

OHIO SECURITIES BULLETIN

A QUARTERLY PUBLICATION OF THE OHIO DIVISION OF SECURITIES

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Governor of Ohio

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Director of Commerce

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Investment Advisers and “Soft Dollars”

By Thomas E. Geyer

An investment adviser has a fiduciary relationship with his or her clients.¹ Among an adviser’s fiduciary obligations is the duty to obtain the best price and best execution for client transactions.² In determining which broker-dealer to use to execute transactions, an investment adviser may consider the commission rates, execution capability and other services offered by the broker-dealer. An investment adviser must keep in mind the fiduciary obligation of best price and best execution when considering these factors.

When an investment adviser causes an account to pay more than the lowest available commission to a broker-dealer in return for research products and services, the research and services provided to the investment adviser are commonly referred to as “soft dollars.”³ Soft dollars can take other similar forms such as an investment adviser’s use of “commission credits” generated by securities trades to pay for research, brokerage, or other products or expenses.

An Introduction to S.B. 32

On July 6, 2001, Governor Taft assisted the Division of Securities in pursuit of its mission of investor protection by signing S.B. 32 into law. The thrust of S.B. 32, sponsored by Senator Doug White, includes financial services modernization amendments consistent with the federal Gramm-Leach-Bliley financial modernization act; e-commerce initiatives allowing securities dealer and investment adviser license applications and renewals over the Internet; fee reductions to reduce regulatory burdens on small businesses; and, enhancements to the anti-fraud provisions of the Ohio Securities Act (Act). S.B. 32 becomes effective October 8, 2001. This article will discuss the changes made to the Act by S.B. 32 and how those changes will affect the public and industry.

The Gramm-Leach-Bliley Act (GLBA) was signed into law on November 12, 1999 and made landmark changes to the federal laws that govern the operation and

The §28(e) Safe Harbor

The law recognizes that the lowest commission rate does not always equate with the best price or the best execution. Section 28(e) of the Securities Exchange Act of 1934 contains a “safe harbor” for certain soft dollar payments.⁴ This safe harbor protects an adviser from claims for breach of fiduciary duty based solely on the fact that the adviser paid more than the lowest available commission rate if the adviser, in good faith, determined that the higher commission was reasonable in relation to the value of the brokerage and research services provided.⁵ Section 28(e)(3) provides that brokerage and research services within the safe harbor include:

- furnishing advice, either directly or through publications or writings, as to the value of securities, the advisability of investing in, purchasing, or

continued on page 2

regulation of the banking, securities and insurance industries. The GLBA is designed to permit financial service providers to affiliate with each other and provide a wide range of financial services “under one roof.” To carry out the Congressional intent on the state level, S.B. 32 amends RC 1707.01(E) to give banks a full exception from the definition of “dealer.” This amendment replaces the current partial exception, aligns Ohio law with the law of approximately forty other states, and removes a regulatory hurdle from bank securities activities in Ohio. In addition to this statutory change, the Division promulgated an administrative rule, effective February 1, 2001, that allows commission sharing between securities dealers and banks consistent with the GLBA. See *OAC 1301:6-3-19(A)(7)* and *Ohio Securities Bulletin 2001:1*. The Division believes changes are necessary to make Ohio an attractive state

continued on page 10

OHIO DEPARTMENT OF COMMERCE DIVISION OF SECURITIES

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Ohio Securities Bulletin

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Table of Contents

Investment Advisers and “Soft Dollars”	1
An Introduction to S.B. 32	1
Division Sponsors Investor Education Initiatives	3
Frequently Asked Questions Regarding Investment Advisers and Investment Adviser Representatives.	4
Enforcement Section Reports	5
Public Notice	9
Licensing Statistics	9
Ohio Securities Conference 2001	10
Registration Statistics	11
Capital Formation Statistics	11

“Soft Dollars”

continued from page 1

selling securities, and the availability of securities or purchasers or sellers of securities;

- furnishing analyses and reports concerning issuers, industries, securities, economic factors and trends, portfolio strategy, and the performance of accounts; or

- effecting securities transactions and performing functions incidental thereto (such as clearance, settlement, and custody) or required in connection therewith by rules of the SEC or a self-regulatory organization of which such person is a member or person associated with a member or in which such person is a participant.

The SEC has issued extensive interpretive guidance on the section 28(e) safe harbor. The leading point of guidance is Securities Exchange Act Release No. 34-23170 (April 23, 1986).⁶ This release provides the following specific guidance:

- *Scope of the Safe Harbor.* The touchstone for determining when a service is within or without the definition in section 28(e)(3) is whether it provides lawful and appropriate assistance to the investment adviser in the carrying out of the adviser's responsibilities.⁷

- *Mixed Use Product.* Where a product or service termed “research” also serves other purposes not related to the making of investment decisions, the adviser should make a reasonable allocation of the cost of the product according to its use.⁸

- *Third Party Research.* It is not necessary that a broker-dealer prepare research “in house” in order for the research to be within the section 28(e)(3) safe harbor. Third party research is within the safe harbor when the broker-dealer has incurred a direct legal obligation to a third party to pay for the research, regardless of whether the research is sent

directly by the third party to the client, or is sent to the adviser who in turn sends it to the client.⁹

- *Disclosure.* Investment advisers engaging in soft dollar arrangements must comply with all applicable disclosure requirements. Disclosure is required even if an arrangement is within the safe harbor provided by section 28(e).¹⁰ (Disclosure obligations are discussed in more detail below.)

- *Best Execution.* An investment adviser must execute securities transactions for clients in such a manner that the client's total cost or proceeds in each transaction is the most favorable under the circumstances. An investment adviser should periodically and systematically evaluate the execution performance of broker-dealers executing their transactions.¹¹

The section 28(e) safe harbor is available for all investment advisers operating in Ohio: those who are registered with the SEC and make a notice filing with the Division, as well as those who are licensed by the Division.

