formed the Association. The purpose of the Association is to sell IRA plans through commissioned salespersons it employs. Such salespersons would visit various companies and attempt to solicit IRA contributions through payroll deduction. Contributions may also be made by bank draft or credit card. No minimum contribution would be required. Client funds would be aggregated to achieve a yield of at least 15 1/4 percent the first year and a guaranteed "Preferred Customer Large Deposit bulk rate" thereafter. Clients making IRA contributions would pay an administrative fee of 8 percent per year for a 10-year period. Since the total fee would be payable in the first year, clients would pay 80 percent of their first year contribution to the Association. In addition, clients would be required to pay an additional maintenance fee of $2.50 per month, starting with the 13th month. The Association would have an account at a bank on which it would draw commission checks for its salespersons and into which client funds would be deposited. Client funds would be wired out to the Brokerage Firm. All investments through the Brokerage Firm would have an independent insurance guarantee return of 100 percent of principal plus interest. An entity called Corporation would act as sponsor for the plans. XYZ, an entity which "merged" with the Association, would act as custodian. Your correspondence indicates that the Association would act as depository for the IRAs; would send out quarterly statements, and would provide personal loans and mortgages to its clients. The Association intends to market its program by mail, telephone or in person. There is no indication that the Association is a bank.

In your letter, you inquire whether the activities outlined above would involve the offer or sale of a "security" within the meaning of Section 36-471(m) of the Act. Section 36-471(m) of the Act defines the term "security" to include "any. . . investment contract." In SEC v. W.J. Howey Co., 328 U.S. 293, 66 S. Ct. 1100, 90 L. Ed. 1244 (1946), the United States Supreme Court defined the term "investment contract" to mean "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." Connecticut has adopted the Howey test in construing the term "investment contract" under state law.

In enacting federal legislation authorizing the establishment of IRAs, Congress specifically indicated that the IRAs would not be automatically excluded from the scope of the federal securities laws. Joint Explanatory Statement of the Committee of Conference H.R. 93-1280 (1974), 338. This position was acknowledged by the Securities and Exchange Commission in Release No. 33-6188, 17 C.F.R. 231.6188 (1980), which further indicated that investment contract analysis would be applied in determining if an IRA was a security under federal law.

In determining if an IRA program involves an "investment contract" under the Act, the following factors are important: 1) the nature of the investment medium; 2) the degree of investment discretion vested in each account holder, and 3) whether funds are pooled or aggregated.

The information provided to this Department indicates that IRA funds would be invested in AAA corporate obligations backed by an independent insurance company. The Individual Retirement Plan and Custodial Account Agreement, however, states that "[a]ssets shall be forwarded by the Custodian to one or more of these mediums: (a) cash (b) money market investment funds (c) stock or bond mutual funds (d) employer's stock...(e) gold bullion (f) secured 1st mortgage real estate loans... (g) secured business loans...(h) commercial paper of firms having over $100,000,000 of assets (i) certificates of deposit (CD's) and acceptances of banks having over $100,000,000 of deposits (j) secured leases for productive equipment and facilities [and] (k) secured factoring with recourse of bona fide accounts receivable supported with purchase orders from firms having credit ratings showing $100,000 or more of liquid assets." The investment options are thus not limited to non-securities or to securities which would be exempt from registration under Section 36-490 of the Act.

The Individual Retirement Plan and Custodial Account Agreement adds that, while "[s]avings/investment mediums are selected by the Depositor", "[w]ithin a given medium the medium's management and/or the discretion of the broker prevail." Consequently, total investment discretion is not vested in each account holder. Moreover, the materials submitted indicate that all funds are "managed by the world renowned Brokerage Firm." This implies that depositors may be led to expect profits solely from the efforts of the promoter or a third party.

The materials also state that "marketing a private master I.R.A. allows a company like the Association to aggregate the funds and provide the small investor yields of a very large deposit with no minimums." This would seem to indicate that the arrangement contemplated by the Association would involve an investment in a common enterprise within the meaning of the Howey formulation.

For the foregoing reasons, this Department is unable to conclude that the arrangement contemplated by the Association would not involve a "security" under Section 36-471(m) of the Act.

In addition, before offering any IRA in this state, it will be necessary for the Association to furnish proof to this Department that it has complied with all requirements of the Internal Revenue Service. Since the Association is not a bank, this Department would also require that you furnish a copy of the application filed with the Commissioner of Internal Revenue pursuant to Section 1.408-2(b)(2)(ii) of the Internal Revenue Code regulations and the response of the Internal Revenue Service to that application. In this regard, you may wish to seek the advice of counsel.

I should also point out that failure to effect a securities registration where required could lead to administrative, civil or criminal sanctions. In addition, any person offering securities in this state is subject to the anti-fraud provisions contained in Section 36-472 of the Act.

Issued: August 7, 1985

SUPERVISORY RESPONSIBILITY FOR DUALLY REGISTERED AGENTS

By George N. Gingold*

With the proliferation of new types of securities and of broker-dealers marketing those securities, agents seeking to offer investors a full range of complementary or competing products may wish to be licensed with more than one broker-dealer. Dual registration raises significant questions as to which broker-dealer will be responsible for which securities activity of the agent. These questions have been addressed from a regulatory perspective both here in Connecticut and at the federal level. Each regulatory position must be considered; the policies of the Securities and Exchange Commission (SEC) and the National Association of Securities Dealers (NASD) are particularly relevant where, for whatever reason, the Banking Commissioner would not have jurisdiction. For instance, the sale of variable annuities at the state level is subject to the insurance rather than the securities laws.

A. Connecticut

Connecticut regulations, Section 36-500-5(b)(4), state that no one "shall be concurrently registered as an agent of more than one broker-dealer or issuer unless written consent is obtained from the commissioner." Both broker-dealers (or issuers) are in violation when there is a dual employment absent prior consent from the Commissioner.

The Banking Commissioner has published in an earlier issue of this Bulletin a Statement of Departmental Policy Concerning Dual Registration of Agents. In essence, the Statement establishes the following guidelines:

1. Each request for dual registration will be considered on its own merits; no request is automatically approved or disapproved.

2. The Securities and Business Investment Division of the Department of Banking will be most likely to recommend approval of the request where each of the following factors is present:

    a. The regulated entities (broker-dealers or issuers) are closely affiliated, with "substantially identical" management and control;

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b. All "employers" consent to the dual "employment" and agree to register the agent and to assume joint and several liability with all other "employers" for any act or omission of the dually registered agent which violates Connecticut law. Counsel should not assume that the reference to "employers" just cited excludes situations where the agent functions as an independent contractor rather than as an employee of one or more of the broker-dealers. See, for example, the SEC position discussed later in this article. It may even be that regulatory concerns over supervisory liability are greater where the broker-dealer lacks the necessary control over an agent to confer more traditional employee status.

One would expect that consents under the Statement of Departmental Policy will frequently be granted where there is a reasonably close affiliation between the broker-dealers, but only rarely where there is no such affiliation. Only infrequently will unrelated broker-dealers be willing to assume joint and several liability for agent activities (the sale of competing or totally different products) which as a practical matter a broker-dealer cannot control well, and then only out of a sense that the value of a particular agent substantially exceeds the risk of liability. Further, if the agent's securities activities take place in more than one state, the position of the other state(s) on dual registration must be considered. Approximately half the states prohibit dual registration outright.

B. Federal

In August 1982, the NASD, a self-regulatory organization to which all SEC-registered broker-dealers belong, distributed to its members a letter from the Director of the SEC's Division of Market Regulation advising the NASD of concern about the status under the Securities Exchange Act of 1934 of securities salespersons designated, whether by themselves or brokerage firms, as independent contractors. The NASD, which has front-line responsibility for monitoring member compliance, urged the member firms to reflect the SEC concerns in their own internal compliance procedures.

The SEC letter did not address the dual registration issue as such, but the desire of so-called "independent contractors" to sell the securities products of more than one broker-dealer without running afoul of dual registration concerns was a likely factor in the apparent unwillingness of individuals and broker-dealers alike, hiding behind the "independent contractor" label, to effect a formal association.

The SEC emphasized that unless the independent contractor were registered individually as a broker-dealer, he or she would have to be registered with the NASD as an associated person of a broker-dealer, and that the broker-dealer had a supervisory obligation:

> Broker-dealers may not shift their obligation to control or supervise the activities of their independent contractor salespersons who are associated persons, and contractual terms that attempt to limit broker-dealer liability for the acts of such persons under the federal securities laws are of no effect...denial of 'control' of an independent contractor by a broker-dealer would not remove its responsibility for supervising that person.

The prevailing case law on supervisory liability picks up where the common-law agency theory of apparent authority leaves off. Thus, if a salesman engages in fraudulent securities activity using broker A's letterhead and in a context where the customers could reasonably believe the salesman is acting on broker A's behalf, then broker A would be liable for the fraud even though A stood to derive no benefit from the activity.

In addition, under Section 15(b)(4) of the Securities Exchange Act of 1934, broker A may be subject to SEC sanctions if the fraudulent activity resulted from a failure to maintain adequate systems of supervisory control reasonably designed to prevent such activity. The foregoing suggests strongly that a salesman and a broker-dealer look hard at the realistic likelihood that a broker would be able to exercise, and a salesman would be willing to accept, a certain amount of supervision as to sales efforts not economically benefiting that broker. If supervision is not feasible, then both parties would be better off if the salesman registered as a broker-dealer and then entered into dealer or other underwriting agreements with the first broker. The salesman, a broker-dealer, would then have to have a separate set of compliance procedures.

C. Conclusion

In essence, if a broker-dealer is amenable to dual registration, under either Connecticut (when permitted) or federal securities laws, the broker-dealer will need to:

- impose a higher standard of compliance regulation upon those registered representatives who are also registered elsewhere:

- see that those compliance standards are communicated to and understood by each such registered representative;

- enforce compliance with the standards through disciplinary action against registered representatives as required.

