OHIO SECURITIES BULLETIN

A QUARTERLY PUBLICATION OF THE OHIO DIVISION OF SECURITIES

Bob Taft
Governor of Ohio

Lt. Governor Jennette Bradley
Director of Commerce

Deborah L. Dye Joyce
Commissioner of Securities

Division Rule Changes and Policy Positions Affecting Ohio Licensed Investment Advisers

By Caryn A. Francis

On April 1, 2004, the Division's new custody rule became effective. This rule is patterned after the revised custody rule adopted by the U.S. Securities and Exchange Commission ("SEC"), on November 5, 2003.[1] All SEC registered investment advisers must be in compliance with the SEC's custody rule by April 1, 2004. Similarly, all Ohio licensed investment advisers and investment adviser representatives must be in compliance with the custody provisions found in O.A.C. Rule 1301:6-3-44(B) by April 1, 2004. In light of the changes to O.A.C. Rule 1301:6-3-44(B), the Division's 2002 Guidance on Commonly Encountered Investment Adviser Issues is repealed as to the Division's position regarding custody.[2]

In addition to changes in the custody rule, the Division has recently examined the issue of investment advisers using model results in advertising. O.A.C. Rule 1301:6-3-44(A) governs the use of advertisements by Ohio licensed investment advisers. As this rule is based upon rule 206(4)-1 of the Investment Advisers Act of 1940 ("'40 Act"), the Division believes that the SEC No-Action Letter, *Clover Capital Management Incorporated* (Oct. 28, 1996), provides persuasive guidance on the issue of prohibited advertising practices.

Custody

Under Ohio law it is a fraudulent, deceptive, manipulative act, practice or course of business for an investment adviser or investment adviser representative[3] to have custody of client funds or securities without complying with O.A.C. Rule 1301:6-3-44(B) (the "Custody Rule"). Although the revised Custody Rule incorporates several specific examples of custody that may cause more advisers to fall within the purview of the rule, it also streamlines and simplifies compliance.

The term "custody" has been redefined and clarified with examples. Pursuant to O.A.C. Rule 1301:6-3-44(B)(3)(a), custody is defined as " … holding, directly or indirectly, client funds or

continued on page 2

OHIO
DEPARTMENT OF
COMMERCE
DIVISION OF
SECURITIES
http://www.securities.state.oh.us

Ohio Securities Bulletin

Issue 2004:1

Table of Contents

securities, or having any authority to obtain possession of them." The Custody Rule then expands on this definition with three separate examples found in O.A.C. Rule 1301:6-3-44(B)(3)(a)(i)-(iii).

An adviser has custody any time it physically holds client securities or funds, even if temporarily.[4] There are two exceptions to this part of the rule. Custody will not result if the client's check or securities are returned ***to the client*** within three business days.[5] Forwarding the client's funds or securities on to a third party is not permissible.[6] Receipt by the investment adviser of a check written by the client and made payable to a third party does not constitute custody.

The custody rule is triggered anytime an investment adviser has an arrangement, including a general power of attorney, where the adviser is authorized or permitted to withdraw client funds or securities maintained with a custodian upon the adviser's instruction to the custodian.[7] Pursuant to this section of the rule, investment advisers will have custody, for example, where the adviser (i) has power of attorney to sign checks on a client's behalf, (ii) may withdraw funds or securities from a client's account, (iii) is authorized to deduct advisory fees or other expenses directly from a client's account, or (iv) may dispose of client funds or securities for any purpose other than authorized trading.[8]

Any time an investment adviser acts in a capacity that gives the adviser legal ownership of, or access to, client funds or securities, the adviser has custody. Specifically, where the adviser acts as a general partner of a limited partnership, managing member of a limited liability company, has a comparable position for another type of pooled investment vehicle, or acts as a trustee of a trust, the investment adviser has custody.[9]

Once an investment adviser has determined that the custody rules apply, compliance with the rule is relatively simple. The client's funds and securities must by held by a qualified custodian, the adviser must give notice to its clients about where and how the assets are being held, and the qualified custodian must deliver quarterly account statements directly to the client.

O.A.C. Rule 1301:6-3-44(B)(3)(c)(i)-(iv) defines "qualified custodian" to mean (i) a bank (which includes trust companies, savings and loan associations, savings banks, and credit unions[10]), (ii) a broker-dealer registered with the SEC and holding client assets in customer accounts, (iii) a futures commission merchant registered with the Commodity Futures Trading Commission and holding client assets in customer accounts, but only with respect to clients' funds and security futures, or other securities incidental to transactions in contracts for the purchase or sale of a commodity for future delivery and options thereon, and (iv) a foreign financial institution that customarily holds

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.

