

Michigan Office of Administrative Hearings and Rules

Administrative Rules Division (ARD)

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**REGULATORY IMPACT STATEMENT
and COST-BENEFIT ANALYSIS (RIS)**

Agency Information:

Department name:

Licensing and Regulatory Affairs

Bureau name:

Corporations, Securities, & Commercial Licensing

Name of person filling out RIS:

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Rule Set Information:

ARD assigned rule set number:

2021-17 LR

Title of proposed rule set:

Securities

Comparison of Rule(s) to Federal/State/Association Standard

1. Compare the proposed rules to parallel federal rules or standards set by a state or national licensing agency or accreditation association, if any exist.

The securities industry is regulated by the federal government, state governments, and self-regulatory bodies. The Corporations, Securities & Commercial Licensing Bureau (“CSCL” or “Bureau”) regulates investment advisers under Articles 4 and 5 of the Michigan Uniform Securities Act (“Act”), 2008 PA 551, MCL 451.2101 et seq.

Investment adviser firms that manage under \$100 million of assets and investment adviser representatives are primarily regulated at the state level, while investment adviser firms that manage over \$100 million of assets typically register with the United States Securities and Exchange Commission (“SEC”). State investment adviser laws are largely preempted for firms registered with the SEC, although the SEC does not register individuals employed by federal covered firms and states maintain antifraud authority. Proposed rule R 451.4.21 adopts the North American Securities Administrators Association model rules (“NASAA”) concerning investment adviser policies and procedures. This model rule was designed to mirror SEC rules requiring policy and procedures for federally registered investment advisers and to make the rules for state-registered investment advisers consistent with SEC rules.

Proposed R 451.4.21(2) mirrors the language of SEC rule 206(4)-7, 17 C.F.R. § 275.206(4)-7, concerning compliance procedures and practices for investment advisers registered with the SEC. Proposed R 451.4.21 (3) mirrors SEC rule 206(4)-6, 17 C.F.R. § 275.206(4)-6, concerning proxy voting policies and procedures for investment advisers registered with the SEC. Proposed rule R 451.4.21(6) mirrors the language of SEC rule 204A-1, 17 CFR § 275.204A-1, concerning investment adviser codes of ethics for investment advisers registered with the SEC.

Proposed R 451.4.21(4) and the model rule require state-registered investment advisers to adopt, implement, and

enforce cybersecurity policies and procedures. There is no comparable federal rule requiring federally registered investment adviser firms to establish cybersecurity policy and procedures. The SEC has cited Regulation S-P, under 17 CFR 248.30(a), in enforcement cases of federally registered investment adviser firms as a regulation that requires investment advisers to establish cybersecurity policy and procedures. Regulation S-P was adopted in 2000 and generally requires investment advisers registered with the SEC to adopt written policies and procedures to address administrative, technical, and physical safeguards for the protection of customer records and information. See 17 CFR 248.30(a). The SEC has taken the position through its enforcement powers and published guidance documents that federally registered investment adviser firms adopt cybersecurity procedures consistent with the U.S. Department of Commerce's National Institute of Standards and Technology (NIST) Cybersecurity Framework, which consists of five elements (identify, protect, detect, respond, and recover) for successful high-profile cybersecurity risk management. The requirements of proposed R 451.4.25(4) derive from the principles of the CIA Triad (confidentiality, integrity, and availability), which are the foundation for development of security system policies for organizations, and the five functions of the NIST Cybersecurity Framework. The CIA Triad and NIST Cybersecurity Framework provide cybersecurity topics for investment advisers to consider including in their policies and procedures, along with a roadmap for what is required to comply with the proposed rule and to protect client information.

Section 10 of Securities Exchange Act of 1934, 15 U.S. Code § 78j, SEC Rule 10b-5 and SEC Rule 10b-5-1, 17 CFR § 240.10b-5 through § 240.10b-5 -1, and section 501 of the Act, MCL 451.2501, prohibit "insider trading" by using material nonpublic information. Investment advisers registered with the SEC are required by 17 CFR 275.206(4)-7 to adopt, implement, and enforce written policies and procedures to ensure compliance with applicable securities laws and rules, including the prohibition on the misuse of material nonpublic information. Proposed R 451.4.21(7) would similarly require an investment adviser to develop and enforce policies that would prevent the misuse of material nonpublic information by its associated persons.

