

SUBJECT: Continuing the State Securities Board

COMMITTEE: Pensions, Investments and Financial Services — committee substitute recommended

VOTE: 9 ayes — Murphy, Vo, Capriglione, Flynn, Gervin-Hawkins, Gutierrez, Lambert, Leach, Wu

0 nays

2 absent — Longoria, Stephenson

WITNESSES: For — (*Registered, but did not testify:* Billy Phenix, Securities Industry and Financial Markets Association)

Against — None

On — Travis Iles and Derek Lauterjung, State Securities Board (*Registered, but did not testify:* Alan Leonard, Sunset Advisory Commission)

BACKGROUND: The State Securities Board was established by the Legislature in 1957 as an independent agency dedicated to protecting the public from securities fraud.

Securities include many types of investments, such as stocks, bonds, interests in oil and gas leases, and other investment contracts. Federal and state entities play a joint role in regulating persons, companies, and offerings in the securities market. The federal Securities and Exchange Commission (SEC) is the primary regulator of this market, but states and other organizations also play key roles in regulating specific products and occupations.

The State Securities Board enforces state law to protect investors from criminal securities activity and fills in regulatory gaps for certain areas of the industry not covered under federal jurisdiction or where regulation is

shared among state and federal entities.

Mission. The securities board's mission is to protect investors and ensure a healthy and productive securities market. In order to achieve this mission, the agency:

- registers dealer and investment adviser entities and their employees involved in securities;
- evaluates securities offerings that must be registered or filed with the agency;
- inspects registered investment adviser companies and dealers;
- investigates violations of agency statute and rules, and brings enforcement actions when necessary against both registered and unregistered persons; and
- assists with criminal prosecutions of agency securities cases in state and federal court.

Governance. The board consists of five public members who are not involved in the securities industry. Board members are appointed to six-year terms by the governor, with the advice and consent of the Senate, and the governor selects the board's chair. The board appoints the securities commissioner to administer the agency's functions.

Funding. The agency collected almost \$158 million in revenue and expended about \$7 million in general revenue funds and appropriated receipts on programs and administration in fiscal 2017.

Staffing. At the end of fiscal 2017, the agency had 85 staff positions. About 65 percent of the agency's employees work in Austin, but some are located at agency field offices in Corpus Christi, Dallas, Houston, and Lubbock.

Registration. The agency registers dealers, investment advisers with up to \$100 million in assets under management, their employees involved in securities, and their representatives. Dealers are companies or individuals that sell or are otherwise involved in transacting securities, and investment

advisers are companies that solicit clients, make analyses, or provide financial advice.

State law exempts certain securities overseen by federal securities regulators from registration with the State Securities Board. Issuers of non-exempt securities must register with or give notice to the board before offering securities in Texas. In fiscal 2017, 99 percent of securities applications, amendments, and renewals processed by the agency were notifications of securities either registered with the SEC or exempted from state securities regulation under federal law.

Criminal enforcement. The securities board investigates unregistered securities, unregistered activities, and securities fraud based on complaints from the public, coordination with law enforcement and regulatory agency counterparts, and proactive monitoring of investment offerings. The agency issues cease-and-desist orders to halt fraudulent activity and refers suspected criminal cases to county and district attorneys for prosecution. County and district attorneys can appoint State Securities Board staff to assist prosecutors in preparing for and arguing these cases, in addition to serving as witnesses.

Administrative compliance and enforcement. The board periodically inspects registrants and investigates complaints to protect or take action against violations of agency rules. The offices and work papers of each registered investment adviser and intrastate securities dealer are inspected by agency staff at least once every five years to ensure compliance with the state Securities Act and agency rules. The agency also conducts investigations based on complaints generated by inspections as well as administrative complaints from the public, other registrants, and the board's regulatory partners.

The State Securities Board would expire on September 1, 2019, unless continued in statute.

DIGEST: CSHB 1535 would continue the State Securities Board until September 1,

2031.

The bill would authorize the board to provide staff support to county and district attorneys in criminal securities prosecutions and require the board to implement a process to determine the level of resources that could be provided to support such cases. The bill also would authorize the board to order refunds for violations of agency statute and rules.

The requirement for registered companies to register branch offices would be removed, but the securities board would retain its ability to inspect and monitor branch office activities.

Prosecutorial assistance. CSHB 1535 would allow the State Securities Board to assist a county or district attorney who requested assistance in a criminal prosecution involving an alleged violation of the state Securities Act. Before referring a case to a county or district attorney for prosecution, the securities commissioner would be required to make a determination of the potential board resources, including the number and types of board employees, that would be needed to assist in the prosecution and the availability of those resources.