Ohio Division of Securities
77 South High Street, 22nd Floor • Columbus, Ohio 43215-6131
http://www.securities.state.oh.us

financial assets for its customers, provided that the foreign financial institution keeps the advisory clients' assets in customer accounts segregated from its proprietary assets. Under O.A.C. Rule 1301:6-3-44(B)(2)(a), an investment adviser with clients who own shares of an open-end investment company as defined in Section 5(a)(1) of the Investment Company Act of 1940 (a mutual fund), may use the mutual fund transfer agent in lieu of a qualified custodian, but only with respect to the mutual fund shares. The transfer agent must still fulfill all aspects of the role of qualified custodian as set forth more fully below.

Once an investment adviser has selected a qualified custodian to hold the client's funds or securities, the adviser must ensure that the qualified custodian maintains the funds and securities either in (i) a separate account for each client under that client's name, or (ii) accounts that contain only the investment adviser's clients' funds and securities, under the adviser's name as agent or trustee for the clients.[11] The investment adviser is then responsible for giving prompt notice to the client about how their assets are being held. The adviser must provide their client in writing the name and address of the qualified custodian and the manner in which the client's funds or securities are being maintained. The adviser must also promptly notify the client in writing of any changes to this information.

Finally, under O.A.C. Rule 1301:6-3-44(B)(1)(c), clients must receive, at least quarterly, account statements directly from the qualified custodian.[12] The account statements must identify the amount of funds and each security held in the account at the end of the period, and set forth all transactions in the account during that period. The adviser cannot receive the quarterly account statements from the qualified custodian and then forward them on to their clients. Where the investment adviser is acting as the general partner of a limited partnership, managing member of a limited liability company, or holds a comparable position for another type of pooled investment vehicle, the qualified custodian must send the quarterly account statements to <u>each</u> limited partner or member or other beneficial owner,[13] or to their independent representative.[14] In addition, the quarterly account statements for a limited partnership, limited liability company, or other type of pooled investment vehicle must reflect the transactions and holdings of the <u>entire</u> pool, partnership, or limited liability company, not just the individual investor's interest in the investment.[15]

The rule further requires that the investment adviser have a reasonable basis for believing that the qualified custodian has sent a quarterly account statement to the client. Pursuant to O.A.C. Rule 1301:6-3-44(B)(1)(c)(iv), an adviser can meet the reasonable belief requirement by receiving duplicate copies of the client account statements from the qualified custodian. Many investment advisers have called the Division inquiring as to whether the duplicate copies of account statements must be paper copies. While paper copies are certainly an acceptable alternative, this is not the sole means of forming a reasonable belief. The SEC has stated that electronic delivery of quarterly account statements to the client is permissible subject to certain restrictions,[16] and if an adviser is copied on the electronically delivered custodial statements to the adviser's client, this will suffice for purposes of forming a reasonable belief.[17] The Division adopts the SEC's position for purposes of compliance with O.A.C. Rule 1301:6-3-44(B)(1)(c)(iv). The Division does not believe that advisers who are merely able to access their client's accounts on-line meet the requirement of forming a reasonable basis for believing that the qualified custodian has sent quarterly account statements to the client. Ohio licensed investment advisers are cautioned that they must maintain evidence, in some medium, documenting their compliance with O.A.C. Rule 1301:6-3-44(B)(1)(c)(iv), and have that information readily accessible for Division personnel.

Pursuant to O.A.C. Rule 1301:6-3-44(B)(1)(c)(ii), if the investment adviser chooses to send the quarterly account statements to its advisory clients, the adviser must have an independent public accountant conduct a surprise audit. The accountant, without giving prior notice to the investment adviser, must conduct the examination annually and the date chosen by the accountant must be irregular from year to year. The accountant must file with the Division a Form ADV-E within thirty days after the examination has been conducted, stating that it has examined the funds and securities and describing the nature and extent of the examination. If the independent public accountant finds any material discrepancies during the course of the examination, the accountant must notify the Division by facsimile or electronic transmission, within one business day of the finding. The notification by fax or electronic transmission must be followed by notification to the Division by first class mail. If the investment adviser is a general partner of a limited partnership, managing member of a limited liability company, or holds a comparable position for another type of pooled investment vehicle, and chooses to deliver the quarterly account statements rather than using the qualified custodian, the adviser must deliver the quarterly account statements to each of the limited partners or members or other beneficial owners. Ohio licensed investment advisers should be aware that nothing in O.A.C. Rule 1301:6-3-44(B)(1)(c)(ii) obviates the need for the adviser to maintain custody of client assets with a qualified custodian. It simply provides the mechanism by which the adviser can assume responsibility for delivery of the quarterly account statements.

Special rules apply where the accounts of limited partnerships, limited liability companies and pooled investment vehicles are audited annually. An Ohio licensed investment adviser is not required to comply with the quarterly account statement delivery requirements where (i) the limited partnership, limited liability company or pooled investment vehicle is audited at least annually, (ii) the audited financial statements are prepared in accordance with generally accepted accounting principles, and (iii) the audited financials are distributed to all limited partners, members or other beneficial owners within 120 days of the fiscal year end of the audited entity.[18] The funds and securities must still be maintained in the custody of a qualified custodian, and the investment adviser still must provide written notice concerning where and how the assets are being maintained.