The Division especially emphasizes the following in regard to soft dollar arrangements:

- investment advisers engaging in soft dollar arrangements must comply with all applicable disclosure requirements, and disclosure is required even if an arrangement is with the safe harbor provided by section 28(e);

- although an investment adviser need not solicit competitive bids on each transaction, an investment adviser should periodically and systematically evaluate the execution performance of broker-dealers executing their transactions; and

- where an investment adviser is affiliated with or has a relationship with the brokerage firm executing the transaction, and a commission higher than the lowest available rate is paid, the adviser's burden of showing that it acted solely in the interest of the client is particularly heavy.

Disclosure

Certain information about soft dollar arrangements must be given in response to Item 8 of Part 1 of the Form ADV. More detailed disclosure about soft dollar practices must be contained in the investment adviser's brochure pursuant to Item 12 of Part II of the Form ADV. The investment adviser must

OHIO SECURITIES BULLETIN

Desiree T. Shannon, Esq., Editor

The *Ohio Securities Bulletin* is a quarterly publication of the Ohio Department of Commerce, Division of Securities. The primary purpose of the *Bulletin* is to (i) provide commentary on timely or timeless issues pertaining to securities law and regulation in Ohio, (ii) provide legislative updates, (iii) report the activities of the enforcement section, (iv) set forth registration and licensing statistics and (v) provide public notice of various proceedings.

The Division encourages members of the securities community to submit for publication articles on timely or timeless issues pertaining to securities law and regulation in Ohio. If you are interested in submitting an article, contact the Editor for editorial guidelines and publication deadlines. The Division reserves the right to edit articles submitted for publication.

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Enforcement 466-6140
Registration 466-3440
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describe the factors considered in selecting brokers and determining the reasonableness of their commissions. If the value of products, research and services given to the investment adviser or related person is a factor, the investment adviser must describe: (1) the products, research and services; (2) whether clients may pay commissions higher than those obtainable from other brokers in return for those products and services; (3) whether research is used to service all of the investment adviser's accounts or just those paying for it; and (4) any procedures the investment adviser used during the last fiscal year to direct client transactions to a particular broker in return for products and research services received.

In addition, Item 13A of Part II of the Form ADV requires a description of any arrangement pursuant to which an investment adviser is paid cash or receives commissions, equipment or non-research services from a non-client in connection with giving advice to clients.

Failure to disclose properly soft dollar arrangements violates the investment adviser anti-fraud standards.¹²

Mr. Geyer is an Assistant Director of the Department of Commerce. He served as Commissioner of Securities from 1996 to 2000.

- 1 SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191, 194 (1963).
- 2 See, e.g., In the Matter of Michael L. Smirlock, SEC Release No. IA-1393, 1993 WL 492792 (1993).
- 3 Lemke and Lins, Regulation of Investment Advisers, § 2.02[15][a][i] (2001 ed.).
- 4 15 U.S.C. 78bb(e). "The Congress added Section 28(e) to the Act to make clear that [investment advisers] could consider the provision of research, as well as execution services, in evaluating the cost of brokerage services without violating their fiduciary responsibilities." Securities Exchange Act Release No. 34-23170 (April 23, 1986) at § I, 17 C.F.R. 241.23170.

- 5 Section 28(e) only excuses paying more than the lowest available commission and does not shield a person who exercises investment discretion from charges of violations of the antifraud provisions of the federal (or state) securities laws or from allegations, for example, that the adviser churned an account, failed to seek the best price, or failed to make required disclosures. See Securities Exchange Act Release No. 34-23170 (April 23, 1986), 17 C.F.R. 241.23170.
- 6 Securities Exchange Act Release No. 34-23170 (April 23, 1986), 17 C.F.R. 241.23170.
- 7 *Id.* at § II.A.
- 8 *Id.* at § II.B.
- 9 *Id.* at § III.
- 10 *Id.* at § IV.A.1.
- 11 *Id.* at § V.
- 12 See, e.g., In the Matter of Marvin & Palmer Associates, Inc., SEC Release No. IA-1841, 1999 WL 777443 (1999).

Division Sponsors Investor Education Initiatives

The Ohio Division of Securities is committed to investor education efforts year-round, and it has recently allocated additional resources to educational initiatives. Some of the Division's recent investor educational initiatives are summarized here.

Financial Literacy 2001

Gary Suhadolnik, Director of the Ohio Department of Commerce, and Dr. Susan T. Zelman, Ohio Superintendent of Public Instruction, announced a partnership in 1999 of a financial education program for high school students, "Financial Literacy 2001." The program offers the *Basics of Savings and Investing* teaching guide, an interactive Web site for teachers, and teacher newsletters. The teaching guide was developed by the Investor Protection Trust, the North American Securities Administrators Association ("NASAA") (of which the Division is a member) and the National Association of Securities Dealers ("NASD"), in conjunction with Eastern Michigan University.

The teaching guide highlights such topics as how to design a personal financial plan; how financial markets work; how to select among various savings and investment options; how to find and use investment information; and how to recognize and protect yourself against investment fraud. The teaching guide includes units of instruction that contain learning objectives, background information, suggested activities, overhead transparency masters, student handouts, worksheets, additional resources and a unit test. An appendix includes sources of additional information and a glossary of terms.

The Ohio teaching guides are being distributed on an ongoing basis by the Division at no charge to teachers. A letter of support for the program by the Ohio Department of Education, signed by Dr. Susan T. Zelman, is also provided to the teachers. The teaching guides are provided to the Division by the Investor Protection Trust. To date, the Division has distributed over 2000 guides to Ohio teachers.

The Division planned a training session on the program for the Ohio Council on

Economic Education coordinators. Some of these coordinators have in turn held training sessions for high school teachers around the state. The Division has also taught training sessions for teachers at teacher conferences in Ohio. The Division has also utilized the training guide in its educational outreach efforts to students.

