DRAFT STATEMENT OF BASIS AND PURPOSE

Promulgation of Amendments to Division Rules

Colorado Division of Securities
March 6, 2017

Pursuant to the authority found in the Colorado Securities Act ("Act"), sections 11-51-101, et seq., C.R.S. (2017), including part 6 of the Act, the Securities Commissioner adopts amendments to Division Rules 51-2.2, 51-3.1, 51-3.4, 51-3.5, 51-3.9, 51-3.13, 51-3.19, 51-3.24, 51-3.30, 51-4.2, 51-4.3, 51-4.5, 51-4.6, 51-4.8, 51-4.3(IA), 51-4.4(IA), 51-4.6(IA), 51-4.7(IA), 51-4.8(IA), 51-4.9(IA), 51-6.1, 51-6.2, 51-6.3, 51-6.4, 51-6.5, 51-9.3 and proposes Division Rules 51-3.31, 51-3.32, 51-3.33, 51-4.9, 51-4.11(IA), 51-4.12(IA), 51-4.13(IA), 51-4.14(IA), 51-4.15(IA) 51-6.2.5 on March 6, 2017.

Rule 51-2.2, SEC Amendments Coordinated, contained a spelling mistake, [ective date, instead of effective date. This has been fixed.

Rule 51-3.1, Registration by Coordination, formatting has been amended to be consistent with the Rules under the Colorado Securities Act (collectively, the "Rules")(individually, "Rule"). All of the underlining has been removed from this Rule.

Rule 51-3.4, Escrow and Release of Funds under Section 11-51-302(6), C.R.S., contained a spelling mistake, transanctions, which has been changed to transactions.

The general purpose of amending Rule 51-3.5, Notice of Intention to Sell in Reliance on Investment Company Exemption under Section 11-51-307(1)(k), is to promote efficiencies and save costs. The amendment requires that the Uniform Investment Company Notice Filing Form (Form NF) and the appropriate fee be filed annually. It also removes the requirement that any amendments to Form NF be filed with the Colorado Division of Securities (the "Division"). This will save time and money for the investment company compliance officers, as well as the Division, in reducing both the amount of filing, and the amount of review required. Investors remain equally protected because Form NF is still filed on an annual basis, reflecting any changes that would have previously required an amended filing.

The general purpose of amending Rule 51-3.9, Transactional Securities Exemption for Non-Issuer Distribution of Outstanding Security, is to remove manuals which no longer exist and to add manuals from OTC Markets Group Inc. ("OTC Markets Group"). Standard and Poor's Standard Corporation Descriptions no longer exists and has been removed from the Rule. Additionally, the Rule adds OTC Markets Group (with respect to securities included in the OTCQX and OTCQB markets) to the manual exemption. The OTCQX and OTCQB markets require that companies disclose all of the information required under the Manual Exemption, and that information is publicly available for free on the OTC Markets Group website. OTCQX and OTCQB companies meet their disclosure requirements by meeting one of the following standards: 1) filing periodic reports with the SEC; 2) making required filings under the SEC's Regulation A, Tier 2: 3) reporting to their banking regulator; 4) complying with Exchange Act

Rule 12g3-2(b); or, 5) following OTCQX U.S. Disclosure Guidelines, originally developed by NASAA. In addition to this fundamental information, the website also provides real-time pricing information, a repository of each company's prior public disclosures, the company's corporate action history, independent research from third parties, and other tools and information. "OTC Markets Group monitors OTCX and OTCQB company disclosure, and companies that become delinquent in providing the required information are removed from OTCQX or OTCQB, as applicable."

The general purpose of repealing Rule 51-3.13, Transactional Securities Registration Exemptions under section 11-51-308(1)(p), C.R.S., is to comply with the federal rule regarding Regulation A. The current Rule conflicts with the federal rule and the Division is pre-empted from regulating Regulation A offerings as it currently does. This amendment repeals the old "test the waters" provision. The North American Securities Administration Association ("NASAA") has asked for public comment regarding a Proposed Model Statute, a Proposed Model Rule, and a Proposed Solicitation of Interest Form to Permit Testing the Waters in Regulation A Tier 1 Offerings. A new test the waters provision will be added after a model rule has been promulgated and the Division has a chance to evaluate what NASAA proposes.

The new Rule 51-3.13, Transactional Securities Registration Exemptions under Section 11-51-308(1)(p), requires issuers who are relying on Regulation A, Tier 2 offerings to provide notice to the Division. The notice filings are not pre-empted under federal law. The new Rule makes clear that C.R.S. §11-51-308(1)(p) only applies to Tier 1 offerings (which is all Colorado can regulate). The proposed Rule is a NASAA model rule for notice filing for issuers relying on Regulation A, Tier 2.

Rule 51-3.9 Model Accredited Investor Exemption, was changed to make the Rule's organization consistent with the rest of the rules. 3.19(E)(2)(f)(1-3) was changed to 3.19(E)(2)(f)(i-iii).