A final exception to the Custody Rule applies in the instance of privately offered securities. Where an investment adviser has custody but certain securities are (i) acquired from the issuer in a transaction or chain of transactions not involving any public offering, (ii) uncertificated, and ownership is recorded only on books of the issuer or its transfer agent in the name of the client, *and* (iii) transferable only with prior consent of the issuer or holders of the outstanding securities of the issuer, then the adviser is not required to comply with the custody rules. Investment advisers should note that this exception applies exclusively to the privately offered securities. It does not relieve the adviser from its obligation to comply with the custody rule with respect to any other client funds or securities over which the adviser may have custody. In addition, this exception does not apply to privately offered securities held for the account of a limited partnership, limited liability company or other type of pooled investment vehicle, unless all three of the above referenced requirements are met, and the limited partnership or other entity is audited annually, with distribution of the audited financial statements made to all limited partners, members or other beneficial owners within 120 days of the end of its fiscal year.

Many advisers have inquired about what is required to be reported on the Form ADV. The SEC amended the instructions to Item 9 of Form ADV to make clear that investment advisers that have custody ***exclusively*** as a result of deducting advisory fees directly from client accounts may respond “no” to Part 1, Item 9 of Form ADV. All

other advisers that fall within the definition of custody pursuant to O.A.C. Rule 1301:6-3-44(B)(3)(a) must respond affirmatively to Item 9. In addition, the SEC revised Part II of Form ADV to eliminate the requirement that advisers with custody of client assets include an audited balance sheet in their disclosure statements, commonly known as the "brochure". However, investment advisers that charge prepayment of fees exceeding five hundred dollars, six or more months in advance, are still required to provide a balance sheet on Schedule G of Part II of Form ADV.

Using Model Results in Advertising

The Ohio Securities Act prohibits investment advisers from distributing any advertisement[19] that contains any untrue statement of material fact, or that is otherwise false or misleading.[20] The SEC has taken the position that the use of model results, or actual results of an adviser's investments, would be false or misleading if it implies, or a reader would infer from it, something about the adviser's competence or about future investment results that would not be true had the advertisement included all material facts. Any adviser using such an advertisement must ensure that the advertisement discloses all material facts concerning the model or actual results so as to avoid these unwarranted implications or inferences.[21]

The SEC No-Action Letter, *Clover Capital Management Incorporated*, (Oct. 28, 1996) ("Clover Capital"), sets forth a list of prohibited advertising practices. The Division adopts the position taken by the SEC in Clover Capital. As with the SEC, we take the position that this list is by no means exhaustive of all prohibited advertising practices, nor does it create a safe harbor that may be relied upon by an adviser as an exclusive list of the factors that must be considered in determining the type of disclosure necessary when advertising model or actual results.[22] It is the Division's view that O.A.C. Rule 1301:6-3-44(A)(1) prohibits an advertisement that:

1. Fails to disclose the effect of material market or economic conditions on the results portrayed (e.g., an advertisement stating that the accounts of the adviser's clients appreciated in value 25% without disclosing that the market generally appreciated 40% during the same period);

2. Includes model or actual results that do not reflect the deduction of advisory fees, brokerage or other commissions, and any other expenses that a client would have paid or actually paid;[23]

3. Fails to disclose whether and to what extent the results portrayed reflect the reinvestment of dividends and other earnings;

4. Suggests or makes claims about the potential for profit without also disclosing the possibility of loss;

5. Compares model or actual results to an index without disclosing all material facts relevant to the comparison (e.g. an advertisement that compares model results to an index without disclosing that the volatility of the index is materially different from that of the model portfolio);

6. Fails to disclose any material conditions, objectives, or investment strategies used to obtain the results portrayed (e.g. the model portfolio contains equity stocks that are managed with a view towards capital appreciation);

7. Fails to disclose prominently the limitations inherent in model results, particularly the fact that such results do not represent actual trading and that they may not reflect the impact that material economic and market factors might have had on the adviser's decision-making if the adviser were actually managing clients' money;

8. Fails to disclose if applicable, that the conditions, objectives, or investment strategies of the model portfolio changed materially during the time period portrayed in the advertisement and, if so, the effect of any such change on the results portrayed;

9. Fails to disclose, if applicable, that any of the securities contained in, or the investment strategies followed with respect to, the model portfolio do not relate, or only partially relate, to the type of advisory services currently offered by the adviser (e.g., the model includes some types of securities that the adviser no longer recommends for its clients);

10. Fails to disclose, if applicable, that the adviser's clients had investment results materially different from the results portrayed in the model;

11. Fails to disclose prominently, if applicable, that the results portrayed relate only to a select group of the adviser's clients, the basis on which the selection was made, and the effect of this practice on the results portrayed, if material.