The Division participated with the West Virginia Securities Division in a financial literacy event for high school students in March at the St. Clairsville Mall called "Money Matters." Approximately 120 students attended six educational sessions throughout the day. Students from three Ohio high schools were also invited and attended the event.

Educational Mall Event for High School Students

Participants who gave presentations at each session were various West Virginia agencies, including the Insurance Commission; the Bureau of Public Debt; the Attorney

continued on page 5

Frequently Asked Questions Regarding Investment Advisors and Investment Advisor Representatives

1. *How do I use IARD?*

The Investment Adviser Registration Depository (IARD) is the internet-based electronic filing system for investment advisers operated by NASD-Regulation. IAs must follow an “entitlement process” and submit certain forms to NASDR in order to access the system. SEC-registered IAs may use the IARD to make notice filings with the Division, although we still accept paper filings. Information about IARD is available at www.iard.com.

2. *How is IARD being implemented?*

In four phases. In the first phase, SEC registrants entered the system. In the second phase, state-licensed IAs will enter the system. In the third phase, investment adviser representatives will enter the system, and, in the fourth phase, the information from new Part 2 of the new Form ADV (the new “brochure rule”) will be entered into the system.

3. *As an SEC registrant using the IARD, I am not required to file Part 2 of the new ADV (my brochure); nonetheless, do I have to file it as part of my notice filing with the Division?*

No. When the fourth phase of the IARD is deployed, the Division will receive electronic versions of the brochures of notice filers, but notice filers need not file a paper brochure with the Division in the interim.

4. *Do I have to use the “new” Form ADV?*

In connection with the deployment of the IARD, the SEC adopted a new version of the Form ADV. SEC-registered IAs using the IARD must use the

new ADV because that is the only option offered by the system. At the present time, SEC-registered IAs submitting a notice filing to the Division may use either the old ADV or the new ADV. Similarly, at the present time Ohio-licensed IAs may use either the old ADV or the new ADV. Ohio-licensed IAs choosing to use the new ADV should complete and submit new Parts 1A and 1B, and complete and submit old Part II (or a brochure in compliance therewith).

5. *What happened to Schedule I?*

Schedule I to the old ADV was the document on which an IA indicated its eligibility for SEC registration. The categories of eligibility for SEC registration now appear in Item 2 of Part 1A of the new ADV.

6. *How do I amend or update my Ohio notice filing?*

Once an IA enters the IARD, updates will be filed through the IARD.

7. *How do I amend or update my Ohio license file?*

Currently, O.A.C. 1301:6-3-151(E) requires that Ohio-licensed IAs file certain updates with the Division. The update filing should consist of an executed copy of page 1 of the ADV, and the page(s) containing the amended information. There is no fee. The Division is reviewing these provisions, so be on the lookout for changes in the second half of 2001.

8. *Do investment adviser representatives of SEC-registered investment advisers have to be licensed by the Division?*

Yes, unless the representative is within one of the exceptions to licensing described in Revised Code 1707.161.

9. *Do solicitors have to be licensed with the Division?*

No, Ohio does not issue a solicitor’s license. However, if the solicitor “fits” within the definition of “investment adviser” or “investment adviser representative”, they must obtain that type of license.

10. *Does the Division conduct field examinations of investment advisers?*

Yes. We implemented a field examination program in June 2000. In general, our examination authority is limited to Ohio-licensed investment advisers (we may examine an SEC-registered adviser in the case of fraud or deceit).

11. *How does the Division determine which investment advisers to examine?*

So far, we have examined those advisers who have raised concern among Division staff based on filings or other communications made with the Division.

12. *Are there common deficiencies?*

The most common deficiencies we have seen are: a general lack of compliance with the books and records rules (O.A.C. 1301:6-3-151(C)); lack of understanding of and compliance with the custody rule (O.A.C. 1301:6-3-44(B)); and lack of compliance with the brochure rule (O.A.C. 1301:6-3-151(H)).

13. *Can a Division examiner fix a deficiency?*

No. We can identify problems, but it is up to the adviser to determine how to remedy the problems.

Enforcement Section Reports

Donahue Securities, Inc.

On April 12, 2001, the Division revoked the Ohio securities dealer license of Donahue Securities, Inc. Respondent is located in Cincinnati, Ohio.

On March 9, 2001, the Division suspended Respondent's license and issued a Notice of Intent to Revoke and Notice of Opportunity for Hearing pursuant to Revised Code Chapter 119. The Division found that Respondent was not of "good business repute" as that term is defined in Revised Code section 1707.19(A)(1) and Ohio Administrative Code rule 1301:6-3-19(D)(2). Respondent did not request a hearing and a Final Order revoking Respondent's Ohio securities dealer license was issued on April 12, 2001.

Stephen Greg Donahue

On April 12, 2001, the Division revoked the Ohio securities salesperson license of Stephen Greg Donahue, of Cincinnati, Ohio.

On March 9, 2001, the Division suspended Respondent's license and issued a Notice of Intent to Revoke and Notice of Opportunity for Hearing pursuant to Revised Code Chapter 119. The Division found that Respondent was not of "good business repute" as that term is defined in Revised Code section 1707.19(A)(1) and Ohio Administrative Code rule 1301:6-3-19(D). Respondent did not request a hearing and a Final Order revoking Respondent's Ohio securities salesperson license was issued on April 12, 2001.

Brad Polinko

On April 12, 2001, Division Order No. 01-117, a Final Order Denying the Securities Salesperson Application and a Cease and Desist Order, against Brad Polinko, was issued after a 119 hearing. Respondent is an Ohio resident who was seeking to become a licensed securities salesperson with Quantum Securities Corporation.

On October 4, 2000, the Division issued a Notice of Opportunity of Hearing, Division Order No. 00-343, to Brad Polinko. The Division alleged that the Respondent had violated the provisions of Revised Code Section 1707.44(A)(1) by selling securities without being licensed as a securities salesperson. The Division also alleged that these

continued on page 6

Education Initiatives

continued from page 3

General's office; the consumer Credit Counseling Services and the Securities Division. In addition, the Canton Better Business Bureau, the National White Collar Crime Center and the Division participated and gave presentations.