The general purpose of amending Rule 51-3.24, Crowdfunding-Additional Issuer Requirements, is to ensure that issuers relying on crowdfunding are not also relying on any other registration exemption within a twelve month period. This provision requires issuers who are relying on crowdfunding and another exemption to integrate the offerings. The amendment clarifies that whether an issue is part of the same offering is a question of fact and depends on the particular circumstances. The amendment provides factors to determine if an offering is part of the same issue and should therefore be integrated.

Rule 51-3.30, Crowdfunding – Disqualification from Relying on Crowdfunding Exemption, was amended to make stylistic changes. First, the numbers in parenthesis were changed to romanettes, reflecting the overall structure of the Rules. Second, certain statutes were unnecessarily bold and the bold was therefore removed (e.g. 15 U.S.C. 78**o**(b)).

Rule 51-3.31, Notice Filing Requirement for Federal Crowdfunding Offerings, requires issuers who are relying on the federal crowdfunding rule to complete a notice filing in Colorado. The notice is required if the principal place of business is Colorado or if 50% of the aggregate amount of the offering is sold to residents of Colorado. Additionally, this Rule clarifies when the

notice filing must be completed and for how long the notice is effective. Finally, it defines how to renew the filing. This is NASAA's model rule.

The addition of Rule 51-3.32, Use of Electronic Offerings Documents and Electronic Signatures, defines how electronic offering documents and electronic signatures can be used. The Division is adopting this Rule to ensure that investors remain protected, as increasingly documents and signatures are completed only electronically. The Rule sets the standard for how and when an electronic document and signature can be used instead of a paper copy. The Rule incorporates the Federal E-Sign Act and the Uniform Electronic Transactions Act.

The general purpose of adding Rule 51-3.33, Licensing Exemption for Merger and Acquisition Brokers, is to provide a licensing exemption for a broker engaged in the business of effecting securities transactions solely in connection with the transfer of ownership of an eligible privately held company. The Rule excludes explicit activities, like receiving stock, and includes federally defined disqualifications. This is NASAA's model rule.

Rule 51-4.2, Withdrawal of a Broker-Dealer License, was amended to include a hyphen between broker and dealer. This makes this Rule consistent with the rest of the Rules use of the term "broker-dealer."

Rule 51-4.3, Application for a Sales Representative License was amended to make the organizational structure consistent with the rest of the Rules. The "K" in Rule 51.4.3(J)(2)(K) should be lowercase and the Rule has been amended to reflect this.

Rule 51-4.5, Books and Records Requirements for Licensed Broker-Dealers, was amended to accurately reflect the federal rules that they reference. Currently, the Rule cites to SEC rules 15c2-6, which is reserved for future use, and 75 CFR 240.15c2-11, which does not exist. The amendment changes 15c2-6, to all of 15g (17 CFR 240.15g-1 through 240.15g-100). 15c2-6 was originally penny stocks, which are now covered by 15g. The amendment to this Rule reflects the change in the federal rule.75 CFR 240.15c2-11 was a misprint, and has been changed to 17 CFR 15c211.

Rule 51-4.6, Financial Responsibility and Books and Records Requirements for Mortgage Broker-Dealers', organization was changed to be consistent with the organizational structure of the Rules.

Rule 51-4.7, Unfair and Dishonest Dealings organizational structure was changed to be consistent with the rest of the Rules.

The general purpose of adding Rule 51-4.8, Broker-Dealer Cybersecurity, and Rule 51-4.14(IA), Investment Adviser Cybersecurity, is to clarify what a broker-dealer and investment adviser must do in order to protect information stored electronically. The Rule provides guidance to broker-dealers and investment advisers on what factors the Division will consider when determining if the procedures by the firm are reasonably designed to ensure cybersecurity.

The general purpose of amending Rule 51-4.3(IA), Application for an Investment Adviser License, is to provide guidance on who needs to be licensed as an investment adviser. The Rule makes it abundantly clear who is required to be licensed as an investment adviser or investment adviser representative. The Rule clarifies that lawyers, accountants, engineers and teachers are required to be licensed as investment advisers only if the advice given is not "solely incidental" (as defined in the Rule) to the professional's regular professional practice with respect to clients. Additionally, this Rule clarifies when a broker-dealer and broker-dealer agent, insurance agents, and others must be licensed as an investment adviser or investment adviser representative.

The general purpose of amending Rule 51-4.4(IA), Application for an Investment Adviser Representative License, is to require an investment adviser who has an unpaid arbitration award to explain the details of the award. It is not in the public interest to have former securities sales representatives who have an unpaid FINRA award against them become an investment adviser representative without further explanation. This amendment is intended to protect the public by requiring the applicant to explain the details of the unpaid arbitration award. C.R.S. §11-51-403, gives the Commissioner the power to make applicants submit "additional information that is material to an understanding of information about the applicant." Because the Commissioner considers this information material, the application will remain incomplete until the information is provided.

