

DRAFT STATEMENT OF BASIS AND PURPOSE

Promulgation of Amendments to Division Rules

Colorado Division of Securities

February 28, 2017

Pursuant to the authority found in the Colorado Securities Act (“Act”), sections §11-56-1-101, et seq., C.R.S. (2017), including part 6 of the Act, the Securities Commissioner adopts amendments to Division Rules 51-3.13, 51-4.3, 51-4.6(IA), 51-4.7(IA), 51-4.9(IA), 51-4.10(IA), 51-4.11(IA), 51-4.13(IA), 51-6.10, 51-6.3.

Rule 51-3.13 Transactional Securities Registration Exemptions under section 11-51-308(1)(p) was amended to add flexibility and simplicity to the rule. The language now conforms to how other fees are calculated in other sections of the Division’s Rules.

Rule 51-3.22 Crowdfunding- Disclosure Document is being amended to change the requirement that issuers raising over \$1 million need to have audited financials. In subsection (c), the rule is being amended so that issuers only need reviewed financials, not audited. This will help business use Colorado’s Crowdfunding rules because it allows the issuer to raise more money without having to bear the substantial cost of audited financials.

Rule 51-3.23-Crowdfunding Issuer Records was amended to include the phrase “or issuer” at subsection (a)(3). The entire Crowdfunding section is being amended to remove the intermediary requirement for offerings under \$500,000. This will allow issuers to raise money without additional expenses. This will make Crowdfunding more appealing to smaller businesses.

Rule 51-3.24 Crowdfunding- Additional Issuer Requirements was amended to include businesses who can handle escrow agreements, but do not meet the definition of “depository institution.” To that effect, subsection (F) was amended to include the phrase “or other escrow agent approved by the Securities Commissioner.” Similarly, subsection (F)(1)(b) was amended to replace the word “depository” with “escrow agent.” Finally, subsection (F)(2) was amended to replace “depository” with “escrow agent.”

Additionally, Rule 51-3.24 Crowdfunding-Additional Issuer Requirements was amended to allow the Securities Commissioner to waive the minimum and maximum requirements. This allows businesses to raise money, as long as they have a detailed plan for what they will use the money for, at any given level of money raised.

Finally, Rule 51-3.24 Crowdfunding- Additional Issuer Requirements is having another subsection added to make it clear that if an On-Line intermediary violates C.R.S. 11-51-308.5, these rules, or any order, that they are subject to the enforcement authority of the Commissioner under section §11-51-602 C.R.S.

Rule 51-3.27 Crowdfunding- On-Line Intermediary Written Supervisory Procedures is being repealed. This will decrease the cost for On-line Intermediaries, which will help businesses use the Crowdfunding rules and raise funds over \$500,000.

Rule 51-3.29 Crowdfunding – On-line Intermediary Prohibited Activities was amended to allow on-line intermediaries to have a carried-interest, as long as it is disclosed. This allows on-line intermediaries to make a profit while still protecting consumers by forcing the intermediary to disclose.

Rule 51-3.31(B) (the former section (B) is retitled as section (C)) was added to allow the Securities Commissioner to reject an offering if it fails to follow C.R.S. §11-51-308.5(3)(a)(IV)(A). While the licensing Statute gives the Division the authority to deem a licensing application incomplete, there is not any comparable language in the Crowdfunding Act. This Rule will allow the Division to declare an offering incomplete under the Crowdfunding Act.

Rule 51-4.3 Application for a Sales Representative License was amended to remove all references to the Series 64 examination. This test is no longer offered. Additionally, subsection (G) was amended to allow federally licensed registered representatives to become state licensed registered representatives without having to re-take the applicable examination. Finally, subsection (k) was mislabeled and should be subsection (K); this was fixed.

Rule 51-4.6(IA)(19) Books and Records Requirements for Licensed Investment Advisers was amended to provide more flexibility to investment advisers in how they will design written supervisory procedures that are reasonably designed to achieve compliance with applicable securities laws and regulations. The amendment reflects the reality that a majority of investment advisers licensed with the Colorado Division of Securities only have one or two investment adviser representatives. Further, most only have one office (or work at of their personal residence). The rule still requires larger firms to have supervisory procedures that encompass multiple employees while providing a framework that allows smaller firms to achieve compliance with the Division's books and records requirements.

Rule 51-4.7(IA) Mandatory Disclosure was amended to fix technical errors in the previous rule and to add clarity. Subsection (B) was labeled Initial Delivery to separate this section of the rule from the annual delivery requirement, which was also added in Subsection (C). Additionally, the old rule allowed for oral contracts, but Colorado requires licensees to have a written contract with clients. The reference to an oral contract was removed. Subsection (C) was added to be consistent with NASAA Model Rule 203(b)-1 and consistent with the language of the Division's rule throughout the section. Finally, former subsection (E) (current subsection F) was amended to also reflect the NASAA model rule.

Rule 51-4.9(IA) Payment of Cash Fees for Solicitation was repealed because the rule is inconsistent with recently adopted Rule 51-4.3(IA)(J)(4)(a)(iii) , which requires licensure for anyone who receives a fee from an investment adviser for client referrals.

Rule 51-4.10(IA) Custody and Safekeeping Requirements was amended to reflect the changing practices of the industry. This updated language requires investment advisers who are charging a

fee, not related to assets under management, to itemize what services they are charging clients for and how much clients are being charged for the investment adviser's services.

Rule 51-4.11(IA) Licensing Exemption for Investment Advisers to Private Funds contains a technical correction and removes a section that is no longer applicable. Subsection F changes "paragraph (b)(2)" to read "paragraph (B)(2)." Subsection (I) was removed. This section was a grandfathering provision that no longer applies.

Rule 51-4.13(IA) Net Worth Requirements was amended to include multiple formatting updates and removes an exemption that makes reference to a part of the rule that was never adopted. The first change removes, from subsection (A)(3), (a) and moves the language into the flush language of (A)(3). Next, subsection (4) removes "by this subsection (c)." There is no subsection c. Finally, under subsection (B)(2)(a), the rule make reference to another section of the rule that does not exist.

Rule 51-6.10 Representation was amended for clarification.

Rule 51-6.3 Hearings on Orders to Show Cause Why a Cease and Desist Order Should Not Enter was amended to clarify that requests for production of documents are not allowed in discovery. Additionally, subsection (D)(9) was added to ensure that the Hearing Panel or Administrative Law Judge quickly hear the case and reach a decision. It also stops the Hearing Panel or Administrative Law Judge from evading the time limit contained in the rule. This rule ensures prompt resolution of an action filed in front of the Hearing Panel or Administrative Law Judge.

The Securities Commissioner finds that the adoption of these amendments to the Rules is necessary and appropriate in the public interest, and is consistent with the purposes and provisions of the Act. The Securities Commissioner further finds that the record demonstrates the need for the Rules; the Rules are clearly and simply stated; proper statutory authority exists for the Rules; the Rules do not conflict with any other rules or statutes governing the Division of Securities; and the Rules are coordinated with the federal acts and statutes and the rules and regulations promulgated thereunder to which references are made, to the extent coordination with them is consistent with the purposes and provisions of the Act.

This general statement of basis and purpose is incorporated by reference in the rules adopted by the Securities Commissioner on _____, 2017. The rules become effective on _____, 2017.

DATED this ___ day of _____, 2017.

Gerald Rome
Securities Commissioner