The high school students were given incentives from the mall merchants at the educational events, such as at an overview of the "Stock Market Game" where students utilized play money. Commissioner Debbie Dye Joyce attended the event and gave presentations at each session to the students from the "Financial Literacy 2001" *Basics of Savings and Investing* curriculum.

Savings and Investing Education Month

Governor Taft issued a resolution proclaiming the month of April as "Saving and Investing Education Month" in the State of Ohio, reflecting his continued support of financial literacy education of Ohioans. This observance month, which is part of an international investor education campaign, involved the Division's fourth annual educational outreach initiatives designed to encourage consumers to save, invest wisely, and protect themselves against fraud.

The Ohio Department of Commerce continued its support of the joint partnership with the Ohio Department of Education for the financial literacy program "Financial Literacy 2001," a high school program of personal finance curriculum. Seventeen Division personnel gave 96 presentations to approximately 2200 students and teachers. The presentations were given statewide to elementary, middle and high school students and teachers, and also to students of college-sponsored classes. In addition, a presentation was given to women at the Ohio Reformatory for Women in Marysville to equip them with saving and investing principles for use later in life.

The Division also worked at spreading the saving and investing message to Ohioans through the media. Six media releases were issued on educational topics during the month. (The releases can be found on the Division's Internet home page within the *Press Releases* section.) A total of 14 radio interviews were given, 3 television news appearances aired, and 21 newspaper articles were published. State Senator Doug White also based a newspaper column on the Division's educational events.

The Division sent its toll-free number along with classified advertisement notices to Ohio newspapers and suggested newspapers could help protect their readers by running the advertisements. Thirty-four (34) Ohio newspapers ran a classified advertisement

notice encouraging the public to call the Division of Securities to gather information before making an investment.

New Investor Education Publications Available

The Division issued several new investor educational publications during April. The following is a list and a brief description of the new publications:

- (1) *10 Tips for Online Investors*: This flyer explains how an online transaction is conducted and how investors can protect themselves in the process;
- (2) *How To Check Out Your Stockbroker or Brokerage Firm*: This pamphlet explains how investors can check if a stockbroker or brokerage firm is properly licensed and if there has been any disciplinary actions taken against them by obtaining CRD information;
- (3) *Promissory Note Brochure*: This publication, issued by the Division along with NASAA, the Securities and Exchange Commission, NASD Regulation, and the Securities Industry Association, warns investors

continued on page 8

Enforcement Section Reports

continued from page 5

violations precluded the Respondent from being of good business repute as required for the issuance of a securities salesperson license. The Respondent requested a 119 hearing and the hearing was held on November 20, 2000.

Thereafter, on April 12, 2001, the Division issued Division Order No. 01-117, a Final Order Denying the Securities Salesperson Application and a Cease and Desist Order finding that the Respondent had violated Revised Code Section 1707.44(A)(1).

3Rivers Resort Ltd, 3rivers-resort.com, and Edwin Adiotomre

On April 20, 2001, the Division issued a Cease and Desist Order, Division Order No. 01-126, to 3Rivers Resort Ltd., 3rivers-resort.com, and Edwin Adiotomre, of Toledo, Ohio.

On March 15, 2001, the Division issued a Notice of Opportunity for Hearing, Division Order No. 01-090, to Respondents pursuant to Revised Code Chapter 119. The Division alleged that Respondents violated Revised Code section 1707.44(C)(1) by offering unregistered common stock of 3Rivers Resort Ltd. to Ohio residents over the internet. The Division also notified Respondents of their right to an adjudicative hearing pursuant to Chapter 119 of the Revised Code. A hearing was not requested and a final Cease and Desist Order was issued on April 20, 2001.

Tee to Green Golf Parks, Inc.; **Steven D. Blumhagen**

On April 24, 2001, the Division issued Division Order No. 01-132, a Cease and Desist Order, against Tee to Green Golf Parks, Inc. and Steven D. Blumhagen. Respondent's business address is located in New York.

On March 23, 2001, the Division issued to the Respondents a Notice of Opportunity for Hearing, Division Order No. 01-095, in accordance with Revised Code Chapter 119. The Order alleged that the Respondents had violated the provisions of Revised Code Sections 1707.44(B)(4),

1707.44(C)(1) and 1707.44(G). These sections, respectively, prohibit making false representations of material and relevant facts in the sale of securities, selling securities without proper registration or claim of exemption from registration and failing to disclose material and relevant facts in the sale of securities. The allegations stem from the Respondents' sale of unregistered promissory notes and the rolling over of promissory notes into new notes. The Order notified the Respondents of the right to an administrative hearing. The Respondents failed to timely request an administrative hearing. Therefore, the Division issued Cease and Desist Order No. 01-132.

American Investment Services, Inc.

On May 1, 2001, the Division issued Division Order No. 01-134, a Cease and Desist Order with Consent Agreement, against American Investment Services, Inc. The Respondent's principal place of business is Illinois. It has a branch office in Ohio.

The Division's investigation found that the Respondent sold unregistered membership interests in limited liability companies formed by Wolverine Energy, LLC to Ohio residents. The Cease and Desist Order finds that the sale of the membership interests violated Revised Code section 1707.44(C)(1). This section prohibits selling securities without proper registration or claim of exemption from registration. The Cease and Desist Order also found that there were sales that were unsuitable for investors in violation of Ohio Administrative Rule 1301:6-3-19(A)(5).

Robert A. Coffey; **Viatical Consulting Associates, Inc.**

On May 4, 2001, the Division issued a Cease and Desist Order, Division Order No. 01-140, to Robert A. Coffey and Viatical Consulting Associates, Inc., of Cincinnati, Ohio.