The prohibitions set forth in items 1-6 apply to both model and actual results, items 7-10 apply to model results, and item 11 applies only to actual results. Ohio licensed investment advisers must be aware that to the extent that it is more difficult to verify or objectively test the criteria underlying the model portfolio in question, the disclosure obligation of the adviser would correspondingly increase. Advisers should keep in mind that they must retain all documents necessary to show the basis for their calculation of the model or actual results.

(Endnotes)

[1] The SEC amended rule 206(4)-2 under the Investment Adviser Act of 1940 ("'40 Act"), and amended Part 1A, Item 9 and Part II, Item 14 of Form ADV.

[2] The SEC No-Action Letters upon which the Division's guidance was based have been withdrawn by the SEC. *See* SEC Release IA-2176 "Final Rule: Custody of Funds or Securities of Clients by Investment Advisers" (Sept. 25, 2003) (hereinafter "SEC Release IA-2176").

[3] Hereinafter, references to "investment adviser" or "adviser" will include investment adviser representatives.

[4] O.A.C. Rule 1301:6-3-44(B)(3)(a)(i)

[5] *Id.* Some investment advisers have inquired of the Division whether the custody rule is triggered when the adviser receives a client's check made payable to the investment adviser for payment of advisory fees. The purpose of the custody rule is to protect a client's assets from risk of loss or misuse. SEC Release IA-2176. An investment adviser is clearly entitled to be paid for his services without receipt of the fees constituting custody. However, the custody rules <u>are</u> triggered when an investment adviser receives funds from the client in the form of cash or a check made payable to the adviser, where the understanding is that such funds will be forwarded by the adviser to a custodian or to another third party.

[6] SEC Release IA-2176.

[7] O.A.C. Rule 1301:6-3-44(B)(3)(a)(ii).

[8] SEC Release IA-2176.

[9] O.A.C. Rule 1301:6-3-44(B)(3)(a)(iii).

[10] *See* O.R.C. §1707.01(O).

[11] O.A.C. Rule 1301:6-3-44(B)(1)(a)

[12] Many investment advisers have contacted the Division to inquire whether monthly delivery of account statements will satisfy the rule. As the Custody Rule requires that account statements must be delivered by the qualified custodian *at least* quarterly, monthly delivery to the client will comply with the requirements of the rule.

[13] The custody rules were originally proposed by the SEC to prevent advisers from jeopardizing client assets by their own unlawful activities or from the financial reverses of the adviser's business, including insolvency. Investment Advisers Act Release No. 122 (Nov. 6, 1961). The SEC's proposal for the current amendments was designed to offer even greater protection for advisory clients. SEC Release IA-2044 (July 18, 2002). Investment advisers that intend to misuse client assets can easily falsify client account statements, hence the need to have a qualified custodian send account statements directly to the client. However, where an investment adviser acts in the capacity of a trustee of a trust, the core purpose of rule cannot be served if a qualified custodian delivers the quarterly account statements to the trust, and consequently, to the trustee/investment adviser. The Division takes the position that where the custody rules apply due to an adviser's role as trustee of a trust, the quarterly account statements issued by the qualified custodian must be delivered to either the grantor(s), beneficiaries or an independent representative appointed by those parties for purposes of receiving account statements on their behalf.

[14] O.A.C. Rule 1301:6-3-44(B)(1)(c)(iii). The term "independent representative" is defined in O.A.C. Rule 1301:6-3-44(B)(3)(b) as meaning a person designated by the <u>client</u> that (i) acts as agent for an advisory client, including in the case of a pooled investment vehicle, for limited partners of a limited partnership or members of a limited liability company, or other beneficial owners of another type of pooled investment vehicle, and by law or contract is obliged to act in the best interest of the advisory client or the limited partners or members, or other beneficial owners, (ii) does not control, is not controlled by, and is not under common control with the investment adviser, ***and*** does not have, and has not had within the past two years, a material business relationship with the investment adviser.

[15] SEC "Staff Responses to Questions About Amended Custody Rule" (March

15, 2004), available at www.sec.gov/division/investment/custody_faq.htm, question VI.2.

[16] SEC Release IA-2176, at n. 29. The SEC made clear that electronic delivery must comply with the SEC's interpretive guidelines on delivering documents electronically, as set forth in SEC Release No. 33-7288 "Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information; Additional Examples under the Securities Act of 1933, Securities Exchange Act of 1934, and Investment Company Act of 1940" (May 9, 1996). The SEC has further elaborated on the issue of electronic delivery of quarterly account statements in its "Staff Responses to Questions About Amended Custody Rule" (March 15, 2004). The SEC has indicated that qualified custodians may use electronic delivery for quarterly account statements, but only so long as (i) the client has given informed consent to receiving information electronically (consent that specifies the electronic medium or source through which the information will be delivered, the period during which the consent will be effective, and which describes the information that will be delivered using such means), (ii) the client can effectively access the electronically delivered information, and (iii) evidence of the delivery is received, such as an e-mail return receipt or other confirmation that the information was accessed. An adviser must still form a reasonable belief that the clients are receiving their quarterly account statements, even if the adviser's clients choose to receive the statements electronically.