The general purpose of amending Rule 51-4.6(IA), Books and Records Requirements for Licensed Investment Advisers, is to clearly define what the staff at the Division looks at when determining if the investment adviser's supervisory procedures are reasonably situated to the firm. Additionally, it provides what minimum supervisory procedures a firm must have. If a firm does not have written supervisory procedures, it is deemed to have violated §11-51-410(1)(g), C.R.S.

Additionally, Rule 51-4.6(IA) was amended to make the organizational structure consistent with the rest of the Rules. Finally, the Rule refers to an investment adviser being "registered." This should be licensed and has been amended.

The amendment to Rule 51-4.7(IA), Mandatory Disclosure changes the name of the form from Part II of the investment adviser's Form ADV to Part 2. This change reflects the change in the name of the universal form. Additionally, the Rule was amended to require investment advisers and investment adviser representatives who participate in a wrap fee program to give every client, including prospective clients, a copy of the Form ADV in addition to a copy of Part 2A appendix 1 of Form ADV (the wrap fee brochure). Similarly, investment advisers and investment adviser representatives must give clients participating in a pooled investment vehicle a copy of Part 2 of the investment adviser's Form ADV.

The amendment to Rule 51-4.8(IA), Dishonest and Unethical Conduct, also changes the name of the form from Part II of the investment adviser's Form ADV to Part 2, but, additionally, includes organizational structural changes, again for consistency.

Rule 51-4.9(IA), Payment of Cash Fees for Solicitation, was amended to make its organizational structure consistent with the rest of the Rules.

The general purpose of adding Rule 51-4.11(IA), Licensing Exemption for Investment Advisers to Private Funds is to allow investment advisers who manage funds that meet the private fund definition in the Securities and Exchange Commission ("SEC") Rule 203(m)-1, 17 C.F.R. 275.203(m)-1, to be exempt from licensing. This Rule includes a list of disqualifications (17 C.F.R. 230.506(d)(1), 17 C.F.R. 275.204-4) and requires a fee to be paid to the Division. This is a NASAA model rule.

The general purpose of Rule 51-4.12(IA), Business Continuity and Succession Plan is to ensure that investment advisers consider disaster scenarios. This rule helps investment advisers ensure as minimal disruption as possible to their clients. It requires "minimizing service disruptions and client harm that could result from a sudden significant business interruption." This is a NASAA model rule.

The general purpose of adding Rule 51-4.13(IA), Net Worth Requirements is to ensure that investment advisers have a positive net worth. For investment advisers with discretionary authority over client funds, they maintain, at a minimum, a $10,000 net worth requirement. Investment advisers with custody are required to have a net worth of $35,000. Additionally, the Rule requires that an investment adviser notify the Commissioner if they fail to maintain the appropriate net worth requirements. This Rule is fairly similar to NASAA's model rule, Minimum Financial Requirements for Investment Advisers, Amended September 11, 2011.

The general purpose of adding Rule 51-4.15(IA) Performance-Based Compensation Exemption for Investment Advisers is to define when and how an investment adviser may charge a fee based on performance. The Rule limits the use of the fee to "qualified clients," as defined by the SEC. For a "natural person," there is a net worth requirement of $2 million, inclusive of a spouse, but exclusive of the primary residence.

Chapter 6 Procedures for Hearings Conducted by the Colorado Securities Board has been re-organized for usability. Requirements which apply to all hearings have their own section. Additionally, the Rules now require hearings regarding denial, suspension or revocation of either a registration statement or registration to be scheduled within 120 days. Similarly, Rule 51-6.5 has been expanded to include all of the powers listed in §11-51-410, C.R.S. This includes denying a license, or suspending, revoking, censuring, limiting, or other conditions on the securities activities of a broker-dealer, sales representative, investment adviser or investment adviser representative. The Division of Administrative Hearings has been changed to the Office of Administrative Courts throughout the chapter. Finally, rules for withdrawing as an attorney have been added to Rule 51-6.4 and Rule 51-6.5. Previously, only Rule 51-6.3 regarding cease and desist hearings mentioned how an attorney can withdraw from their representation.

The amendment to Rule 51-9.3 Registration, Reports, and Bookkeeping of the Local Government Investment Pool Trust Funds, has been updated to reflect what information the Division needs from Local Government Investment Pool Trust Funds ("LGIPs"). The amendment eliminates the requirements that LGIP's submit Form TRQ-1 (QUARTERLY REPORT TO MEMBERS) and TRQ-2 (PORTFOLIO ASSETS). The Forms no longer exist.

The amendment to the Rule reflects input from the current LGIPs, and the Division is asking that the LGIPs provide the information which they are already providing to their clients.

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

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

DATED this ___ day of _____, 2017.

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Gerald Rome
Securities Commissioner