Coffey entered into a Consent Agreement with the Division in conjunction with the Cease and Desist Order. The Order found that Coffey violated Revised Code sections 1707.44(A)(1) and 1707.44(C)(1) by selling unregistered securities and selling securities without a license to do so. The securities sales involved viatical settlements.

This action arose after the Division conducted an examination of Viatical Consulting Associates and learned that Coffey had sold viatical settlements to residents of Ohio and other states.

Great Start Limited; **Richard P. Dresner;** **Andrew F. Davis;** **and Hubert W. Patterson**

On May 8, 2001, the Division issued Division Order No. 01-148, a Cease and Desist Order, against Great Start Limited; Richard P. Dresner; Andrew F. Davis and Hubert W. Patterson. The Respondents' business address is located in Ohio.

On April 5, 2001, the Division issued to the Respondents a Notice of Opportunity for Hearing, Division Order No. 01-112, in accordance with Revised Code chapter 119. The Order alleged that Great Start Limited, Andrew F. Davis, and Richard P. Dresner had violated Ohio Revised Code section 1707.44(C)(1), by selling securities that were not registered by description, coordination or qualification in the sale of investment contracts. The Order further alleged that Respondent Hubert W. Patterson had violated Ohio Revised Code sections 1707.44(A)(1), 1707.44(B)(4) and 1707.44(C)(1), respectively, by selling investment contracts without a license as a dealer, making false representations of material and relevant facts in the sale of securities and selling securities without proper registration. The Division's allegations stemmed from the Respondent's false representation of high return on a joint venture to Ohio investors in a contractual agreement. The Order also notified the Respondents of their right to an administrative hearing. The Respondents failed to timely request an administrative hearing as permitted by Revised Code chapter 119. Therefore, the Division issued Cease and Desist Order No. 01-148.

A.C. Financial, Inc.

On May 9, 2001, the Division issued Division Order No. 01-152, a Cease and Desist Order with Consent Agreement, against A.C. Financial, Inc. The Respondent is located in Ohio.

The Division's investigation found that the Respondent sold unregistered viatical

settlements, which constitute an investment contract and a security, to Ohio residents. The viatical settlements were sold by sales agents of the Respondent on behalf of LifeTime Capital, Inc. The Cease and Desist Order finds that the Respondent violated Revised Code section 1707.44(C)(1). This section prohibits selling securities without proper registration or claim of exemption from registration.

Alexander Chase Company

On May 9, 2001, the Division issued Division Order No. 01-153, a Cease and Desist Order with Consent Agreement, against Alexander Chase Co. The Respondent is located in Ohio.

The Division's investigation found that the Respondent sold unregistered viatical settlements, which constitute an investment contract and a security, to Ohio residents. The viatical settlements were sold by sales agents of the Respondent on behalf of LifeTime Capital, Inc. The Cease and Desist Order finds that the Respondent violated Revised Code section 1707.44(C)(1). This section prohibits selling securities without proper registration or claim of exemption from registration.

LifeTime Capital, Inc.

On May 9, 2001, the Division issued Division Order No. 01-154, a Cease and Desist Order with Consent Agreement, against LifeTime Capital, Inc. The Respondent is located in Florida.

The Division's investigation found that the Respondent sold unregistered viatical settlements, which constitute an investment contract and a security, to Ohio residents. The Respondent represents itself to be in the business of "identifying, qualifying, and purchasing at a discounted percentage of face value, life insurance policies, and all related Policy Benefits, being held on the lives of individuals with Medically Determinable Life Expectancies." The Cease and Desist Order finds that the Respondent violated Revised Code section 1707.44(C)(1). This section prohibits selling securities without proper registration or claim of exemption from registration.

William L. Ullom, III

On May 9, 2001, the Division issued Division Order No. 01-151, a Cease and Desist Order, against William L. Ullom, III of Canton, Ohio.

On December 15, 2000, the Division issued to Respondent Division Order No. 00-478, a Notice of Opportunity for Hearing, in accordance with Revised Code chapter 119. The Order alleged that William L. Ullom, III, had violated Ohio Revised Code 1707.44(C)(1), which prohibits the sale in Ohio of securities that are not registered or exempt from registration by description, coordination or qualification. The allegation stems from the sale of an investment contract to an Ohio resident. The Respondent did timely request an adjudicatory hearing in accordance with Revised Code Chapter 119, but withdrew the hearing request on March 13, 2001. The Division and the Respondent entered into a Consent Agreement allowing the issuance of Cease and Desist Order No. 00-469.

Sun Broadcasting Systems, Inc.; John Sloan

On May 29, 2001, the Division issued Division Order No. 01-170, a Cease and Desist Order, against Sun Broadcasting Systems, Inc. and John Sloan. Respondents' business address is located in Palm Springs, California.

On January 12, 2001, the Division issued to Respondents Division Order No. 01-011, a Notice of Opportunity for Hearing, in accordance with Revised Code chapter 119. The Order alleged that Sun Broadcasting Systems, Inc. and John Sloan had violated Ohio Revised Code section 1707.44(C)(1), which prohibits the sale in Ohio of securities that are unregistered or not exempt from the registration requirements. The allegations stem from the sale of high yield promissory notes that were not exempt by description, coordination or qualification with the Division. The Respondents failed to timely request an adjudicatory hearing in accordance with Revised Code chapter 119. Therefore, the Division issued Cease and Desist Order No. 01-170.

Viatical Capital Inc.

On May 30, 2001, Viatical Capital Inc., located in Sarasota, Florida, through its

President C. Douglas York, entered into a Consent Agreement with the Division and consented to the issuance of a Cease and Desist Order, Division Order No. 01-172.