[17] SEC "Staff Responses to Questions About Amended Custody Rule," at question IV.1.

[18] O.A.C. Rule 1301:6-3-44(B)(2)(c)

[19] O.A.C. Rule 1301:6-3-44(A)(2) defines the term "advertisement" to include any notice, circular, letter or other written communication addressed to more than one person, or any notice or other announcement in any publication or by radio or television, which offers: (a) any analysis, report, or publication concerning securities, or which is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (b) any graph, chart, formula or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (c) any other investment advisory service with regard to securities. The Division takes the position that electronic advertisements, such as advertisements on the internet generally or on the investment adviser's web page, fall within the definition set forth above.

[20] O.A.C. Rule 1301:6-3-44(A).

[21] Clover Capital Management, Inc., SEC No-Action Letter (Oct. 28, 1986)

[22] In using the term "model" results, the Division is referring to investment results derived from a model or hypothetical portfolio, including where an investment adviser applies "backtesting" (*i.e.*, backtesting performance involves a hypothetical reconstruction, based on past market data, of what the performance of a particular account would have been had the adviser been managing the account using a particular investment strategy). Actual results refers to the use by the adviser of actual investment results of client accounts under management of the adviser.

[23] The adviser's performance figures must be presented net of fees and expenses. A written explanation of the existence and amount of fees and expenses does not suffice to meet this requirement.

Enforcement Section Reports

Carmen Civiello

On December 18, 2003, the Division issued Order No. 03-245, a Cease and Desist Order, against Carmen P. Civiello. Civiello sold water management systems on behalf of Aquadyn Technologies, Inc. to Ohio residents. These water management systems were investment contracts and therefore securities under the Ohio Securities Act, but were not registered with the Division. Furthermore, Civiello's' conduct with respect to selling these water management systems constituted his acting as a dealer, as defined by Revised Code section 1707.01(E)(1), even though he was not licensed as such.

On November 10, 2003, the Division issued Order No. 03-204, a Notice of Opportunity for Hearing, against Civiello for allegedly violating Revised Code section 1707.44(C)(1), the unregistered sale of securities, along with Revised Code section 1707.44(A)(1), selling securities to an Ohio resident without being licensed as a dealer. The Respondent did not request a hearing pursuant to Chapter 119 of the Ohio Revised Code, thereby allowing the Division to issue its Cease and Desist Order No. 03-245, which incorporated the allegations set forth in the Notice of Opportunity for Hearing.

Roland P. Wilson

On January 30, 2004, the Division issued Division Order No. 04-021, a Cease and Desist Order to Roland P. Wilson of Boardman, Ohio. The Division found that Wilson violated the provisions of Revised Code sections 1707.44(A)(1) and 1707.44(C)(1) by selling unregistered securities in the form of viatical settlements for Integrity Assured Life Settlements, Inc. to Ohio investors while he was unlicensed as a securities salesperson. The Division found that Wilson was paid commissions of 18% by Integrity Assured Life Settlements, Inc. for selling the securities. The Division also found that the viatical settlements were not registered or exempt from registration requirements.

The Division notified Wilson of his right to an adjudicative hearing pursuant to Chapter 119 of the Revised Code in a Notice of Opportunity for Hearing, Order No. 03-251, issued on December 29, 2003. A hearing was not requested and the Cease and Desist Order was issued on January 30, 2004.

Integrity Assured Life Settlements, Inc.; David Hoover

On February 11, 2004 the Division issued Division Order No. 04-035, a Cease and Desist Order to Integrity Assured Life Settlements, Inc. and David Hoover, President, whose last known business address was Bear, Delaware. The Division found that Integrity Assured Life Settlements, Inc. and David Hoover violated the provisions of Revised Code sections 1707.44(A)(1) and 1707.44(C)(1) by selling or causing to be sold unregistered securities in the form of viatical settlements to Ohio investors without being licensed to do so. The Division found that Integrity Assured Life Settlements, Inc. and David Hoover were unlicensed dealers as they paid commissions of 12% to 18% to salespeople to sell the viatical settlements. The Division found that the sales information and the purchase agreement provided for a predetermined 12% profit for a 12-month contract up to a 60% profit for a 48-month contract. The purchase agreement also provided for various risk factors for the investment. According to the offering documents, the funds were to be given to a trustee appointed by Integrity and investors had no control over the selection of people whose policies were purchased, the prices paid for the policies, the trustee who was appointed to hold the funds, or any other managerial decision of the company. The Division also found that the viatical settlements were not registered nor exempt from registration requirements.

The Division notified Integrity Assured Life Settlements, Inc. and David Hoover of their right to an adjudicative hearing pursuant to Chapter 119 of the Revised Code in a Notice of Opportunity for Hearing, Order No. 03-250, issued on December 29, 2003. After legal publication was completed on the Division Order, a hearing was not requested and the Cease and Desist Order was issued on February 11, 2004.