Without high standards supported by strong supervisory controls, the path of dual registration of registered representatives, even when permitted at the state level, is "fraught with danger" for broker-dealers, registered representatives and customers alike.

THE GOVERNMENT SECURITIES MARKET

The information contained in this piece was obtained from the Federal Reserve Bank of New York, the Securities and Exchange Commission and from other sources which are listed at the end of this article.

The trading market in U.S. government and agency securities is the largest securities market in the world. It is estimated that the total monthly trading volume of these securities exceeds $1.2 trillion. This dollar volume is estimated to be fifteen (15) times that of all corporate securities traded.

The significance of this market results from both its enormous size as well as its participants. Participants include the U.S. Treasury, the Federal Reserve, government securities dealers, investment banking houses, commercial banks, savings and loans associations, local municipalities, money market funds and corporations. Virtually all participants in the market are institutions, not individuals.

As a consequence, when a failure occurs, it has significant ramifications. The losses to several institutions and municipalities in the wake of the collapse earlier this year of E.S.M. Government Securities, Inc. ("ESM") and Bevill, Bresler and Schulman Asset Management Corporation ("BBS"), two small unregulated government securities dealers, exceeded $525 million. In the case of ESM, a privately insured Ohio savings and loan's association's losses exceeded the association's insurance fund. This precipitated the Ohio "bank holiday" which temporarily closed seventy-one savings and loan associations in Ohio.

The government securities market is vital to the U.S. Treasury, as a vehicle for financing the federal debt, and to the Federal Reserve System ("Fed") in carrying out the nation's fiscal and monetary policies.

The Federal Reserve can increase or decrease the supply of money in the banking system by either: 1) purchasing and selling U.S. government or federal agency securities and bankers acceptances in the open market; 2) raising or lowering the required percentage of reserves held against deposits; or 3) changing the "discount rate"; i.e. the interest charged to those borrowing from Federal Reserve Banks to offset reserve deficiencies.

Of the monetary tools used by the Fed, the temporary purchase and sale of U.S. government and agency securities in the open market is of primary importance. In conducting these open market operations, the Fed uses "repurchase agreements" ("repo's") and "matched sale-purchase" transactions (reverse repos). These operations supplement the outright purchases or sales of U.S. government and agency securities.

From the standpoint of the Fed, when it purchases government securities from a dealer, it pays for those securities by directly crediting the reserve account of a commercial bank in which the dealer firm has its account. As a result, new bank reserves are created. When the transaction is reversed, the dealer repurchases the securities and funds are withdrawn from the reserve account.

Generally then, in a repo transaction an investor purchases a government security from a dealer (usually a bank or securities firm) which in turn promises to repurchase the obligation after a specified period of time. The dealer pays the original price, plus an agreed-upon return. The proceeds of the repo are slightly less than the full value of the securities purchased. This difference in value is referred to as "margin" and serves to protect the initial purchaser in the event of market price declines when repurchasing the security.

Repurchase agreements are popular cash management tools that enables investors with short-term excess funds to earn a market rate of interest. It is currently estimated that securities dealers and local governments trade $60 billion of government securities daily while the repo and reverse-repo markets reach almost a trillion dollars in a single day.

The Treasury securities market has a multi-tiered system of participants. At the apex is the U.S. Treasury followed by the Federal Reserve Bank. The first tier outside government consists of the "primary dealers". These are the dealers with whom the Federal Reserve Bank of New York is willing to deal directly in conducting its open market operations. At present, there are only 36 primary dealers in treasury securities. Of this total, 13 are banks, 12 are broker-dealers registered with the Securities and Exchange Commission ("SEC"), and 11 are unregistered dealers.

Primary dealers are expected to bid for substantial amounts of treasury securities offered through the Federal Reserve Bank in addition to maintaining active secondary markets for these securities. There are approximately 200-300 dealers with whom the Fed does not deal directly, and these are referred to as the "secondary" dealers.

Primary dealers are required to submit daily, monthly and annual reports to the Fed indicating transactions, positions and capital. The Fed monitors the activity and financial soundness of primary dealers through reports and on-site visits. The Fed encourages secondary dealers to report monthly the same information provided by the primary dealers. As of April 1985, 27 non-bank secondary dealers were voluntarily reporting the information.

Current Fed oversight is based on voluntary compliance and "moral suasion", as the Fed has no statutory authority over dealers. A review of the 36 primary dealers indicates that 25 are regulated by one or more bank regulatory agencies or the SEC. The same holds true for half of the 27 voluntary reporting non-bank secondary dealers.

Government securities are exempt from the securities registration provisions of federal as well as state blue sky securities laws. However, transactions in those securities are still subject to the general anti-fraud provisions. Broker-dealers who effect transactions exclusively in government securities are exempt from the broker-dealer registration provisions of federal law. If they have no place of business in Connecticut, they are also exempt from this state's broker-dealer registration requirements.

The lack of a comprehensive and effective regulatory framework has led to a number of widely publicized failures involving unregulated government securities dealers. These failed dealers were, in most instances, affiliates of registered broker-dealers:

Winters Government Securities - (1977)
Hubbard & O'Connor Government Securities - (1979)
Drysdale Government Securities - (1982)
Lombard-Wall - (1982)
Lion Capital - (1984)
E.S.M. Government Securities, Inc. - (1985)
Bevill, Bresler & Schulman Asset Management Corp. - (1985)

Additionally, ESM, although an unregulated government securities dealer, was a voluntary reporting dealer to the Fed.

Investors involved in repos and reverse repo transactions with ESM sustained losses in excess of $300 million. ESM also resulted in the failure of an Ohio savings and loan association which had serious banking repercussions. ESM is alleged to have failed to reflect in its financial statements losses it incurred for a period of five years. BBS allegedly failed to adequately collateralize its customers who engaged in repo and reverse repo transactions, causing customer losses of approximately $225 million.

In both cases, the substantial losses resulted in part from fraud and/or deceit by the dealers as well as the failure of the savings and loan associations and banks to take the necessary measures to assure adequate possession and control of their collateral. The Fed recommends that custody of the securities be with someone beside the seller, such as a custodian bank. The Fed further suggests that investors receive from the custodian confirmations for each transaction and notice that the securities are being held exclusively for the investor's account. Investors are also cautioned by the Fed to take an adequate amount of margin and check the market value of the securities daily. The Fed also cautions investors to have a written repurchase agreement.

Partly as a result of ESM's failure, the Fed has recently adopted capital adequacy standards for government securities dealers not otherwise subject directly to any federal regulations and consequently to any capital standards. According to the Fed,, dealers take two types of operating risk: 1) trading risk resulting from market price fluctuations of dealer inventory and 2) credit risk involving the ability of the dealer's customers to meet their financial obligations.

Losses are first absorbed by the dealer's liquid capital. Once that is depleted, further losses may be borne by customers. The capital adequacy guideline therefore measures trading and credit risk and compares it to the dealer's liquid capital. The Fed's recommended standard is a ratio of liquid capital to risk that exceeds 120 percent. The adequacy standard may be calculated according to the SEC's broker-dealer Uniform Net Capital Rule 15c3-1 or the Fed's capital adequacy calculation.

At present, the capital adequacy program is voluntary and does not provide for federal oversight. The Fed has encouraged market participants who conduct business with unregulated dealers to do so only with those that certify compliance with the 1.2 to 1 liquid capital to risk standard. To insure that an unregulated dealer is adhering to the adequacy standard the Fed recommends that customers obtain from the dealer:

1. A letter of certification from the dealer that it will adhere to the capital adequacy standard on a continuing basis.

2. Audited financial statements that report the amount of liquid capital and confirm for the audit date that the dealer was in compliance.

3. A copy of a letter from the dealer's public accounting firm stating that it found no material weaknesses in the dealer's internal systems and controls incident to adherence to the standard.

Lack of action on the part of Congress to enact legislation to curb the abuses in the government securities market can seriously erode investor confidence. The 200-300 secondary dealers suffer as investors move "upstream" to conduct business with primary dealers or alternatively seek other investment strategies.

One possible solution to this problem is to vest oversight of this market with the Fed. Alternatively, creation of a self regulatory organization (SRO) under Fed oversight and in consultation with the Treasury would provide an effective mechanism for: 1) promulgating rules and establishing adequate record-keeping requirements; 2) registering government dealers and their principals; 3) conducting on-site examinations; and 4) taking disciplinary actions when necessary against members. Fees generated from the registration process and/or nominal transaction charges can provide the funding necessary to support an SRO. This same symbiotic relationship exists between the SEC, the stock exchanges and the National Association of Securities Dealers, Inc., as well as between the Commodity Futures Trading Commission and the National Futures Association. In addition, the Legislation Committee of the North American Securities Administrators Association has been charged with studying issues concerning state regulation of government securities. It will be interesting to see what, if any, policies NASAA adopts with respect to this matter.

List Of The Government Securities Dealers Reporting To The Market Reports Division Of The Federal Reserve Bank of New York

Bank of America NT & SA
Bankers Trust Company
Bear, Stearns & Co.
Briggs, Schaedle & Co., Inc.
Carroll McEntee & McGinley Incorporated
Chase Manhattan Government Securities, Inc.
Chemical Bank
Citibank, N.A.
Continental Illinois National Bank
  and Trust Company of Chicago
Crocker National Bank
Discount Corporation of New York
Donaldson, Lufkin & Jenrette Securities
  Corporation
Drexel Burnham Lambert Government Securities Inc.
The First Boston Corporation
First Interstate Bank of California
First National Bank of Chicago
Goldman, Sachs & Co.
Greenwich Capital Markets, Inc.
Harris Trust and Savings Bank
E. F. Hutton & Company, Inc.
Kidder, Peabody & Co., Incorporated
Kleinwort Benson Government Securities, Inc.
Aubrey G. Lanston & Co., Inc.
Lehman Government Securities,Inc.
Manufacturers Hanover Trust Company
Merrill Lynch Government Securities Inc.
Morgan Guaranty Trust Company of New York
Morgan Stanley & Co. Incorporated
The Northern Trust Company
Paine Webber Incorporated
Wm. E. Pollock Government Securities, Inc.
Prudential-Bache Securities, Inc.
Refco Partners
Salomon Brothers Inc.
Smith Barney Government Securities, Inc.
Dean Witter Reynolds Inc.