On January 12, 2001, the Division issued a Notice of Opportunity of Hearing, Division Order No. 01-008, to Viatical Capital Inc. The Division alleged that Viatical Capital Inc. had violated the provisions of Revised Code Sections 1707.44(B)(4), 1707.44(C)(1) and 1707.44(G), respectively, by knowingly making false representations in connection with the sale of unregistered securities and knowingly employing a person not licensed as a securities salesperson to make those sales of securities. The Division's allegations stem from Viatical Capital Inc.'s sale of limited liability membership interests in Viatical Funding LLC-G-8; Viatical Funding LLC-GC-1; Viatical Funding LLC-G-14; Viatical Funding LLC-GI-9; Viatical Funding LLC-IN-11; Viatical Funding LLC-GC-1; Viatical Funding LLC-GC-2; Viatical Funding LLC-GC-3; Viatical Funding LLC-IN-1; Viatical Funding LLC-IN-2; Viatical Funding LLC-IN-3; Viatical Funding LLC-GC-7; Viatical Funding LLC-IN-8; Viatical Funding LLC-IN-7; Viatical Funding LLC-IN-8; Viatical Funding LLC-IN-9; Viatical Funding LLC-GC-11; Viatical Funding LLC-IN-11; Viatical Funding LLC-GC-10; and Viatical Funding LLC-GC-14, all Nevada limited liability corporations.

The Division notified Viatical Capital Inc. of its right to an administrative hearing pursuant to Chapter 119 of the Revised Code and a hearing was requested. Viatical Capital Inc. withdrew its hearing request after the parties entered into a Consent Agreement and a Final Order to Cease and Desist was issued on May 30, 2001.

Quantum Capital Corporation

On June 7, 2001, Quantum Securities Corporation located in Columbus, Ohio, through its President Robert Cargin, entered into a Consent Agreement with the Division and consented to the issuance of a Cease and Desist Order, Division Order No. 01-182.

On November 3, 2000, the Division issued a Notice of Opportunity of Hearing, Division Order No. 00-397, to Quantum Securities Corporation. The Division alleged that Quantum Securities Corporation had violated the provisions of Revised Code

continued on page 8

Enforcement Section Reports

continued from page 7

sections 1707.19(A)(1) and Ohio Administrative Code section 1301:6-3-19(B)(9) by, respectively, knowingly allowing a salesperson to engage in sale activities prior to being licensed as a securities salesperson with the Division and failing to adequately supervise that salesperson.

The Division notified Quantum Securities Corporation of its right to an administrative hearing pursuant to Chapter 119 of the Revised Code and one was requested. Quantum Securities Corporation withdrew its hearing request after the parties entered into a Consent Agreement and the Final Order to Cease and Desist was issued on June 7, 2001.

Tri-West Investment Club; Jason Kingsley

On June 20, 2001, the Division issued Division Order No. 01-192, a Cease and Desist Order against Tri-West Investment Club and Jason Kingsley. The Respondents' business addresses are in San Diego, California; Nassau, Bahamas; and Belize City, Belize.

The Division's investigation found that Tri-West Investment Club and its president, Jason Kingsley, solicited and offered investments in a bank debenture trading program consisting of leveraged bonds, debentures and evidences of indebtedness through a Web site address on the Internet. In addition, the Web site provides for the payment of bonuses for recruiting investors into the bank debenture trading program. On March 28, 2001, the Division issued a Notice of Opportunity for Hearing, Division Order No. 01-098, against Tri-West Investment Club and Jason Kingsley.

The Division's investigation also found that the Tri-West Investment Club Web site states that there is no risk of investors losing their principal investment and investors will receive a 10% per month return for a period of one year. The Division found that the Securities and Exchange Commission and the International Chamber of Commerce have both issued releases stating that prime bank instrument scams, described as programs with the same characteristics as the program offered by the Respondents, are fraudulent. The Division found that R.C.

section 1707.03(V) and O.A.C. 1301:6-3-03(E)(8) which provide for an exemption for an offer of securities by an issuer on the Internet was not adhered to by the Respondents.

The Division found the Respondents violated R.C. section 1707.44(C)(1) by soliciting and offering unregistered, non-exempted securities on the Internet, and R.C. section 1707.44(G) by soliciting and offering securities while engaging in acts and practices to defraud and failing to disclose material facts in conjunction with the sales of the bank debenture trading program.

Lee Hyder

On June 27, 2001, Lee Hyder entered into a Consent Agreement with the Division and consented to the issuance of a Cease and Desist Order, Division Order No. 01-196.

The Division found that Lee Hyder violated the provisions of Revised Code Sections 1707.44(A)(1) and 1707.44(C)(1) by selling unregistered securities while acting as a securities dealer without being licensed as a dealer. The Division's allegations stem from Mr. Hyder's sale of payphones and service agreements for Phoenix Telecom LLC, a Georgia corporation.

By entering into a Consent Agreement with the Division, Mr. Hyder waived his right to the issuance of a Notice of Opportunity for Hearing and his right to an administrative hearing pursuant to Chapter 119 of the Revised Code. The Final Order to Cease and Desist was issued on June 27, 2001.

Jerry Lee Getter

On May 22, 2001, the Division issued Division Order No. 01-164, a Cease and Desist Order against Jerry Lee Getter. Getter conducted business from Brookville, Ohio.

On April 20, 2001, the Division issued a Notice of Opportunity of Hearing, Division Order No. 01-127, to Jerry Lee Getter. The Division alleged that the Respondent had violated the provisions of Revised Code section 1707.44(C)(1) and Ohio Administrative Code 1301:6-3-19(A)(19), respectively, by selling unregistered securities and by "selling away". The Division's allegations stem from Respondent's sale of promissory notes of World Vision Entertainment, Inc., Sebastian International Enterprises, Inc.,

Millennium 2100, Inc. and Canko Environmental Technologies, Inc. At the time of these note sales, Respondent was a licensed salesperson with Pruco Securities Corporation. The Division notified Respondent of his right to an administrative hearing pursuant to Chapter 119 of the Revised Code. Respondent failed to timely request an adjudicative hearing pursuant to Chapter 119 of the Ohio Revised Code. Therefore, the Division issued Cease and Desist Order No. 01-164.