Robert A. Anderson

On February 11, 2004, the Division issued Order No. 04-036, a Cease and Desist Order, against Robert A. Anderson. From December of 2000 through November of 2001, Anderson, as president of Plateau Energy Corp. sold to Ohio residents interests in an oil and gas well. These interests are securities under the Ohio Securities Act but were not registered with the Division. In addition, Anderson failed to disclose to one investor that funds would be utilized for a loan to Anderson rather than for costs associated with drilling an oil and gas well.

On July 18, 2003, the Division issued Order No. 03-140, a Notice of Opportunity for Hearing, against Anderson for allegedly violating Revised Code section 1707.44(C)(1), the unregistered sale of securities, along with Revised Code section 1707.44(G), for failing to disclose a material fact. Anderson initially requested a hearing pursuant to Chapter 119 of the Ohio Revised Code. However, he subsequently withdrew the request, thereby allowing the Division to issue its Cease and Desist Order No. 04-036, which incorporated the allegations set forth in the Notice of Opportunity for Hearing.

Plateau Energy Corp.

On February 11, 2004, the Division issued Order No. 04-036, a Cease and Desist Order, against Plateau Energy Corp. From December of 2000 through November of 2001, Plateau Energy Corp. sold to Ohio residents interests in an oil and gas well. These interests in an oil and gas well are securities under the Ohio Securities Act, but were not registered with the Division. In addition, the Respondent failed to disclose to one investor that funds would be utilized for a loan rather than for costs associated with drilling an oil and gas well. Therefore, on July 18, 2003, the Division issued Order No. 03-140, a Notice of Opportunity for Hearing, against the Respondent for allegedly violating Revised Code section 1707.44(C)(1), the unregistered sale of securities, along with Revised Code section 1707.44(G), for failing to disclose a material fact. The Respondent initially requested a hearing pursuant to Chapter 119 of the Ohio Revised Code. However, the Respondent subsequently withdrew the request, thereby allowing the Division to issue its Cease and Desist Order No. 04-036, which incorporated the allegations set forth in the Notice of Opportunity for Hearing.

R&J Funding

On February 12, 2004, the Division issued Division Order No. 04-042, a Cease and Desist Order to R&J Funding of Boardman, Ohio. The Division found that R&J Funding violated the provisions of Revised Code sections 1707.44(C)(1) and 1707.44(A)(1) by selling unregistered securities in the form of viatical settlements for Integrity Assured Life Settlements, Inc. to Ohio investors while it was unlicensed as a securities salesperson. The Division found that R&J Funding was paid commissions of 18% by Integrity Assured Life Settlements, Inc. for selling the securities. The Division also found that the viatical settlements were not registered or exempt from registration requirements.

The Division notified R&J Funding of its right to an adjudicative hearing pursuant to Chapter 119 of the Revised Code in a Notice of Opportunity for Hearing, Order No. 03-251, issued on December 29, 2003. A hearing was not requested and the Cease and Desist Order was issued on February 12, 2004.

Investment Network, Inc.

On February 26, 2004, the Division issued Division Order No. 04-045, Revocation of Ohio Investment Advisor License No. 15423, against Investment Network, Inc. In the Order, the Division found that Investment Network, Inc. violated Revised Code sections 1707.23(A), 1707.19(A)(6) and 1707.19(A)(10)(b), which generally concern the furnishing of required information to the Division. Respondent's license was initially suspended "out of the box" for failure to provide requested information to the Division. The revocation was issued after respondent failed to request a hearing in the required time period. Investment Network is a Fairlawn, Ohio, company owned by Gary Arnold.

Lawrence C. Schmelzer

On February 27, 2004, the Division issued Division Order No. 04-047, a Cease and Desist Order and Consent Agreement to Lawrence C. Schmelzer of Cleveland, Ohio. The Division found that Schmelzer violated the provisions of Revised Code sections 1707.44(B)(4) and 1707.44(G), which are anti-fraud provisions, while selling shares of Beechport Capital Corp. common shares of stock to an Ohio investor. The Division found that Schmelzer, who was once the president and a director of Beechport Capital Corp., entered into a contract with the investor to sell and transfer restricted shares of Beechport to the investor. However, the Division's investigation found that he still had not transferred or given all the shares to the investor. In addition, the Division found that Schmelzer failed to disclose to the investor that there were extensive conditions to be met involving transferring his restricted shares of Beechport Capital Corp. Rule 144 under the Securities Act of 1933 must be adhered to that includes limitations for the sale of restricted shares.

The Division notified Schmelzer of his right to an adjudicative hearing pursuant to Chapter 119 of the Revised Code in a Notice of Opportunity for Hearing, Order No. 03-139, issued on July 16, 2003. A request for an adjudicative hearing pursuant to Chapter 119 of the Revised Code was received. The request for the hearing was later withdrawn. Schmelzer entered into a Consent Agreement with the Division, and the Cease and Desist Order and Consent Agreement were issued by the Division on February 27, 2004.

Blake Aaron Prater and Wellspring Capital Group, Inc. dba Wellspring Communities Corporation.