Sources and Further Reading Materials

Securities and Exchange Commission Release No. 34-21959, 17 C.F.R. Part 240; A Capital Adequacy Standard for U.S. Government Securities Dealers (Federal Reserve Bank of New York, July, 1985); Do You Know Where Your Collateral Is? Basic Information on Repurchase Transactions (Federal Reserve Bank of New York, June, 1985); Repurchase and Matched Sale-Purchase Transactions (Federal Reserve Bank of New York, May 1983); and A Day at the Fed (Federal Reserve Bank of New York, 1983), as well as interviews with municipal and government securities dealers. Reference should be made to these publications for further details on the government securities markets. For additional reading, see: "House Panel Advocates Federal Regulation of Government Securities - SEC Chairman Says More Study is Needed," Executive Disclosure Guide/SEC Compliance, (CCH), Vol. 10, No. 7 (April 3, 1985); The U.S. Government Securities Market, Government Bond Division, Investment Department, Harris Trust and Savings Bank (1976); "Repos and Reverse Repos: A Guide to Government-Securities Markets," Wall St. Jour., April 22, 1985; "Policy Government Securities," The N.Y. Times, August 4, 1985; and The New York Times, July 28, 1985.

INVESTOR ALERT ON FINANCIAL PLANNERS

The Investor Alert is a quarterly program jointly sponsored by the Council of Better Business Bureau (CBBB) and the North American Securities Administrators Association, Inc. (NASAA) to expose investment frauds to the public and provide useful information on how to avoid sophisticated and unlawful schemes that prey on investors. In a recent release, the CBBB and NASAA issued to investors some cautionary notes on the investment risks involved in the financial planning industry.

THE RISE OF FINANCIAL PLANNERS

Originally, the term "financial planner" was loosely applied to any of a number of personal financial advisers, including brokers, attorneys, accountants, and insurance agents. But in the last two decades, "financial planning" has evolved into a multi-billion-dollar industry, with thousands of advisers who plan and monitor investors' overall finances, rather than just a single aspect or two.

Under a law drafted a quarter of a century before the birth of the modern financial planning industry, the Securities and Exchange Commission (SEC) required the registration of "investment advisers." A total of 37 states also impose their own versions of the federal Investment Advisers Act. Though these laws were meant to encompass all individuals providing investment advice at a cost to their clients, fewer than 10,000 investment advisers are registered with the SEC. It is estimated that there are 200,000 self-proclaimed financial planners in the United States, which means that many thousands who should be registered as investment advisers under federal and state law are not.

The financial planning industry is in the midst of a meteoric rise today, fueled by the emergence of well-heeled young professionals, two-income families, the graying of the American population and aggressive advertising. Industry groups estimate that there are 10 million Americans -- many of them middle-income wage earners -- who could use financial planning services. That estimate takes in about 15 percent of American households. A national survey conducted in 1982 found that 5 percent of U.S. households were already signed up with financial planners.

LEARNING THE FINANCIAL PLANNING ROPES

There are three basic types of financial planners:

1) FEE-ONLY. Some financial planners who concentrate on upper-income clients charge a fee for their services but do not have products of their own to promote, such as stocks or real estate partnerships. These planners charge either an annual fee based on assets and investment activity or an hourly fee of $50-$200 or more. The claimed advantage here is that the planner does nothing more than give advice and is not burdened by the potential conflict of interest in promoting an investment product.

2) COMMISSION. Some planners charge no fee, but do get a commission on the investment products they sell, for example, 8.5 percent on a mutual fund or 3.5 percent or more on a tax shelter investment. The argument here is that since a financial plan requires investments, the customer benefits from the convenience of "one-stop shopping" and would, in any event, have to pay a commission no matter where the product is purchased.

3) FEE/COMMISSION. Some planners charge a fee for the financial plan and a commission for the sale of products. The claimed advantage here is that the fee is usually much lower than those charged by fee-only planners.

No matter which type of financial planner you decide to do business with, you should get the following services for your money:

1. A clearly written and individualized financial plan, including a balance sheet of assets versus liabilities, and a projected cash flow statement for at least one year. This plan should include a precise definition of your financial objectives and the steps you will take to achieve them.

2. A discussion of the amount of risk you are willing to tolerate in achieving your financial goals.

3. Specific suggestions for improving your personal cash management.

4. A detailed explanation of the assumptions underlying your financial plan, including projections for shifts in the rates of inflation and interest.

5. A range of investment choices, with the pros and cons for each course of action. You should be provided with several alternatives.

6. Additional advice, if needed, from other professionals, including lawyers, accountants and stockbrokers. This is particularly important if you do not already have established contacts with professionals in these areas.

7. A specific schedule for monitoring the progress of your financial plan, including periodic opportunities for reviewing your objectives and checking on the performance of your planner's advice.

PROSPECTS FOR CONSUMER PROTECTION

State and federal securities regulators have expressed concern in recent months that the financial planning industry is subject to little or no effective oversight.

A major SEC official recently described the federal Investment Advisers Act as a "charade." The SEC administrator explained: "Whenever I see 'registered with the SEC' on an ad (for a financial planner), I want to laugh. People think that is equivalent to the Good Housekeeping seal of approval, but it isn't." Registration under the Investment Advisers Act means that an applicant has paid $150 to the SEC, filled out a short form and waited 45 days for it to be processed. No professional standards must be met or tests passed to secure the SEC registration.

In March 1985, NASAA conducted the first-ever national hearings on new approaches to regulation of the financial planning industry. So far this year, a number of states -- including Hawaii, California, Minnesota, Maryland, Oregon, Maine and Arizona -- have considered either legislative or adminstrative rules for regulation of financial planners. NASAA and the SEC are now considering a tougher, expanded Investment Adviser Act, which would require federal and state registration of all planners and disclosure of key information to potential clients. Additionally, the International Association of Financial Planners (IAFP), an Atlanta-based industry trade group, proposed in June that Congress create a self-regulatory organization that would allow the financial planning industry to police itself in much the same way that the National Association of Securities Dealers (NASD) oversees stockbrokers.

THE RED FLAGS OF FINANCIAL PLANNING FRAUD AND ABUSE

1. Determine if a "planner" has a criminal record or a history of securities-related complaints. Even if information is not available directly about financial planners, state securities agencies and Better Business Bureaus may have information about the previous business and investment-promotion activities of a financial planner. Check out the promoter before you turn over your financial records or funds.

2. Be on your guard for possible Ponzi schemes. Self-styled financial planners with little or no experience have become prime vendors for Ponzi schemes, the house-of-cards swindles in which a few initial investors are paid interest out of the proceeds of later investors, who end up with nothing when the bubble bursts and the promoter pockets most or all of the remaining money. In this often confusing era of financial deregulation, Ponzi schemes masquerade as tax shelters, precious metals investments, commodities, high-tech stocks, and other new investment vehicles. The trick is to avoid financial planners who urge you to put your money in anything with "guaranteed" rates of short-term interest far above prevailing market rates. This no-risk promise is the No. 1 sign of a possible Ponzi rip-off.

3. Avoid financial planners who give you few or no alternatives in your investment plan. Regard any such pressure as a "yellow light" that may be signaling the planner's intention to steer you into a fraudulent scheme. (This may also indicate that the "planner" is primarily or even entirely a salesman of a specific product and is more interested in his or her commission than in your financial well-being.)
The securities

division of the Oregon Corporation Commission recently shut down a financial planner who charged a $1,500 fee to analyze a client's tax returns, and draw up a financial plan and a will. Though he never made good on producing the financial plan or the will, the self-proclaimed planner did urge over 2,500 clients to immediately put an average of $4,000 into what later was determined to be an abusive tax shelter scheme.

4. Be cautious of financial planners who fly "solo". Massachusetts Securities Commission Director Michael Unger advises that investors should never use a financial planner whose only address is a post office box or whose office staff is nothing more than a telephone answering service. It is easy for a "footloose" planner to pick up and move quickly, leaving behind a trail of bad advice and failed or even fraudulent investments. Visit your potential financial planner's office. Proper planning, record keeing and monitoring require computers or a number of workers. Make sure that your prospective planner has established ties with other reputable professionals, particularly lawyers and accountants. No one financial planner can single-handedly master the myriad dimensions of laws on investments, real estate, taxes and pensions.

THE KEY QUESTIONS TO ASK A FINANCIAL PLANNER

1. What is your professional background? Look for a strong track record of education and job experience covering the basics of financial planning. Make sure that your planner has also taken advantage of continuing education and training to update his or her knowledge of the fast-changing investment world. Also contact your state securities division to determine if the planner is complying with state and federal laws governing broker-dealers and investments advisers.

2. How long have you been a financial planner? Look for an adviser who has had adequate experience as a financial planner. A good rule of thumb is that he or she also should have logged five or more years of previous experience as a broker, insurance agent, accountant or lawyer.

3. How long have you been in the community? The basic rule of investing applies here: Deal with those individuals you either know or can check out through reliable references with trusted friends, business colleagues, bankers, accountants and lawyers. And remember that these opinions can be suplemented with information from your state securities regulator and local BBB.

4. Will you provide references from three or more clients you have counseled for at least two years? Take the time to check out the individual track records of a financial planner. Get the names of several long-term clients and ask them about their level of satisfaction, returns, and intentions about staying with the financial planner. Avoid financial planners who pressure you to rely on the word of one or two new clients, since a planner promoting a Ponzi scheme may line you up with one of the handful of early investors who are paid off in order to lure in new investors like yourself.

