

2001 HOUSE APPROPRIATIONS

HB 1011

2001 HOUSE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. HB 1011

House Appropriations Committee
Government Operations Division

Conference Committee

Hearing Date January 9, 2001

Tape Number	Side A	Side B	Meter #
1/9/01 tape #1		3485 - 6222	
1/9/01 tape #2	0 - 870		
Committee Clerk Signature <i>Patricia Hall</i>			

Minutes:

The committee was called to order, and opened the hearing on HB 1011, the appropriation budget for the Securities Commissioner.

Syver Vinje: North Dakota Securities Commissioner. Had prepared testimony. The Securities Commissioner administers and enforces the following chapters of the NDCC - Chapter 10-04 (Securities Act of 1951), Chapter 51-19 (Franchise Investment Law), Chapter 51-23 (Commodities Act), and Chapter 43-10.1 (Pre-need Funeral Services Contracts). The office exists to protect North Dakota investors. This is a lot for 8 persons to do. The Securities Commissioner regulates the offer and sale of securities and franchises within ND. The jurisdiction extends past the ND borders and encompasses all activity directed toward ND residents. Statutes require registration of all securities and franchises offered for sale in ND. All persons who act as brokers, dealers, and agents for the sale of securities in ND must be registered with the Securities Commissioner prior to engaging in such activities. The Securities

Commissioner is responsible for investigation of alleged violations of securities laws, and is to initiate administrative and civil proceedings when deemed appropriate. The Securities Commissioner maintains a close working relationship and cooperates with various city, county, state, national and international law enforcement and regulatory agencies. Cases involving criminal violations are referred to the States Attorneys of various counties, the Attorney General, or the US Attorney. In these cases, the Securities Commissioner provides ongoing investigative and prosecutorial assistance. The Securities Commissioner is also responsible for promoting investor education and for fostering the formation of capital by legitimate business enterprises.

Major accomplishments in recent years include significantly increased enforcement activities. Recoveries for ND investors has increased from an average of \$200,000 per year, to more than \$500,000 per year, varying over the last three years from \$350,000 to more than \$3,500,000 annually. Since 1998, the office has improved working relationships with the Attorney General, the Insurance Commissioner, and Banking Commissioner at the state level, with local law enforcement and prosecutors at the local level, and with the SEC, FTC, FBI, USOIS, and NASD at the federal level. The office has also worked jointly with the securities regulators from Bermuda and the Bahamas regarding international fraud schemes directed at ND residents. In the past 3 years, ND has assumed a position of leadership in enforcement of interstate securities registration, regulation, and enforcement through active participation and leadership positions in NASAA (North American Securities Administrators Association) and with other state and provincial securities regulators. North Dakota maintains a system of Merit Review of securities offerings to assure that securities and franchises offered to state residents are fair and equitable to investors. This is different from a "buyer beware" review. Since 1998 the office has developed continuing education courses for financial service sales professionals.

These courses are taught several times a year at various locations across the state. In the past 4 years, the number of securities sales agents licensed to do business in ND has gone from 22,000 to more than 48,000.

In the past three years the Securities Commissioner has increased surveillance of print and electronic advertising to ND residents, including Internet surveillance. During the past fiscal year two examiner/investigator positions were added. At least four major investigations are going on at this time. In addition to enhancing the Securities Commissioner's ability to conduct "for cause" investigations and examinations, the office began a systematic program of routine examinations of sales and marketing filed offices in ND for financial sales professionals and registered investment advisors. The Securities Commissioner has established a website with links to various industry sponsored educational/informational sites offering novice and experienced investors an opportunity to learn more about our market economy. The office also offers brochures and handbooks. Capital markets are highly competitive with a limited amount of potential investors and investment dollars available. Registration and the merit reviews provide assurance to investors that they are fully informed of risk factors when making investment decisions. Registration, licensing, and monitoring of sales activity provides reasonable assurances that the financial services salespersons operating in ND are doing business honestly and fairly. The registration and enforcement activities help assure a level playing field for businesses that seek to raise capital, and for sales professionals.

The office of Securities Commissioner annually assists more than 100 ND businesses with the formation of capital through equity and debt securities offerings. The office has worked with security attorneys and small businesses to streamline the capital formation process in ND. "Test the Waters" legislation has been adopted, promoted and implemented very successfully.