On March 2, 2004, the Division issued Division Order No. 04-050, a Cease and Desist Order, to Blake Aaron Prater and Wellspring Capital Group, Inc. dba Wellspring Communities Corporation, both of Connecticut. The Division found that Blake Aaron Prater and Wellspring Capital Group, Inc. dba Wellspring Communities Corporation violated Revised Code section 1707.44(C)(1) by selling unregistered securities in the form of investment contracts. The Division also found that Respondents violated Revised Code section 1707.44(G) by failing to disclose material information to investors regarding Respondent Prater's criminal background. The Division's investigation was a coordinated effort with the United States Securities and Exchange Commission and with other state securities regulators, including Vermont, Connecticut and Indiana. The Securities and Exchange Commission obtained a preliminary injunction against Respondents on September 26, 2003. A hearing regarding a permanent injunction is presently set for Summer 2004.

On January 30, 2004, the Division issued Division Order No. 04-022, a Notice of Opportunity for Hearing against Blake Aaron Prater, Wellspring Capital Group, Inc. dba Wellspring Communities Corporation. The Division notified Respondents of their right to an adjudicative hearing pursuant to Chapter 119 of the Revised Code. A hearing was not requested and the above-cited Cease and Desist Order was issued on March 2, 2004.

Steve Gentry dba Gentry Services

On March 2, 2004, the Division issued Division Order No. 04-048, a Cease and Desist Order, to Steve Gentry dba Gentry Services of Kettering, Ohio. The Division found that Steve Gentry dba Gentry Services violated Revised Code sections 1707.44(A)(1) and 1707.44(C)(1) by selling unregistered securities in the form of investment contracts for Wellspring Capital Group, Inc. while he was unlicensed as a securities salesperson. The Division's investigation was a coordinated effort with the United States Securities and Exchange Commission and with other state securities regulators, including Vermont, Connecticut and Indiana. The Securities and Exchange Commission obtained a preliminary injunction against Wellspring Capital Group, Inc. and related entities on September 26, 2003. A hearing regarding a permanent injunction is presently set for Summer 2004.

On January 30, 2004, the Division issued Division Order No. 04-025, a Notice of Opportunity for Hearing against Steve Gentry dba Gentry Services. The Division notified Gentry of his right to an adjudicative hearing pursuant to Chapter 119 of the Revised Code. A hearing was not requested and the above-cited Cease and Desist Order was issued on March 2, 2004.

Rebecca Losh dba RSL Enterprises

On March 2, 2004, the Division issued Division Order No. 04-049, a Cease and Desist Order, to Rebecca Losh dba RSL Enterprises of Columbus, Ohio. The Division found that Rebecca Losh dba RSL Enterprises violated Revised Code sections 1707.44(A)(1) and 1707.44(C)(1) by selling unregistered securities in the form of investment contracts for Wellspring Capital Group, Inc. while she was unlicensed as a securities salesperson. The Division's investigation was a coordinated effort with the United States Securities and Exchange Commission and with other state securities regulators, including Vermont, Connecticut and Indiana. The Securities and Exchange Commission obtained a preliminary injunction against Wellspring Capital Group, Inc. and related entities on September 26, 2003. A hearing regarding a permanent injunction is presently set for Summer 2004.

On January 30, 2004, the Division issued Division Order No. 04-026, a Notice of Opportunity for Hearing against Rebecca Losh dba RSL Enterprises. The Division notified Losh of her right to an adjudicative hearing pursuant to Chapter 119 of the Revised Code. A hearing was not requested and the above-cited Cease and Desist Order was issued on March 2, 2004.

John C. Farrell

On March 4, 2004, the Division issued a Cease and Desist Order and Consent Agreement, Order No. 04-051, to John C. Farrell of Delaware, Ohio. Farrell waived his rights to the issuance of a Notice of Opportunity for Hearing and a 119 Hearing and entered into a Consent Agreement with the Division. The Order found that Farrell was acting in violation of Revised Code section 1707.44(A)(2), by acting as an Investment Adviser without a license.

Bernard Technologies, Inc.

On March 4, 2004, the Division issued Division Order No. 04-052, a Cease and Desist Order with Consent Agreement, against Bernard Technologies, Inc. ("BTI"). BTI is a Delaware corporation with its principal place of business in Chicago, Illinois.

BTI made three different notice filings with the Division pursuant to Revised Code section 1707.03(X), related to its Series D Convertible Preferred Stock. Revised Code section 1707.03(X) requires that sales of securities be made in reliance on the exemption provided in Rule 506 of Regulation D under the Securities Act of 1933 and in accordance with Rules 501 to 503 of Regulation D. The Division's investigation found that BTI's sales did not

satisfy the terms and conditions of Rules 501 to 503 of Regulation D, and did not meet the requirements of Rule 506 of Regulation D, which precluded BTI from relying on the exemption available under 1707.03(X). The Cease and Desist Order finds that BTI violated Revised Code section 1707.44(C)(1). This section prohibits selling securities without proper registration or claim of exemption from registration.