5. Will I be dealing with you or an associate? If your planner will be turning over all or most of the day-to-day work on your financial plan to a junior associate, check out that individual as well. Don't rely on the reputation and credentials of one planner if another planner will actually do the work.

6. May I see examples of plans and monitoring reports you have drawn up for other investors? Make sure that these documents meet all of the financial plan criteria described above. Pay particular attention to the frequency and quality of the monitoring reports, since these updates will be vital to recharting your financial objectives.

7. What financial planning trade organizations do you belong to? Industry groups provide training and membership services to financial planners. Get the names of the groups to which the planner claims to belong. Ask about the additional university or trade education and listing standards he or she claims to have met. Some of the major trade groups and related education and listing standards are listed below. Call and determine if the planner is telling the truth. Several recent cases of major investment fraud have involved financial planners making false claims about their titles and training.

Group: College for Financial Planning
Denver, Colo.
303-755-7101

Institute of Certified Financial Planners (ICFP)
Denver, Colo.
303-751-7600
Title: Certified Financial Planner (CFP) and continuing education

Group: American College
Byrn Mawr, Penn.
215-896-4500
Title: Chartered Financial Consultant (ChFC)

Group: International Association of Financial Planners
Atlanta, GA.
404-252-9600
Title: Registry of Financial Planning Practitioners

SUPREME COURT REVIEWS FEDERAL REGULATION OF NEWSLETTER PUBLISHERS

Background

On June 10, 1985, the United States Supreme Court decided Lowe v. SEC, FED. SEC. L. REP. (CCH) para. 92,062 (1985), a case involving whether investment advisory publications could be regulated under the federal Investment Advisers Act of 1940.

Lowe was the president and principal shareholder of Lowe Management Corporation, a federally registered investment adviser. He was convicted of various offenses, including misappropriating funds of an advisory client; acting as an unregistered investment adviser in New York; tampering with evidence to cover up fraud of an investment advisory client and stealing from a bank. As a result, the SEC held a hearing and ordered that the investment adviser registration of Lowe Management Corporation be revoked and that Lowe not associate with any investment adviser. The SEC then brought an action in federal district court for the Eastern District of New York for injunctive relief restraining the distribution of newsletters published by Lowe and enforcing the SEC order. The SEC claimed that Lowe, Lowe Management Corporation, Lowe Publishing Corporation and Lowe Stock Chart Service, Inc. were violating the Investment Advisers Act of 1940 and that Lowe was violating the SEC order by publishing, for paid subscribers, two purportedly semi-monthly newsletters containing investment advice and commentary and soliciting subscriptions for a stock chart service.

A typical issue of the Lowe Investment and Financial Letter contained general commentary about the securities and bullion markets; reviews of market indicators and investment strategies; and specific recommendations for buying, selling or holding stocks and bullion. The publication advertised a telephone hotline which subscribers could use to obtain current information. Although it was advertised as a semi-monthly publication, only eight issues of the newsletter were published in the 15 months following the entry of the SEC order. The Lowe Stock Advisory published only four issues between May 1981 and March 1982. It analyzed and commented on the securities and bullion markets and focused on lower-priced stocks. Subscribers were told that they could get periodic letters with updated recommendations about specific securities and that they could utilize a telephone hotline. The Lowe Chart Service was advertised as a weekly publication that would contain charts for all AMEX and NYSE listed securities and for the 1,200 most actively traded over-the-counter stocks as well as charts on gold and silver prices and market indicators. Unlike the other two publications, the Lowe Chart Service did not propose to offer specific investment advice. Although it had 40 subscribers, no issues were published.

The district court enjoined the distribution of information to subscribers by telephone, individual letter or in person. However, it refused to enjoin Lowe from continuing his publishing activities and refused to require him to disgorge any of his earnings from the publications. Although acknowledging that the Investment Advisers Act of 1940 did not, on its face, distinguish between personal and impersonal advice, the district court concluded that the Act had to be construed to allow a publisher who was willing to comply with existing reporting and disclosure requirements to register for the limited purpose of publishing such material and to engage in such publishing activity.

The Second Circuit Court of Appeals reversed, stating that the Act did not distinguish between person-to-person advice and impersonal advice given in publications. Consequently, Lowe and his two corporations were investment advisers. In addition, the exclusion in Section 202(a)(11)(D) of the Advisers Act for "the publisher of any bona fide newspaper, news magazine, or business or financial publication of general and regular circulation" was not applicable. The Court of Appeals also indicated that Lowe's history of criminal conduct justified characterizing his publications as potentially deceptive commercial speech.

The Supreme Court Decision

The Supreme Court granted certiorari to consider the constitutional question of whether the First Amendment prohibited an injunction against the publication and distribution of the newsletters. The Court's analysis, however, did not address the constitutional question directly. Instead, the Court opted for statutory construction as a means of narrowing or eliminating the constitutional issue. In so doing, the Court shunned a plain meaning approach to statutory construction and looked to the purpose of the federal Advisers Act as explained in its legislative history. The Court's heavy reliance on a statutory purpose approach permitted greater latitude in statutory construction while lending support to the Court's declared intention to exercise judicial restraint. It is questionable whether interpreting the law in the context of its passage was the proper route for the Court to take. The effect of the Court's interpretation was to underscore the weaknesses of the federal regulatory scheme, specifically its lack of comprehensiveness.

The Court found that since the newsletters were distributed for compensation and as part of a regular business and contained analysis or reports concerning securities, the basic definition of an "investment adviser" applied to the publications. The Court next turned to whether the exclusion from the definition contained in Section 202(a)(11)(D) of the Investment Advisers Act was applicable. Section 202(a)(11)(D) of the Investment Advisers Act of 1940 excludes from the definition of "investment adviser" "the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation." Noting that neither the text of the Act nor its legislative history defined the scope of the exclusion, the Court observed that Congress did not intend to exclude publications that were distributed by investment advisers as a normal part of the business of servicing their clients.

According to the legislative history, Congress was primarily interested in regulating the business of rendering personalized investment advice, including publishing activities that were a normal incident thereto. The Court observed that Congress, plainly sensitive to First Amendment concerns, wanted to clarify that it did not seek to regulate the press through the licensing of nonpersonalized publishing activities. Since two First Amendment cases were cited in the legislative history, the Court rejected the customary narrow reading given to securities exclusions and construed the provision broadly.

The Court read the word "bona fide" in the exclusion to mean "genuine." "Genuine" meant that the publication contained disinterested commentary and analysis. The Court concluded that Lowe's publications were genuine since they were published by one engaged solely in the publishing business and were not personal communications masquerading as newspapers, news magazines or financial publications. It is unclear whether the Court intended that publications distributed by one not engaged solely in the publishing business would be considered "genuine" and thus "bona fide."

According to the Court, the words "regular and general circulation" in the exclusion did not denote consistency of circulation but rather the lack of timing to specific market activity or events affecting or having the ability to affect the securities industry. A publication that was both "bona fide" and of "regular and general circulation" was to be sharply contrasted with a publication distributed by "hit and run tipsters" and "touts." Both of these terms were lifted from the federal legislative history. A "tout" was one who published promotional material rather than disinterested commentary and analysis. A "tipster" was one who offered to send, for a nominal price, a list of stocks that were sure to go up. Publications issued by such persons would not be covered by the exclusion and thus would be subject to registration as investment advisers. The same would hold true for persons sending out bulletins from time to time on the advisability of buying and selling securities in response to episodic market activity.

The Court held that since the content of Lowe's publications was completely disinterested and since those publications were offered to the public on a regular schedule, Lowe was excluded from the definition of "investment adviser" by virtue of Section 202(a)(11)(D) of the Advisers Act. The Court added that the publications did not fall within the central purpose of the statute since they contained no individualized advice attuned to any specific portfolio or client's particular needs.

The Court's distinction between "personalized" and "nonpersonalized" advice does not appear on the face of the Advisers Act. The Court derived the distinction from the legislative history and from an assumption that, by focusing on a specific class of investment advisers (i.e. those who had a one-on-one relationship with their clients), Congress intended to remove most others from federal regulation. The majority opinion did not adequately explore the fact that "professional" investment counselors having a personal relationship with their clients were the most visible and most organized component of the advisory industry forty-five years ago and the group with which Congress compromised in formulating the legislation. What the Court did was impute to Congress an intent to regulate only members of the group with the strongest lobbying power. A reading of the federal legislative history indicates that Congress did not intend to so limit the scope of the legislation. Indeed, restricting the application of the legislation to the more reputable counseling firms produces an ironic result.

There is little authority for the proposition that Congress did not intend to exclude publishing activities that were a normal part of a personalized adviser-client relationship. If personalized advice may be regulated in its own right, publishing activities are of slight consequence from a regulatory standpoint.

In rendering its decision, the Court indicated that the dangers of fraud, deception or overreaching and conflicts of interest that motivated the enactment of the federal Advisers Act were present in personalized communications but not replicated in publications advertised and sold in an open market. This highly questionable assumption fails to acknowledge the important relationship between the qualifications of a publisher and the quality of the advice rendered. In addition, the Court found that the absence of control over subscriber funds was significant. Realistically, however, a subscriber who implements a publisher's recommendations through independent means is not necessarily shielded from harm should those recommendations turn out to be baseless.

By significantly broadening the exclusion, the Court essentially adopted an after-the-fact approach to the regulation of publishers at the federal level. Although "tipsters" and "touts" would not be excluded, one cannot identify a "tout" until he or she has published the promotional material. Similarly, a "tipster" cannot be identified until the fraud has occurred and harm done. Only then can enforcement action be taken and registration required. However, registration would be of little utility at that point, and enforcement efforts would be undermined since the Court's opinion effectively abolished prophylactic regulatory measures, except with respect to professional investment advisers rendering personalized advice. Although publishers of nonfraudulent advice are presumptively excluded from the definition of "investment adviser," tipsters and touts might as well be excluded as well since they would not be subject to regulation until the SEC recognizes them for what they are. Given the dwindling resources of the SEC, and the fact that little or no information on the tipster or tout would be on file, chances are that the central thrust of the Act would be thwarted. Needless to say, this produces a strange result and does little to enhance public opinion of those newsletter publishers whose conduct is marked by integrity. Of course, once the harm has been done, tipsters or touts who repeat their conduct may be sanctioned. By then, however, it may be too late.