Criminal Updates

Essam Mikhail

Essam Mikhail was indicted by a Franklin County Grand Jury on May 25, 2001, on one count each of acting as an unlicensed investment adviser, engaging in fraud as an investment adviser, mishandling funds while acting as an investment adviser, theft, forgery and intimidating a crime victim or witness. Mikhail was scheduled to be arraigned on June 8, 2001.

Education Initiatives

continued from page 5

to beware of promissory notes, which often are advertised as investments with high returns and low risk. In fact, the notes can be very risky and are often fraudulent; and

(4) *Web Bookmark:* This bookmark is designed for use with books, encourages Ohioans to "bookmark" the Division's Web site on their personal computer for easy access to the Division's investor education materials.

These new investor education publications were added to the Division's inventory of other publications it distributes to the public. The Division continually distributes its investor education publications year-round. The publications are available free of charge through our toll-free number, 1-800-788-1194, or in Columbus at 466-6140. In addition, many of the Division's publications can be accessed on the Division's Internet home page at www.securities.state.oh.us.

Ms. Terhune is the Assistant Manager in the Division's Enforcement Section.

PUBLIC NOTICE

At 10:00 a.m. on September 24, 2001, the Ohio Division of Securities will hold a public hearing regarding the Division's intent to amend Ohio Administrative Rules 1301:6-1-03, 1301:6-3-041, 1301:6-3-141, 1301:6-3-15, 1301:6-3-151, 1301:6-3-16, 1301:6-3-161, 1301:6-3-44, and to rescind 1301:6-3-05. The hearing will be held in the offices of the Division located at 77 South High Street, 22nd Floor, Columbus, Ohio 43215.

Copies of the proposed amendments may be obtained by contacting the Ohio Division of Securities at the above address or by calling the Division at (614) 644-7381. Copies of the proposed amendments may also be obtained from the Division's Internet homepage located at www.securities.state.oh.us or the *Register of Ohio* located at www.registerofohio.state.oh.us. Each of the proposals is summarized in the following:

OAC 1301:6-1-03 The purpose of the proposed amendment is to make the Division's public notice publication in line with the provisions of RC 119.037 and the electronic *Register of Ohio*. The rule will require notice on the electronic *Register of Ohio*, and rather than requiring publication in the *Ohio Securities Bulletin*, permits additional publication in that manner.

OAC 1301:6-3-041 The proposed amendment will allow the Division to determine the materiality of the offeror's financial statements during a control bid. The purpose of the proposed rule is to make the Form 041 filing with the Division consistent with the federal Form TO filing required by the Securities and Exchange Commission.

OAC 1301:6-3-05 The purpose of the proposed amendment is to reflect the rescission of the statutory provision supporting the rule. The rule is to be repealed in its entirety.

OAC 1301:6-3-141 The purpose of the proposed amendment is to streamline the notice filing process for purposes of using the Investment Adviser Registration Database (IARD) and to further make the existing process parallel federal provisions. Changes in the rule recognize the amended federal Form ADV and streamline the timeframe during which renewal filings may be submitted.

OAC 1301:6-3-15 The purpose of the proposed amendment is to parallel the NASD in its elimination of the Series 8 examination. The series 8 will no longer be accepted as a mechanism for establishing minimum competency. The proposal also eliminates the separate consent requirement since a consent is included in the Form BD.

OAC 1301:6-3-151 The purpose of the proposed amendment is to better enable investment adviser applicants to use the IARD for filings. The proposal reflects the newly adopted federal Form ADV and streamlines the application; eliminates Ohio specific forms; eliminates the separate consent since a consent is included on the Form ADV; eliminates the designated principal requirement; clarifies minimum competency standards for sole proprietors; ensures that investment adviser retain the Form ADV-E; and parallels renewal and updating requirements with those requirements of the SEC.

OAC 1301:6-3-16 The purpose of the proposed amendment is to parallel the NASD in its elimination of the Series 8 examination. The series 8 will no longer be accepted as a mechanism for establishing minimum competency.

OAC 1301:6-3-161 The purpose of the proposed amendment is to enable more applicants to use the IARD, streamline the application process, eliminate Ohio-specific forms, and eliminate an "old" NASD examination. Ohio specific forms are being eliminated; the series 8 as an applicable exam is being eliminated with other more corrective amendments proposed.

OAC 1301:6-3-44 The purpose of the proposed rule is to eliminate the need to file paperwork with the Division and to prevent waivers of compliance with the Ohio Securities Act. The proposed amendment will require investment advisers to retain accountants' statements rather than requiring a filing with the Division. In addition, the proposed rule provides that contractual provisions attempting to waive compliance with the Ohio Securities Act or rules are void.

Licensing Statistics

License Type	YTD 2000
Dealer	2,308
Salesmen	124,820
Investment Adviser	1,401
Investment Adviser Representative	8,260

OHIO SECURITIES CONFERENCE 2001

presented by

**Ohio Department of Commerce, Division of Securities and The Cybercurities Law Institute at the University of
Toledo College of Law**

November 2, 2001

Executive Conference and Training Center, Vern Riffe Center, 77 South High Street, 31st Floor, Columbus, Ohio

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Ohio Division of Securities Update

Deborah L. Dye Joyce, Commissioner
Matthew Fornshell, Attorney Inspector
Caryn A. Francis, Division Licensing
Counsel

Michael P. Miglets, Control Bid Attorney

The meetings of the Ohio Division of Securities Advisory Committees will be held in conjunction with this Conference. In September, a Conference Brochure with detailed information and registration instructions will be sent to all Ohio subscribers to the Ohio Securities Bulletin.

An Introduction to S.B. 32

continued from page 1

in which to offer financial services in the post-GLBA environment.