Sumner A. Barenberg and Peter N. Gray

On March 4, 2004, the Division issued Division Order No. 04-053, a Cease and Desist Order with Consent Agreement, against Sumner A. Barenberg and Peter N. Gray. Barenberg and Gray conducted business from Chicago, Illinois and both served as officers on the board of directors of Bernard Technologies, Inc. ("BTI"), a Delaware corporation with its principal place of business in Chicago, Illinois.

The Division's investigation found that Barenberg and Gray sold shares of Common Stock of BTI to the RAM Group, which is purportedly an Ohio general partnership formed for the purpose of investing in stock of BTI. The Cease and Desist Order finds that Barenberg and Gray violated Revised Code section 1707.44(C)(1), which prohibits selling securities without proper registration or claim of exemption from registration.

Knight Equity Markets, L.P.

On March 23, 2004, the Division issued a Cease and Desist Order and Consent Agreement, Order No. 04-069, to Knight Equity Markets, L.P., of Jersey City, New Jersey.

Knight waived its right to the issuance of a Notice of Opportunity for Hearing pursuant to Revised Code Chapter 119 and entered into a Consent Agreement with the Division. The Cease and Desist Order found that Knight violated Revised Code section 1707.44(A)(1) by selling securities to Ohio residents as an unlicensed dealer.

Criminal Updates

Mark Anthony Rizzi

On February 10, 2004, Mark Anthony Rizzi was sentenced in Lorain County Common Pleas Court to five years of community control, a suspended 100 days in county jail, and was ordered to pay restitution of $26,958 at $250 a month. On November 26, 2003, Rizzi pled guilty to one count each of theft, forgery and passing bad checks. A pre-sentence report was ordered by the judge.

Rizzi was on the Board of Trustees and served as Treasurer and Chairperson of the Finance Committee for the Golden Crescent Montessori Association of Elyria, Ohio. He falsely represented himself as a financial representative for Robert Baird & Co. He was not licensed by the Ohio Division of Securities in any capacity. Rizzi misrepresented that he was investing funds, created fictitious records and had funds diverted for his own use.

Robert T. Young

A Bill of Information was filed against Robert T. Young in Hamilton County Common Pleas Court on March 19, 2004. The charges include four felony counts, including a second degree felony count of securities fraud (R.C. 1707.44(G)), a second degree felony count of false publications of securities transactions (R.C. 1707.44(K)), a third degree felony count of aggravated theft, and a fourth degree felony count of theft. Young, while a licensed broker with Money Concepts Capital Corp., allegedly falsified documents relating to customer accounts and committed securities fraud and theft in conjunction with brokerage accounts under his control.

Ohio Securities Conference 2004

October 15, 2004

Executive Conference and Training Center
Vern Riffe Center
77 South High Street
31st Floor
Columbus, Ohio 43215-6131

Public Offering Guidelines
Investment Adviser Update
Securities Law in Cyberspace/Corporate Law Issues
Ohio Division of Securities Panel

Presented by
The Ohio Division of Securities
and
The Cybersecurities Law Institute at the University of Toledo College of Law

The meetings of the Ohio Division of Securities Advisory Committees
will be held in conjunction with this Conference.

Additional information will be included in the next edition of the Ohio Securities Bulletin
and will be available on the Division's website at www.securities.state.oh.us

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. Consequently, for purposes of calculating an aggregate capital formation amount, each indefinite filing has been assigned a value of $1,000,000.*

Filing Type	1st Qtr 2004	YTD 2004
Exemptions		
Form 3(Q)	$46,726,095	$46,726,095
Form 3(W)	4,525,000	4,525,000
Form 3(X)	57,962,002,935	57,962,002,935
Form 3(Y)	890,000	890,000
Registrations		
Form .06	1,368,194,856	1,368,194,856
Form .09/.091	7,997,457,148	7,997,457,148
Investment Companies		
Definite	106,244,000	106,244,000
Indefinite**	601,000,000	601,000,000
TOTAL	**$68,087,040,034**	**$68,087,040,034**

Registration Statistics

The following table sets forth the number of registration, exemption, and notice filings received by the Division during the first quarter of 2004, compared to the number of filings received during the first quarter of 2003. Likewise, the table compares the year-to-date filings for 2004 and 2003.

Filing Type	1st Qtr '04	YTD '04	1st Qtr '03	YTD '03
1707.03(Q)	26	26	33	33
1707.03(W)	5	5	7	7
1707.03(X)	356	356	275	275
1707.03(Y)	2	2	1	1
1707.04/.041	0	0	0	0
1707.06	27	27	23	23
1707.09/.091	46	46	30	30
Form NF	1171	1171	1137	1137
Total	1633	1633	1506	1506

Licensing Statistics

License Type	YTD 2004
Dealers	2,303
Salespersons	121,349
Investment Adviser/Notice Filers	1,708
Investment Adviser Representatives	9,770