First Amendment Considerations

Significantly, the Court in Lowe did not declare any provision of the federal Advisers Act unconstitutional on its face as violative of the First Amendment.

Moreover, it did not expressly rule that the application of the federal Act to Lowe's publications would contravene the First Amendment. However, it is possible to imply that the Court's ruling involved a determination that the federal regulatory scheme was unconstitutional as applied in light of the Court's construction of the Act's statutory language which was based on its legislative history and an undercurrent of constitutional considerations. ~~were articulated obliquely.~~

The Court, for example, was obviously troubled by the fact that since an investment adviser registration covered both publishing and nonpublishing activities, revocation of that registration for misconduct unrelated to publishing activity could possibly infringe upon First Amendment protection. Indeed, the Court noted as significant the fact that: 1) no adverse evidence concerning the quality of the publications was introduced; 2) no evidence existed that Lowe's criminal convictions were related to the publications; 3) no evidence was present that Lowe engaged in any trading activity in any securities that were the subject of advice or comment in the publications, and 4) no contention was made that any of the published information was false or materially misleading.

The Court made two references to First Amendment considerations in its decision. Remarking that "Congress was undoubtedly aware of two major First Amendment cases that... [the] Court decided before the enactment of the Act," the Court quoted from Near v. Minnesota ex rel. Olson 283 U.S. 697 (1931) and Lowell v. City of Griffin 303 U.S. 444 (1938), concluding that "[t]he reasoning of Lowell, particularly since the case was cited in the legislative history, supports a broad reading of the exclusion for publishers." (emphasis added) Later in its opinion, the Court stated that "[t]o the extent ... [Lowe's] chart service contains factual information about past transactions and market trends, and the newsletters contain commentary on general market conditions, there can be no doubt about the protected character of the communications, a matter that concerned Congress when the exclusion was drafted." One cannot ascertain from this statement the extent to which specific advice on specific securities may be protected. In a footnote, the Court added that "because we have squarely held that the expression of opinion about a commercial product ... is protected by the First Amendment, it is difficult to see why the expression of an opinion about a marketable security should not also be protected." The Court, however, did not explain the extent of such protection or whether advisory publications would involve commercial speech or fully protected speech. Because Lowe touched on First Amendment concerns only obliquely, it cannot be considered a landmark First Amendment case.

Justice White's concurring opinion approached the constitutional issue more directly, though narrowly. Without determining whether publications involved commercial speech or fully protected speech, Justice White indicated that outright suppression of Lowe's non-fraudulent publications would not survive constitutional scrutiny. Significantly, he added:

I emphasize the narrowness of the constitutional basis on which I would decide this case. I see no infirmity in defining the term "investment adviser" to include a publisher like petitioner, and I would by no means foreclose the application of, for example, the Act's antifraud or reporting provisions to investment advisers (registered or unregistered) who offer their advice through publications ... I would hold only that the Act may not constitutionally be applied to prevent persons who are unregistered (including persons whose registration has been denied or revoked) from offering impersonal investment advice through publications such as the newsletters published by petitioner.

Assessing the constitutional impact of Lowe is difficult at this point since there is no clear line dividing the majority's statutory and constitutional analysis. Although the majority claimed to be deciding the case on statutory grounds, constitutional considerations seep through the opinion, but not in such quantity to constitute an adequate test for measuring the First Amendment impact on state legislation.

The Connecticut Regulatory Scheme

Like Section 202(a)(11) of the federal Investment Advisers Act of 1940, Section 36-471(f) of the general statutes defines an "investment adviser" as "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities." Section 36-471(f) of the general statutes was patterned after Section 410(f) of the Uniform Securities Act which in turn was taken almost verbatim from the definition in Section 202(a)(11) of the Investment Advisers Act of 1940. Section 36-471(f)(4) of the general statutes resembles in some respects the exclusion contained in Section 202(a)(11)(D) of the Advisers Act. Section 36-471(f)(4) excludes from the definition of "investment adviser" a publisher of any bona fide newspaper, news magazine, or business or financial publication of general, regular, and paid circulation,except an investment advisory publication wherein the advice is not solely incidental to that publication." The federal legislation does not contain the reference to an "investment advisory publication" found in the Connecticut Act.

Section 36-471(o) of the general statutes defines the term "investment advisory publication" to mean "a publication distributed and published at periodic intervals wherein the publisher or any of his employees specifically recommends to subscribers in writing, either directly or indirectly, the advisability of investing in, purchasing or selling specific securities or specific categories of securities."

The implication of Section 36-471(f)(4) of the general statutes is that 1) only an investment advisory publication that contained advice solely incidental to that publication would be considered eligible for the exclusion and 2) investment advisory publications may, in some circumstances, be deemed a subset of the class comprising newspapers, news magazines or business or financial publications. Distinguishing an investment advisory publication is the fact that it is distributed and published at "periodic intervals." The word "periodic" translates to "regular" but not to "general." Thus, if an investment advisory publication is of general circulation and if its advice is solely incidental, it is excluded from the definition of "investment adviser." Conversely, if an investment advisory publication is of general circulation and its specific recommendations are more than incidental to the publication, the exclusion would not come into play. Finally, if an investment advisory publication is not of general circulation, then it is not excluded, regardless of whether the advice is incidental. Implicit in the exclusion is a recognition that the advice in generally circulated newspapers, news magazines and business or financial publications is incidental to those publications.

Superimposing the Court's construction of the federal exclusion on Section 36-471(f)(4) is problematic since 1) the Connecticut exclusion, adopted over forty years following the enactment of the federal exclusion, lacks the extensive legislative history of the federal law; 2) the Court's construction is contrary to the plain meaning of Section 36-471(f)(4) of the general statutes; and 3) the Court's construction would only extend to the general exclusion and not to the exception for investment advisory publications. Compounding the problem is the fact that the Court, for example, never explicitly defines "general", although it attempts to define "regular" and "general and regular" (collectively) in terms of what the words do <u>not</u> mean, which is just as helpful as defining an "apple" to mean "something that is not a carrot."

<u>Preemption Questions</u>

The majority opinion in <u>Lowe</u> raises the subsidiary issue of what, if any, preemptive effect, the Court's declaration of Congressional intent would have on the regulation of publishers at the state level. Section 222 of the Investment Advisers Act of 1940 provides that "[n]othing in this subchapter shall affect the jurisdiction of the securities commissioner (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this subchapter or the rules and regulations thereunder." Many state statutes, such as that of Connecticut, do not conflict with the federal act on their face. However, under the Supremacy Clause, U.S. Const., Art. VI, Cl. 2, state regulation may be preempted by federal law if the state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." <u>Hines v. Davidowitz</u>, 312 U.S. 52,67,61 S.Ct. 399, 494, 85 L.Ed. 581 (1941); <u>Capital Cities Cable, Inc. v.</u> Crisp, 104 S.Ct. 2694, 2700 (1984).

The Lowe opinion carefully enunciated Congressional objectives in terms of what Congress did not intend to do. The Court, for example, explained that Congress did not intend to exclude publications distributed as a normal part of the business of servicing clients. Much of Congress' affirmative intent is thus left to implication. Where the Court does discuss affirmative intent, it avoids words like "exclusive" and describes Congressional intent as "primary" or "central," thus implying that Congress may have had more in mind. For example, the Court noted that Congress was primarily interested in regulating the business of rendering personalized advice, including publishing activities that were a normal incident thereto. The implication is that Congress may have intended to regulate other forms of advice as well. Consequently, the Court's interpretation of Congressional intent does not necessarily compel a finding that related state statutes are in conflict with the federal scheme.

The Court indicated, however, that "Congress, plainly sensitive to First Amendment concerns, wanted to make it clear that it did not seek to regulate the press through the licensing of nonpersonalized publishing activities." Aside from the constitutional implications, the fact that a state may require more extensive regulation of investment advisers does not ineluctably lead to the conclusion that a conflict exists between state and federal law. Once the First Amendment factor is introduced, however, the issue ceases to be one concerning preemption under the Commerce Clause and becomes a Bill of Rights matter. Given the Court's failure to articulate the First Amendment concerns involved, the effect that Lowe will have on state securities regulation is unclear.

Conclusion

Because the Supreme Court did not clearly delineate the parameters of Lowe or enunciate specific criteria by which it is to be implemented, the Department of Banking will await further guidance from the courts and administrative agencies. For purposes of definition and registration, under the Connecticut Uniform Securities Act, the Department takes the position that Lowe does not materially alter existing Connecticut statutory and regulatory requirements with respect to investment advisers, unless and until it is shown that Lowe clearly mandates a different position.

SURVEY OF LEGISLATIVE DEVELOPMENTS

On May 13, 1985, Governor William A. O'Neill signed into law Public Act 85-169 which amended Chapter 662 of the Connecticut General Statutes, the Connecticut Uniform Securities Act. The law became effective on May 13, 1985. The most significant amendments concerned broker-dealer regulation in Connecticut.

Any registered broker-dealer that ceases to transact business at any office in Connecticut must provide written notice to the Banking Commissioner before business activity terminates at that office. In addition, the broker-dealer must provide to each customer serviced by that office: 1) written notice, at least three business days before business activity will terminate at the office; 2) if applicable, a description of the procedure the customer may follow to maintain the customer's account at any other office of the broker-dealer; 3) the procedure for transferring the customer's account to another broker-dealer; and 4) the procedure for making delivery to the customer of any funds or securities held by the broker-dealer.