As noted above, S.B. 32 also contained certain e-commerce initiatives. One initiative pertains to securities dealer filings through the national Internet-based Central Registration Depository (CRD). Currently, securities dealers are unable to renew Ohio licenses through the CRD because the CRD is unable to accommodate the Act's graduated, or calculated, license renewal fee structure. Consequently, S.B. 32 changes the dealer license renewal fee to a flat \$100 from the current graduated scale of \$150 to \$5,000. This change is extremely beneficial to the industry as it offers the ease and convenience of Internet filing along with a lower fee.

A second e-commerce initiative pertains to the newly created national Internet-based Investment Adviser Registration Depository (IARD). This system provides for investment adviser notice filings and license applications over the Internet. To minimize the impact of IARD user fees on small advisers, S.B. 32 reduces the Ohio license fee from \$200 to \$50. Similarly, S.B. 32 reduces the

fee for federal notice filers advisers from \$100 to \$50. Again, S.B. 32 offers the industry the ease and convenience of Internet filing along with a lower fee.

S.B. 32 also bolstered the Act's anti-fraud provisions. In the recently decided *State v. Hurd*, 89 Ohio St. 3d 616 (2000), the Ohio Supreme Court held that RC 1707.44(B)(1) prohibits misrepresentations only when registering *securities* by description, not when registering *transactions* by description. S.B. 32 closes this "loophole". In connection with this change, the S.B. 32 makes the intent element consistent throughout the Act at the level of "knowingly" as currently set out in RC 1707.44(B) and (G), RC 1707.29, and as recognized by the court in *State v. Walsh*, 66 Ohio App. 2d 85 (1979). These changes were made in RC 1707.19 and 1707.44.

A technical amendment contained in S.B. 32 pertains to the "list" of items that must be submitted to the Division in connection with a takeover bid. More specifically, S.B. 32 amends RC 1707.23(D) to make it more consistent with RC 1707.19 and allows the Division to promulgate rules regarding when financial statements are material in a

tender offer. Currently, three years of financial statements are required, even if a bidder has commitments from financial institutions to fund the bid.

S.B. 32 repeals RC 1707.05 as a result of its obsolescence, non-use during the last ten years, the availability of numerous alternative sections of the Act for which compliance is more readily achieved, and as a result of the federal National Securities Market Improvement Act of 1996 (NSMIA). RC 1707.05 pertains to a shortened method of registration for "blue chip" securities. The nature of these securities is such that NSMIA may, in some instances, have effectively preempted the Divisions' ability to require filings. Consequently, based on the foregoing factors, S.B. 32 repeals this section in its entirety as well as the references thereto contained in RC 1707.03, 1707.07, 1707.08, 1707.09, 1707.44, and 1707.45.

Finally, S.B. 32 repealed certain "phase-in" language that was placed in the Act as a part of the 122nd General Assembly's Am. Sub. H.B. 695.

Registration Statistics

The following table sets forth the number of registration, exemption, and notice filings received by the Division during the second quarter of 2001, compared to the number of filings received during the second quarter of 2000. Likewise, the table compares the year-to-date filings for 2001 and 2000.

Filing Type	2nd Qtr '01	YTD '01	2nd Qtr '00	YTD '00
1707.03(Q)	31	70	43	116
1707.03(W)	1	9	5	14
1707.03(X)	262	563	420	848
1707.03(Y)	4	4	1	2
1707.04	0	0	0	0
1707.041	0	1	0	0
1707.06	17	40	32	56
1707.09	15	26	21	33
1707.091	19	58	31	60
1707.092(A)*	1109	2517	1197	2520
1707.092(C)**	0	0	0	0
1707.39	0	2	0	6
1707.391	27	48	30	64
Total	1485	3340	1783	3719

* Investment company notice filings.

** Offerings of covered securities not otherwise covered by another statutory provision in the Ohio Securities Act.

Capital Formation Statistics*

Because the Division's mission includes enhancing capital formation, the Division tabulates the aggregate dollar amount of securities to be sold in Ohio pursuant to filings made with the Division. As indicated in the notes to the table, the aggregate dollar amount includes a value of \$1,000,000 for each "indefinite" investment company filing. However, the table does not reflect the value of securities sold pursuant to "self-executing exemptions" like the "exchange listed" exemption in R.C. 1707.02(E) and the "limited offering" exemption in R.C. 1707.03(O). Nonetheless, the Division believes that the statistics set out in the table are representative of the amount of capital formation taking place in Ohio.

* Categories reflect amount of securities registered, offered, or eligible to be sold in Ohio by issuers.

** Investment companies may seek to sell an indefinite amount of securities by submitting maximum fees. Based on the maximum filing fee of \$1100, an indefinite filing represents the sale of a minimum of \$1,000,000 worth of securities, with no maximum. For purposes of calculating an aggregate capital formation amount, each indefinite filing has been assigned a value of \$1,000,000.

Filing Type	Second Qtr 2001	YTD 2001
Exemptions		
Form 3(Q)	\$104,244,451	\$169,533,824
Form 3(W)	6,754,508	24,258,508
Form 3(X)	25,032,057,558	48,997,504,738
Form 3(Y)	3,000,000	3,950,000
Registrations		
Form .06	234,151,215	739,975,346
Form .09	36,685,000	121,785,000
Form .091	3,308,580,450	10,706,539,800
Form .092(C)	0	0
Investment Companies		
Definite	102,429,000	326,513,500
Indefinite**	614,000,000	1,461,000,000
TOTAL	\$29,441,902,182	\$62,551,060,716

Final Order Summaries

The following is a summary of recent final orders issued by the Division in response to salesperson and investment adviser representative license applications.

PARTY	DECISION	ORDER <u>SENT/NO.</u>	ALLEGATIONS <u>H.O. RECOMM.</u>
Brad Polinko	Denied	4/12/01 01-117	O.A.C. 1707.44(A)(1) 1301:6-3-19(D)(8) 1707.19(A)(1) Findings Approved
David Michael Levy	Denied	5/31/01 01-176	O.A.C. 1301:6-3-19(D)(9); 1707.19(A)(1) No Hearing Requested

OHIO SECURITIES BULLETIN

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