The board would be required to establish a process enabling the commissioner to determine whether to provide requested assistance to a prosecutor and, if so, the appropriate amount of such assistance. The process would have to require the commissioner to consider:

- whether resources were available, after taking into account any ongoing investigations or criminal prosecutions for which assistance was being provided;
- the seriousness of the alleged violation or violations in the case, including the severity of the harm and the number of victims involved; and
- the state's interest in the prosecution of a particular case and the availability of other methods of redress for the alleged violations, including the pursuit of a civil action.

For a case in which assistance was requested, the board could provide only those resources determined to be available. If a change in circumstances occurred after the board had determined the available resources, the commissioner could reconsider the determination and increase or reduce the resources made available for a case.

At least biennially, the attorney general would be required to review a sample of criminal cases in which the board provided requested assistance. The review would have to include an evaluation of the board's determination of available resources to support each case being reviewed. The attorney general could report any concerns about the board's provision of assistance to the standing legislative committees with primary jurisdiction over the board.

The board would have to adopt rules necessary to implement the prosecutorial assistance requirements by March 1, 2020.

Reporting requirements. In its required annual report to the governor, the board would have to include a detailed accounting of funds spent by the board providing assistance to county or district attorneys in the criminal prosecution for the violation of securities laws.

The information provided in the report also would have to include a breakdown of cases the board referred for prosecution. This would be broken down by county and district attorney and would have to include the number of cases in which:

- criminal charges were filed;
- prosecution was ongoing; or
- prosecution was completed.

Refund orders. The bill would authorize the securities commissioner to order a regulated person or entity to pay a refund to a client or purchaser of securities as provided in an agreed order or an enforcement order. The refund order could be issued by the commissioner instead of or in addition to the imposition of an administrative penalty or other sanctions.

An ordered refund could not exceed the amount paid to the regulated person or entity by the client or purchaser of securities for a service or transaction. The securities commissioner could not require payment of other damages or estimate harm in a refund order.

Branch office registration. The board would no longer be authorized to collect a branch office registration fee. The bill would not entitle a person to a refund of a registration or other fee paid before the effective date of the bill.

Standard recommendations. CSHB 1535 would make several changes to statute governing the State Securities Board in order to implement standard Sunset recommendations. These changes would modify board member training requirements, require the implementation of a system to promptly and efficiently act on complaints filed with the board, and require the board to develop a policy to encourage the use of appropriate alternative dispute resolution procedures in certain cases.

The board's procedures related to alternative dispute resolution would have to conform, to the extent possible, to any model guidelines issued by the State Office of Administration Hearings for the use of alternative dispute resolution by state agencies. The board would have to coordinate the implementation of the policy, provide training as needed to implement procedures for negotiated rulemaking or alternative dispute resolution, and collect data concerning the effectiveness of those procedures.

Effective date. The bill would take effect September 1, 2019.

**SUPPORTERS
SAY:**

CSHB 1535 would continue the State Securities Board, which plays a critical role in protecting Texas residents from fraudulent or negligent practices by securities professionals and criminal opportunists. The board continues to effectively carry out its mission to protect investors and promote transparency in the securities market and should be continued in statute. Changes to the board proposed by CSHB 1535 would further improve the board's ability to protect Texans and provide effective

regulation of certain financial markets.

Prosecutorial assistance. Statute charges the securities board with preventing and detecting violations of the state Securities Act and referring criminal cases to county and district attorneys, who have the primary authority to pursue those cases in court. Agency staff have unique expertise in securities law, so prosecutors regularly ask agency attorneys and financial examiners to assist as special prosecutors and witnesses in criminal cases, a service the agency provides at no cost to the prosecuting authority.

By authorizing the board to provide prosecutorial assistance and requiring the development of a process to determine what board resources were available for this purpose, the bill would encourage the board to responsibly support the prosecution of securities crimes while being mindful of its other statutory responsibilities.

Refund orders. CSHB 1535 would allow the board to include refunds as a part of its agreed orders to resolve enforcement matters. This authority is already available to other regulatory agencies and would give the board an additional, effective enforcement tool for resolving financial disputes between registered entities and their clients.

Branch office registration. CSHB 1535 would remove the duplicative registration of branch office. Dealers and investment advisers are separately required to provide the location and supervisor of each branch office as part of their registration, making the registration of branch offices redundant.

OPPONENTS
SAY:

CSHB 1535 would remove branch office registration, which is an important revenue stream for the state's general revenue fund. This revenue source should not be eliminated without replacing it with an alternative source.

NOTES:

According to the Legislative Budget Board, the bill would result in a negative impact of about \$850,000 in general revenue related funds

through fiscal 2020-21.