The amendment also permits the broker-dealer to seek an exemption from the provision of customer notice upon an appropriate showing made to the Banking Commissioner.

In addition, any registered broker-dealer that ceases to transact business at any office in Connecticut due to a merger or acquisition must provide written notice to the Banking Commissioner and to each customer serviced by the office. Where a registered broker-dealer ceases to transact business at any office in Connecticut due to the commencement of a bankruptcy proceeding, the broker-dealer must immediately inform the Commissioner in writing.

Public Act 85-169 also permits registered broker-dealers and investment advisers to maintain required records through the use of computer technology.

Public Act 85-169 also amended the registration by coordination provisions of the Act by only requiring that one copy of the latest form of prospectus be filed.

The legislation made other technical changes to the Act and added greater flexibility to the Banking Commissioner's enforcement powers by enabling the Commissioner to issue orders in more circumstances.

REQUESTS FOR EXTENSION OF TIME FOR FILING OF FINANCIAL STATEMENTS BY BROKER-DEALER REGISTRANTS

The broker-dealer registration section of the Securities and Business Investments Division of the Department of Banking would like to bring to the attention of its registrants Section 36-500-13(b) of the Regulations promulgated under the Connecticut Uniform Securities Act concerning requests for an extension of time for the filing of annual financial statements:

> Annual Filing of Audited Financial Statements and Supplemental Current Financial and Operation Reports: (1) Broker-dealer: (A) A broker-dealer shall file annually with the commissioner, on a calendar or fiscal year basis, a report which shall be audited by an independent public accountant or independent certified public accountant. Such report shall contain the information required in Rule 17a5(d) and be in the form required by Rule 17a5(e) promulgated by the Securities and Exchange Commission. The date of the filing shall not be more than 60 days following the end of the calendar or fiscal year. However, if the date of the filing exceeds this 60 day requirement, an unaudited statement similar in all respects must be filed, in addition, and shall not be dated more than 60 days prior to the filing.

A thirty-day extension will be considered by the Commissioner when requested in writing and accompanied by a Focus Report, Part 11 or 11a, indicating compliance with the net capital requirements, and a completed registrant's certificate.

A broker-dealer, Registrants Certificate, suitable for copying, is provided on the next page of this Securities Bulletin.

REGISTRANT'S CERTIFICATE
(Broker-Dealer)

The Undersigned .... deposes and says that
Name of Signer
he is .... of the within named ....
Title Name of Company
.... that he has examined the foregoing report of financial condition of said registrant to the State of Connecticut as of the close of business on ...., and, to the best of his knowledge and belief,
Date of Statement
the facts, set forth therein are true and correct, and, further, that neither the principal, nor any member, partner, officer, or director of the registrant, as the case may be, has any proprietary interest in any account classified solely as that of a customer.

....
Signature

State of ....

County of ....

Subscribed and sworn to before me,

this .... day of .... 19....

....
Notary Public

Important: This report must be signed by a member thereof if a partnership or the executive officer thereof if a corporation or other form of association.

REQUESTS FOR EXTENSION OF TIME FOR FILING OF ANNUAL STATEMENTS BY INVESTMENT ADVISER REGISTRANTS

The Investment Adviser Registration section of the Securities and Business Investments Division of the Department of Banking would like to bring to the attention of its registrants section 36-500-13(b)(2)(A)(iii) of the Regulations promulgated under the Connecticut Uniform Securities Act, which provides:

> The annual report of financial condition required by this subdivision shall be filed within 60 days following the end of the investment adviser's fiscal or calendar year. However, if the date of the filing exceeds this 60 day requirement, an unaudited statement similar in all respects must be filed, in addition, and shall not be dated more than 60 days prior to the filing.

A thirty day extension will be considered by the Commissioner upon receipt of a written request, an unaudited financial statement and a completed registrant's certificate. All financial statements that are submitted to the Department must meet the requirements of Section 36-500-8(c) of the Regulations which requires that tangible assets exceed liabilities to the extent of at least $1,000.

An investment adviser Registrant's Certificate, suitable for copying, is provided on the next page of this Securities Bulletin.

REGISTRANT'S CERTIFICATE
(Investment Adviser)

The Undersigned .... deposes and says that
Name of Signer
he is .... of the within named ....
Title Name of Company
.... that he has examined the foregoing report of financial condition of said registrant to the State of Connecticut as of the close of business on ...., and, to the best of his knowledge and belief,
Date of Statement
the facts, set forth therein are true and correct, and, further, that neither the principal, nor any member, partner, officer, or director of the registrant, as the case may be, has any proprietary interest in any account classified solely as that of a client.

....
Signature

State of ....

County of ....

Subscribed and sworn to before me,

this .... day of .... 19....

....
Notary Public

Important: This report must be signed by a member thereof if a partnership or the executive officer thereof if a corporation or other form of association.

BROKER-DEALER DUE DILIGENCE

This Department is frequently asked what type of due diligence a broker-dealer must perform.

A broker-dealer must conduct a "reasonable" investigation with respect to a securities registration statement to provide reasonable grounds for believing that the registration is complete and accurate..

What constitutes a reasonable investigation depends on the particular situation. The broker-dealer should not limit itself to a cursory review but should develop an investigative technique that will determine what is material in each offering. It should investigate in depth those activities involving substantial risk. If the investigation raises any questions or suggests the need for additional investigation, the broker-dealer should properly review and research the particular offering in more detail. Although counsel for the issuer is often responsible for preparing the offering materials, the broker-dealer should also assist in their preparation. The broker-dealer should not rely solely on the issuer.

The Department of Banking believes that, at a minimum, the broker-dealer should do the following to satisfy due diligence requirements:

1. Meet and have discussions with management, and review any registration statement to acquaint the broker-dealer with the business of the offering materials and the issuer.

2. Meet with suppliers, customers, brokers and anyone else having a material business relationship with the issuer.

3. Review any licenses, permits, trademarks or copyrights.

4. Check the background of directors, officers, counsel and auditors. Conduct personal interviews.

5. Review the properties of the issuer. The investigation should include looking at titles, and searching records for mortgages as well as tax and judgment liens. If the property is critical to the issuer's business,the broker-dealer should retain an outside expert to ascertain its condition or value.

6. Investigate and review documents relating to transactions concerning purchasing contracts and supply commitments.

7. Review pending litigation and administrative proceedings.

8. Review all financial statements and other financial information. The investigation should also include a review of auditors' reports concerning the issuer, a review of budgets and projections and a comparison of actual results. The broker-dealer should discuss financial statements and also the issuer's internal accounting controls with the issuer and its auditors.

9. Review employment contracts, salaries, pension, employee benefit plans and other transactions and arrangements with the issuer. The investigation should also include a review of union contracts, labor disputes and EEOC and OSHA matters.

Broker-dealers relying on a managing underwriter should review documents that outline the extent of the investigation conducted. The documents could be kept in a file if they are needed for review and/or reference.

A broker-dealer that relies on a managing underwriter should be aware that it is responsible and subject to liability, or at least potential liability, even though the investigation was conducted by others. Because of potential liability, a system should be implemented whereby a participating underwriter can ask or direct inquiries to those underwriters or individuals who have the knowledge to answer specific questions. This is especially important in tax shelter investments since they generally involve high risk and little information about the issuer may be available to the public.

FINDER'S FEES

With increased frequency, questions are raised regarding the payment of a "finder's fee" and whether a person receiving such a fee must register under the Connecticut Uniform Securities Act. A Finder's fee may be paid, for example, to a CPA or an attorney for introducing a client to a promoter or to an investment adviser for introducing a client to a broker-dealer.

The question is what type of registration may be required for an individual receiving a "finder's fee. Generally any time a fee is paid that can be attributed to the sale of securities and/or the rendering of investment advice, registration would be required.

For example, when a broker-dealer pays a "finder's fee," solicitation fee and/or a referral fee to an individual for referring a client, registration is required. The person receiving the fee should be registered as an agent of that broker-dealer. Similarly, where an investment adviser pays a finder's or a solicitation or referral fee to an individual, registration as an investment adviser agent would be necessary.

The question of referral fees was addressed in a declaratory ruling (In RE Shearson American Express) issued by the Banking Commissioner on August 24, 1982. The Commissioner noted that the fact that a fee was "referral in nature and not for rendering advice is immaterial since investment adviser agents need not render advice to be considered investment adviser agents." The reason underlying the declaratory ruling applies with equal force to broker-dealers and issuers as well as investment advisers.

This agency has detected abuse where a promoter pays fees to professional people such as financial planners, attorneys and accountants for the referral of clients to the promoter. This occasionally occurs at year-end with tax shelter investments. Acceptance of such fees by professionals and others will necessitate registration as an investment adviser, broker-dealer and/or agent. Since these fees are probably not incidental to the professional's business, there would be no statutory exclusion from the registration provisions.

Promoters should also be cautioned that the Department of Banking closely scrutinizes fees that would otherwise trigger registration where the fees are disguised as "due diligence fees," "promotion fees" or "introduction fees." If this is the case, the registration requirements apply.

Regardless of what the fee is called, if it is based on a referral or solicitation, and it is attributable to the sale of securities or the rendering of investment advice, registration with this office would be necessary.

ADMINISTRATIVE FINES

By Stephen H. Solomson

Responding to the need for protection of its citizens, Connecticut passed one of first "blue sky" laws in the United States. In 1903, the Connecticut legislature adopted a statute that required mining and oil companies to file a certificate showing their financial condition (including the location of their properties and the condition of their operating plants) with the Secretary of State if they wished to offer their shares to Connecticut citizens. [Conn. Pub. Acts 1903-05, ch. 196] Though its scope was limited, this statute set the stage for the adoption by the Connecticut legislature of a more comprehensive set of "blue sky" laws in 1929. In 1977, Connecticut adopted the Uniform Securities Act, which is still in effect today. These Acts, like all "blue sky" laws, were designed to protect the investing public from the fraudulent sales of securities.