We do more "test the waters" offerings in this state than the state of Pennsylvania, that is one of the most active security markets in the country. These efforts enable ND businesses to solicit the interest of potential investors before going to the expense of developing a full securities offering. The Securities Commissioner often receives letters of thanks from ND businesses for improving terms and marketability of securities offerings that have completed the "test the waters" and merit review processes. All registration forms and instructions to conduct a securities offering in ND are available on the web site.

Rep. Skarphol: These "test the waters" clientele, are these North Dakota people primarily?

Response: Primarily, these are ND persons, and in the last session we had proposed interstate test the waters legislation, but the FTC decided we couldn't do that. So the test the waters offerings are intrastate. Test the waters offerings allows a business to file a very short form with the office and go out to solicit interest in securities offerings before they actually go out and expend full amounts and can make some modifications.

Syver Vinje: (continuing from written testimony) - The Securities Commissioner provides annual continuing education to approximately 150 classroom teachers from across the state, through the INVEST NORTH DAKOTA program. This was the first program of its kind in the country, bringing practical economic education to hundreds of teachers who typically did not receive such training in college. This has become a national model for other states' continuing education programs. The web site also offers four monthly education modules that provide the opportunity to learn about personal financial topics. Each monthly module provides a lesson on a general theme that is developed month to month. The office also offers 3 professionally developed MS Power Point presentations and workbooks on personal finance and investing. These programs are available for presentation by office staff, cost free to any public

organization. On page 5 of the written testimony there is a list of the numbers of registered sales agents, broker-dealers, participants, etc. There is 1 for every 15 persons in ND.

Current issues facing regulatory agencies include a blurring of traditional boundaries between banking, insurance, and securities. This mandates that the state be prepared to make difficult decisions in organization and operation of its financial services regulatory agencies. Congressional action pre-empting certain regulatory and enforcement activities of the states in the financial sector will likely continue, and it is important that ND have a place at the table for these discussions and negotiations. More than 65% of American households are now invested in the securities markets. The federal financial services regulatory bodies focus on the integrity of the national and international markets. It is up to the states to protect the interests of the individual investors and small businesses. The states are responsible for the needs of small investors and small businesses.

Believes the executive budget proposal will allow the Securities Commissioner to meet the needs of the next biennium.

Rep. Carlisle: Have the new investigators (noted on page 2) made more money?

Response: Yes, they have increased the level of recovery significantly for ND. The current cases they are working on now are literally hundreds of thousands of dollars in commissions where there was unauthorized trading and other inappropriate activity of a couple local Bismarck brokers. Had these investigators not been available we would not have been able to pursue that case to the level that we have. There will be some restitution of some type to ND investors, and will probably bring an action against the broker/dealer for failure to supervise.

Rep. Koppelman: What is the division of labor when it comes to fraud investigation. At what point do the feds get involved and where does your responsibility end?

Response: The SEC threshold of federal involvement is about 10 million dollars. So that means that most cases in ND will not involve that amount. The SEC brings about 50 actions per year nationally against violators, the states in total bring about 500 actions. WE do about an average number in our state.

Rep. Koppelman: The explosion of the number of dealers of the licensed agents, 1 per 15 persons, and more than doubled in the last 4 years. Why is this?

Response: The number of households involved with security markets has increased quite a bit. Because of that security sales organizations have grown, and created problems in the regulatory arena, because of the old reliable stock brokers we knew and admired have been supplanted by those just looking for a quick buck and do not have high ethical standards. There is just more interest in the securities market overall.

Rep. Koppelman: Please explain the differences between the merit review and full disclosure.

Response: Merit review of full disclosure is an issue of registration of securities and what standards are applied to them. The goal is the same in the long run, to protect investors. About half of the states are merit review states and about half are full disclosure. I personally support the merit system is because when we analyze a securities we can point out deficiencies before that offering is made. It establishes perimeters and guidelines that are discretionary and they have to meet these. In a full disclosure system the party making the offering is to make full disclosure. If they don't, then the only recourse is to bring action if there is a problem. This shifts the focus from prevention to enforcement, and would take more persons.
North Dakota is statutorily merit review.

Rep. Glassheim: Should we change the funding of the agency based more on a user fee than in a general fund operation. Should the registration fee be increased, or a small charge on brokerage activities.

Response: Each of those 48,000 licensed security salespersons pays a \$60 annual fee. We generate 11 million per biennium right now, and spend about 1 million. So we are a small but significant supplier to the general fund.