The Uniform Securities Act was developed to provide a comprehensive and uniform scheme for the regulation of securities by the 50 states. The major points that the drafters had to address included: (1) the need for effective enforcement provisions that would deter fraud, and (2) the necessity for providing sufficient administrative flexibility to address and respond to the myriad factual situations presented to the securities administrator. Loss and Cowell, Blue Sky Law (1958). The purpose of this article is to examine Connecticut's enforcement provisions to determine if they are strong enough to provide an effective deterrent to fraud, and to analyze whether this regulatory scheme provides enough flexibility to allow for the orderly and fair administration of the Uniform Securities Act.

There can be no doubt that there is a strong state interest in providing for the protection of the state's investing public. The Connecticut Supreme Court has stated that "[the] protection of the financial interest of the public ... is a matter of serious concern." State v. Kreminski, 178 Conn. 145, 151-152 (1979) (construing criminal sanctions in statutory predecessor to the Connecticut Uniform Securites Act). It is this writer's opinion that the Connecticut Uniform Securities Act, while generally effective in addressing these concerns, can be substantially improved by augmenting the enforcement powers of the Banking Commissioner.

Under the Connecticut Uniform Securities Act, C.G.S. §36-470, et. seq., the Banking Commissioner is charged with administering the various provisions of the Act. Under C.G.S. §36-496, the Commissioner has authority to seek and impose penalties for violations of the Act. The Commissioner may:

(1) Issue a cease and desist order;

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The views expressed in this article do not necessarily represent those of the Deartment of Banking.

(2) Bring an action in the Superior Court for a permanent or temporary injunction;

(3) Seek a court order imposing a fine not exceeding $1,000;

(4) Apply to the court for an order of restitution; or

(5) Enter into a written consent order in lieu of an adjudication hearing.

The cease and desist order is strictly a matter within the discretion of the Commissioner, and may be issued ex parte. However, after the order is issued, the person(s) named in the order may file a written request for a hearing. The respondents have fourteen days from their receipt of the order to file a hearing request. Conduct of the hearing is governed by the Administrative Procedure Act (Chapter 54 of the general statutes).

The applicability of a statute, rule or order can be challenged by a petition for a declaratory ruling under C.G.S. §4-176. The form of the petition and the procedures after the petition is filed are detailed in §36-1-45, et. seq. of the Regulations of Connecticut State Agencies. The decision to issue a declaratory ruling is within the discretion of the Commissioner. The Commissioner has the option of holding a hearing before issuing a declaratory judgment ruling. If he elects to issue a declaratory ruling, he must notify the petitioner within 10 days. If the Commissioner elects to issue a declaratory ruling, it must be rendered within 90 days of the petition or, if a hearing is held, within 90 days after the close of evidence.

If an adverse declaratory ruling is issued and it is not accompanied by a hearing, or if the Commissioner refuses to issue a declaratory ruling, the petitioner can seek a declaratory judgment in the Superior Court. The aggrieved party may not, however, seek an appeal pursuant to C.G.S. §4-183 under these circumstances. See Shearson American Express, Inc. v. Banking Commission of Connecticut, Conn. Superior Court No. 1468 (1983).

If an adverse declaratory ruling was accompanied by a hearing, the party may appeal to the Superior Court under C.G.S. §4-183. The petition must be filed within 45 days of the final agency decision. The filing of an appeal does not, however, automatically stay an agency decision although a stay may be granted at the discretion of the agency or the court upon appropriate terms. An appeal under 84-183 is conducted by the court without a jury and is confined to the record. The court, upon request, will hear oral argument and receive written briefs. Case law holds that the procedures under the Uniform Administrative Procedures Act exceeds the minimum procedural safeguards mandated by the due process clause. See, Adamchek v. Board of Education of Stamford 174 Conn.366 (1978); see also Hart Twin Volvo Corp. v. Commissioner of Motor Vehicles, 165 Conn. 42 (1974).

In addition to the enforcement powers of the Commissioner enumerated above, there is always the option of referring a matter to a law enforcement agency. C.G.S. §36-497 calls for criminal penalties of up to ten years in jail and/or a fine of $10,000 for willful violations of C.G.S. §36-472 and §36-473 and up to two years in jail and/or a fine of $2,000 for a willful violation of any other provision of the Uniform Securities Act.

While criminal penalties are perhaps the most effective deterrent to fraudulent activity, as a practical matter there have not been a sufficient number of criminal complaints brought to deter illegal conduct. Again, as a practical matter, the majority of enforcement proceedings simply do not justify the involvement of the law enforcement agencies. Thus, the utility of using the criminal enforcement option is generally limited to those situations where the fraud involved is so blatant and far-reaching that civil sanctions are simply inadequate.

What is missing under the Connecticut Uniform Securities Act is the power to levy a penalty administratively without having to file an action in the Superior Court. This procedure would fill the large enforcement "gap" between the commonly used cease and desist order and criminal sanctions. With delays and expenses inherent in bringing an action in the Superior Court, the importance of being able to levy a penalty after an administrative hearing cannot be discounted.

A number of states now have such authority and many others are exploring this enforcement option. In addition, the Revised Uniform Securities Act (presently in the drafting stage) does allow for the imposition of a civil penalty up to a maximum of $2,500 for a single violation or up to $25,000 for multiple violations in related proceedings.

Among the states now authorizing their securities administrator to impose monetary penalties are Virginia, Iowa, Colorado, New Jersey and Maryland. Representatives of each of these states were contacted and stated categorically that the ability to impose monetary penalities under their securities act was very important, if not critical, to the fair and effective enforcement of their securities statutes.

These representatives stated that resorting to criminal penalties or revoking a registrants license to do business may further harm that state's investing public. Though not unmindful of the many abuses of the securities statutes and the need for strict government regulation to weed out the con men and charlatans, these regulators said they were reluctant to disrupt the financial affairs of a firm's customers by revoking that firm's right to operate in that state. A minor to moderate violation simply does not warrant such a penalty. Rather than resort to these harsh penalties, the enforcement divisions have been able in many situations to obtain consent orders that include monetary penalties and/or cease and desist orders.

One example cited by a state regulator illustrates how effective and flexible monetary penalties can be. An out-of-state broker was cited for transacting business without registering in that state. The enforcement division reached a consent agreement with the broker. Unfortunately, the broker continued doing business in the state, which prompted further enforcement action.

The state ultimately reached another agreement with the broker, and, among other things, levied a penalty of $65,000. Though one cannot be certain, the deterrent effect of this fine (which represented the commissions earned by the broker) may have had a much more significant effect on brokers contemplating similar action than a cease and desist order would. By removing the profit motive from misconduct, the state would clearly deter similar conduct in the future. As one regulator said, the stigma of a cease and desist order is simply not what it used to be and it is no longer a very effective deterrent in many instances.

A number of the regulators commented that legitimate firms seem to like the concept of monetary penalties for relatively minor or moderate transgressions of the regulatory scheme. A monetary penalty is a much less draconian measure than a suspension. A suspension can be catastrophic for even the largest firms. For a small firm, it could be fatal. It is significant to note in this regard that the Commissioners' Notes to the Uniform Securities Act emphasize that "not every minor or technical infraction is meant to result in a denial, suspension, or revocation order." Uniform Laws Annotated, Business and Financial Laws, § 204, p. 715 (Master Ed. 1970).

In summary, it appears that there is a significant trend in many jurisdictions toward the imposition of monetary penalties by the securities administrator. These jurisdictions grant the right to a hearing and allow for an appeal to satisfy due process requirements. This option gives greater flexibility to the securities administrator and, in many instances, serves as an effective deterrent. It also appears to work well as a settlement tool, giving both the administrator and the respondent flexibility in resolving the issues, consistent with sound public policy.

If the Banking Commissioner were to obtain such authority, he would not be breaking new ground in Connecticut. Presently, both the environmental protection and motor vehicle commissioners have the authority to levy civil penalties. (C.G.S. §22a-6b; C.G.S. §14-67). It is certainly fair to state that the public interest in protecting investors is no less a concern than the regulation of junk yards. (C.G.S. §14-67v).

Civil penalties simply allow more effective enforcement of the securities laws and have worked well in every jurisdiction that provide for them. The Connecticut legislature would be wise to consider and pass such legislation in order to give its citizens the greatest possible protection.

ENFORCEMENT

Cease and Desist Orders

On May 2, 1985, Commissioner Woolf ordered Playa Petroleum Inc. of Denver, Colorado and its officers, Thomas W. Caulfield, President and Don Tamm, Vice-President, to Cease and Desist from any further violations of the Securities Act. As a result of an investigation conducted by the Securities and Business Investments Division of the Department of Banking, the Commissioner concluded that the respondents offered and sold unregistered securities to Connecticut residents. These securities consisted of units in limited partnerships which were formed for the purpose of acquiring rights to drill and develop oil and gas leases and to produce and operate oil and gas wells. It was also alleged that the securities were not sold through a registered agent and/or broker-dealer.

On June 10, 1985, Commissioner Woolf ordered Computer Supplies International, Inc., ("CSI"), and its officers, of Milford, Connecticut, to Cease and Desist from the offer and sale of business opportunities in Connecticut. An investigation disclosed that the business opportunity registration of CSI lapsed on April 30, 1985 and that CSI failed to renew its registration. The investigation also disclosed that the respondents made untrue statements and failed to disclose certain material facts in connection with the offer and sale of business opportunities. In addition, they made misrepresentations to purchaser-investors regarding potential earnings.

On June 18, 1985, Commissioner Woolf ordered Mountain Capital Corporation of New Canaan, Connecticut, and its principal officer to Cease and Desist from the offer or sale of securities in Connecticut. The Commissioner alleged that the Respondents offered and sold unregistered securities, failed to make proper disclosures to investors and failed to provide investors with current financial information in connection with the offer and sale of subordinated thrift certificates. Through its officers, the company offered investors promotional materials, including personal investment briefs. Representations contained in the promotional materials compared the yield on the subordinated thrift certificates to the yield provided on bank certificates of deposit. The promotional materials offered to investors also contained a guaranteed rate of return. The personal investment briefs provided to investors were misleading in that the yield on the subordinated thrift certificates was "guaranteed" only by the ability of Mountain Capital Corporation to generate sufficient income to pay interest on the notes. The subordinated thrift certificates were guaranteed by a financial or governmental institution.

Administrative Matters

On June 10, 1985, Commissioner Woolf entered into a stipulation with Securities First, Inc., a brokerage firm located in New Haven, Connecticut. An investigation, disclosed that the firm failed to renew its broker-dealer registration, employed unregistered agents and conducted securities business while unregistered. The terms of the stipulation, provided that:

(1) SFI would receive a letter of censure from the Department of Banking.

(2) SFI would review and modify its compliance manual to detect and prevent any further violations of the Connecticut Uniform Securities Act, including recurrence of SFI's failure to timely register with the Department of Banking.

(3) SFI would not effect any purchases or sales of securities for a five-day, period commencing June 17, 1985 and ending June 21, 1985 with the exception that unsolicited sales transactions could be effected. Any commissions earned would be donated to the Ronald McDonald House Charity, in New Haven, Connecticut.

(4) SFI customers would be advised in writing of SFI's unregistered status and five-day suspension.

On June 14, 1985, Commissioner Woolf censured Securities First, Inc. and its president, Sam J. Piccione.

The Securities and Business Investment Division of the Department of Banking, required Bond Timing Services, Inc., an investment adviser located in Boston, Massachusetts, to make restitution to two Connecticut investors in the amount of $1,711. The firm had employed unregistered investment adviser agents who solicited accounts on its behalf.

Administrative Order

On August 12, 1985, Banking Commissioner Brian J. Woolf disqualified himself from hearing or deciding an administrative proceeding involving the possible revocation or suspension of the registration of E. F. Hutton & Co., Inc. Commissioner Woolf appointed Deputy Commissioner Howard B. Brown as successor hearing officer.

On October 7, 1985, at 10:00 a.m. in Rooms W52 and W58 of the State Capitol Annex, Hartford, Connecticut, Deputy Commissioner Brown will hold a hearing to determine whether Hutton's guilty plea to 2,000 counts of mail and wire fraud would warrant suspending or revoking its registration as a broker-dealer and investment adviser in Connecticut.

Deputy Commissioner Brown scheduled the hearing because the present hearing record is incomplete. He wants to examine documents that were requested by Attorney General Joseph I. Lieberman on July 15, 1985 but were not submitted to the hearing officer. Additional evidence would include the report of former U.S. Attorney General Griffin Bell concerning those Hutton employees responsible for the activities and the results of an investigation ordered by Commissioner Woolf into the involvement and accountability of Hutton employees. That investigation also will cover the extent to which Connecticut banks may have been harmed by Hutton's actions.

Civil Referral

On April 26, 1985, Commissioner Woolf requested Attorney General Joseph I. Lieberman to seek restitution for a Connecticut investor who was defrauded by the principals of Microbyx Corporation of Mt. Kisco, New York. On March 19, 1984, Commissioner Woolf issued a Cease and Desist Order alleging that Mr. and Mrs. John Andresen sold a Greenwich resident $24,000 worth of unregistered securities of Microbyx Corporation, a research and development company incorporated in Delaware.

The preliminary Cease and Desist Order issued against the Andresens in March of 1984 became final in March of 1985, following a hearing. It was established that Mr. and Mrs. Andresen: (1) sold unregistered securities of Microbyx stock in violation of state securities laws and (2) failed to disclose to investors certain material information relating to Microbyx stock, including the basis upon which the stock was valued; the fact that the exclusive assets of the company were the subject of litigation; and information concerning the financial condition of the company.

John Andresen was a former Wall Street investment banker and one of the founders of Microbyx Corporation in 1972. He resigned in 1973 as an officer and director but continued to raise capital for the company.

Criminal Referrals

On May 10, 1985, Commissioner Brian J. Woolf and Chief State's Attorney Austin J. McGuigan announced that John Koropatkin, III, of Vernon was arrested and charged with two counts of first degree larceny. Mr. Koropatkin is presently awaiting trial.

The arrest of Mr. Koropatkin is the result of a joint investigation conducted by the Department of Banking and the Economic Crime Unit of the Office of the Chief State's Attorney.

Commissioner Woolf issued a Cease and Desist Order on May 31, 1984 prohibiting Koropatkin from selling securities in or from Connecticut. The order charged that Koropatkin had sold unregistered securities, had made untrue statements to investors, and had violated the state's securities laws by engaging in acts and practices which would operate as a fraud or deceit upon potential investors.

The investigation revealed that Koropatkin approached at least three Connecticut residents and offered them the opportunity to invest money in a real estate re-development deal that promised high returns on their investments in a short period of time. As a further inducement, Koropatkin pledged shares of stock in the Vernon Bowling Lanes, which he claimed to own, as collateral for the investments. As a result, the investors invested $177,500 with Koropatkin. They received only $67,500 back from him. Investigation by the Economic Crime Unit revealed that Koropatkin did not own any shares in the Vernon Bowling Lanes nor was he an owner of that company as he had claimed.

On March 29, 1985, Charles D'Angelo of Torrington, Connecticut, a former branch manager of Smith Barney Harris and Upham Company of New York pleaded guilty to securities fraud. He was scheduled to be sentenced May 23 in the United States District Court in New Haven. It was alleged that Mr. D'Angelo misappropriated approximately $757,000 during the course of his employment with the firm. On August 23, 1984, Commissioner Woolf revoked Mr. D'Angelo's agent registration in Connecticut. On March 29, 1985, the case was referred to Chief State's Attorney Austin McGuigan for criminal prosecution. Mr. D'Angelo was also indicted by the United States Attorney's Office in connection with the same transaction. He was convicted and is serving a federal sentence. Based on the federal conviction, there will be no state prosecution.

Criminal Referrals

On June 11, 1985 Commissioner Woolf referred to Chief State's Attorney Austin J. McGuigan the case involving Minton Group, Inc. and Walter E. Wlodarski, both of New Canaan, Connecticut. As a result of an investigation conducted by the Securities and Business Investments Division of the Department of Banking, it was found that Mr. Wlodarski sold tax shelter limited partnerships to various clients. Most of these limited partnerships involved real estate investments. Mr. Wlodarski purportedly engaged in fraudulent activities in connection with the offer and sale of these investments from 1978 through 1982.

On November 9, 1983, Commissioner Woolf ordered Mr. Wlodarski and the Minton Group, Inc., of which Mr. Wlodarski was president, to Cease and Desist from transacting business as an unregistered investment adviser agent and as an unregistered investment adviser in Connecticut. Commissioner Woolf requested Mr. McGuigan to review this case for criminal prosecution under the Connecticut Uniform Securities Act. The Department requested that, if Wlodarski is convicted, restitution be made a part of his sentence. Presently, Mr. Wlodarski is incarcerated in New York for violations of the New York securities laws. Mr. Wlodarski was also a certified public accountant, and copies of the Cease and Desist Order issued by Commissioner Woolf against Mr. Wlodarski were submitted to the Board of Accountancy.

On July 29, 1985, Richard L. Eastty of 4 North Stonington Road, Old Mystic, Connecticut was arrested by the office of Chief State's Attorney Austin J. McGuigan. He was arraigned on August 12, 1985 in the New London Superior Court for allegedly violating the Connecticut Uniform Securities Act.

It was alleged that Mr. Eastty acted as an unregistered broker-dealer or agent, rendered investment advisory services absent registration and violated the anti-fraud provisions of the state securities laws.

By letter dated January 26, 1984, Commissioner Woolf requested Chief State's Attorney McGuigan to criminally prosecute Mr. Eastty for these alleged violations. Mr. Eastty was a principal in Financial Guidance, Inc., a Connecticut financial consulting company that was incorporated in January 1980. Mr. Eastty is presently awaiting trial.

Criminal Referrals

On July 2, 1985, Commissioner Woolf requested the office of the Chief State's Attorney to criminally prosecute Michael J. Creed for violation of the Connecticut Uniform Securities Act. On August 1, 1985, Chief State's Attorney, John J. Kelly commenced an investigation into this matter.

On May 5, 1985, Commissioner Woolf ordered Mr. Creed to Cease and Desist from the offer and sale of securities within Connecticut. It was alleged that Mr. Creed sold unregistered securities in the form of limited partnership interests and failed to disclose the unregistered status of these securities. It was also alleged that Mr. Creed perpetrated a fraud and deceit upon Connecticut investors.

On June 29, 1984, the Department of Banking issued a subpoena to Mr. Creed, 1722 Bucks Hill Road, Southbury, Connecticut. Mr. Creed failed to appear and produce records on July 12, 1984 as required by the subpoena. On September 10, 1984, this office issued a second subpoena to Mr. Creed commanding him to appear on September 17, 1984. The matter was referred to the Office of the Attorney General for subpoena enforcement. On November 19, 1984, the Superior Court issued an order commanding Mr. Creed to appear before the Banking Commissioner or his agent on December 17, 1984. On December 17, 1984, Mr. Creed appeared, was sworn in and testified at an investigatory inquiry.

Criminal Referrals

On August 23, 1985, Commissioner Woolf referred the case of Herbert C. Young of Trumbull, Connecticut, to Chief State's Attorney John Kelly with the recommendation that Mr. Young be criminally prosecuted under the Connecticut Uniform Securities Act. On July 3, 1985 Commissioner Woolf had ordered Mr. Young to Cease and Desist from the offer and sale of securities in or from Connecticut. It was alleged that Mr. Young sold unregistered securities and that he did not adequately disclose to investors information concerning the premature release of funds from escrow.