Rep. Skarphol: The governor's recommendation has cut your requested budget somewhat, do you see any major difficulty with this.

Response: We have a statutory provision that allows us to recover investigative costs, but cannot do this in every instance because there just isn't any cash, but we expect to be able to replenish the budget from that cost recovery adequately to meet the needs of the agency. Supports the recommendation.

Rep. Carlisle: What was the amount of fees generated ?

Response: \$60 per person, so that is 2.88 million per year. Just from securities sales agents. So 5.6 million per biennium comes from agent registration. Turn all of this back to the general fund, except what is spent in our budget.

Rep. Koppelman: Where do the rest of the fees come from? The rest of the 11 million.

Response: The OMB handed me a printout through December of December of this biennium, franchise registration generated \$90,950, and we have renewal of franchises coming out in March that will generate about another 90,000 in franchise fees. Registration of security offerings 3.6 million, and add to that another \$700,000, and securities dealers and investment companies registrations generate \$363,000 in fees, and security salesman 4.174 million. Most of

those fees have been paid, these are on a cash receipt basis. There must be more outstanding, a large number yet to come in. Security dealers pay \$60 per year, per person.

Rep. Byerly: Going back to the fraud investigation, and the Internet usage. Are we going to need to give you more help in dealing with interstate fraud?

Response: I am hoping that between the SEC and our national organization, we should be able to keep up with these issues, as we become more adept with our own Internet surveillance efforts, and all those organizations are certainly helping with this a great deal. We should be okay with existing sources for now. Maybe in some time in the future, there will be a need.

Rep. Carlisle: Do you coordinate with the Attorney General's office, and get complaints from citizens and they get filed in your office or with the Attorney General.

Response: We cooperate with the Banking Department with some overlap there, and cases that are referred from Insurance and we routinely refer cases to them. And also between us and the Attorney General's office. That communication has increased a great deal in the last few years.

The chairman closed the hearing on this bill.

2001 HOUSE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. HB 1011

House Appropriations Committee
Government Operations Division

Conference Committee

Hearing Date January 16, 2001

Tape Number	Side A	Side B	Meter #
1-16-01 tape 1	1321 - 2540		
Committee Clerk Signature <i>Harold L. Bell</i>			

Minutes:

The committee was called to order, and opened the hearing for continued discussion on HB 1011, the appropriations bill for the Securities Commissioner.

The committee held general discussions between the committee members, all present, as to the budget requests and needs of the agency.

Rep. Byerly: If you remember from the testimony the fees all go to the general fund and then the agency is funded out of the general fund. So we have a significant amount of income coming out of this office. Departmental collections are estimated to be somewhat higher according to Governor Hoeven's budget. Some concerns as to how and why.

Rep. Skarphol: Questioned whether or not there were any bills to be offered that would affect this.

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Government Operations Division

Bill/Resolution Number HB 1011

Hearing Date January 16, 2001

Rep. Byerly: Most of the budget increases were due to the salary wage package. In response to questions, it was answered that last biennium the department got 2 FTE's, and the fees were changed. Any changes to the wage package will be must later in the session.

Rep. Carlisle moved a DO PASS , seconded by Rep. Glassheim.

The vote was 7 yes, 0 no.

The bill was given to Rep. Glassheim to carry to the full committee.

The chairman closed the hearing on this bill.

2001 HOUSE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. HB1011

House Appropriations Committee

Conference Committee

Hearing Date January 26, 2001

Tape Number	Side A	Side B	Meter #
1	x		939 - 1203
Committee Clerk Signature <i>L. S.</i>			

Minutes:

ACTION ON HB1011.

Rep. Elliot Glasshelm: This is the Securities Commission budget and the sub-committee is recommending approval of the Securities Commissioner's budget as submitted by Gov. Schafer and Gov. Hoven and the total is \$1,121, 241 and this is a \$31,200 dollar or 2.9% increase over the current bienium. There are no new FTE's and they remain at 8, despite testimony that there was a 30% increase in workload over the last four years. The operating expenses are cut \$48,000 or 18% from the current bienium and the equipment line item is cut 10%. The securities office is net contributor to the general fund in registration of securities, sales people and other fees are anticipated to bring income to the general fund totaling about 10. 2 million dollars during the next bienium. So there were no real increases in the budget, and were recommending it as submitted.