The SEC, when it adopted 17 CFR 275.206(4)-7, stated in its adopting release that the rule requires an investment adviser to adopt a business continuity plan as a part of its required policies and procedures. See Securities and Exchange Commission Release No. IA-2204 at note 22. Current R 451.4.21 requires an investment advisor to establish, implement, and maintain written procedures relating to a business continuity and succession plan. Proposed R 451.4.21(8) will include the current language of R 451.4.21 as a subrule of a larger policies and procedures rule.

Proposed R 451.4.29 adopts the NASAA model rule concerning continuing education of investment adviser representatives. There is no federal rule or standard establishing a continuing education requirement on investment adviser representatives because investment adviser representatives do not register at the federal level, but only with the states.

The Financial Industry Regulatory Authority ("FINRA"), a private self-regulatory organization overseen by the SEC, requires agents of FINRA-member broker-dealers to complete continuing education. FINRA's continuing education program focuses on compliance, regulatory, ethical, and sales practice standards in the broker-dealer industry. The content of FINRA's continuing education program is from industry rules, regulations, and accepted standards and practices in the industry. Investment advisers and investment adviser representatives are different registration categories that are not subject to FINRA's requirements unless separately registered as broker-dealers or agents. As a result, investment advisers and investment adviser representatives are not subject to any continuing education requirements unless they are also registered as broker-dealers or agents. Investment adviser representatives who are also registered as agents of broker-dealers that have complied with FINRA's continuing education program requirements will comply with the six credits of investment adviser representative (IAR) products and practice requirement in proposed R 451.4.29(2)(b). This is intended to reduce the regulatory burden and minimize the overlap of continuing education requirements for dual registrants. These individuals would still need to complete R 451.4.29 (2)(a)'s ethics component of the continuing education requirement.

A. Are these rules required by state law or federal mandate?

Proposed R 451.4.21 and R 451.4.29 are not required by state law or federal mandate. Section 411(8) of the Act, MCL 451.2411(8), gives permissive authority to the bureau to establish a continuing education requirement for investment adviser representatives registered under the Act. Section 411(3) of the Act, MCL 451.2411(3), provides permissive authority to the Bureau to establish other record-keeping requirements on investment advisers.

B. If these rules exceed a federal standard, please identify the federal standard or citation, describe why it is necessary that the proposed rules exceed the federal standard or law, and specify the costs and benefits arising out of the deviation.

There is no federal standard for continuing education of investment adviser representatives because they are not registered at the federal level. None of the proposed subrules in R 451.4.21 exceed a federal standard.

2. Compare the proposed rules to standards in similarly situated states, based on geographic location, topography, natural resources, commonalities, or economic similarities.

Concerning proposed R 451.4.29, NASAA recently surveyed its member states asking if their member jurisdictions planned to adopt NASAA's Investment Adviser Representative Continuing Education Model Rule. Of the 43 jurisdictions that responded to the survey, only 4 jurisdictions responded they were not planning to adopt NASAA's model rule at this time. The survey showed there are 11 states currently working toward a 2021 adoption with other states to follow in 2022. Among the Midwest states, Wisconsin is currently pursuing the adoption of NASAA's Continuing Education model rule.

At this time, CSCL is unsure whether other similarly situated states plan to adopt NASAA's policies and procedure rule (R 451.4.29). This rule enhances uniformity with the federal regulatory structure for investment advisers and if adopted by other states it will be uniform to their rules.

A. If the rules exceed standards in those states, please explain why and specify the costs and benefits arising out of the deviation.

Proposed R 451.4.21 and R 451.4.29 incorporate the language of model rulesets which are designed for consistency throughout the United States. R 451.4.21 and R 451.4.29 would not exceed the requirements from the states that have adopted these model rulesets.

3. Identify any laws, rules, and other legal requirements that may duplicate, overlap, or conflict with the proposed rules.

These rules will not duplicate, overlap, or conflict with any laws, rules, and other legal requirements. Proposed R 451.4.21 was designed to make investment adviser policies and procedures requirements consistent with SEC rules, federal law, and the regulations of other state jurisdictions that regulate investment advisers. Proposed R 451.4.29 is designed to be consistent with other state jurisdictions that adopt the NASAA model rule on investment adviser representative continuing education.

A. Explain how the rules have been coordinated, to the extent practicable, with other federal, state, and local laws applicable to the same activity or subject matter. This section should include a discussion of the efforts undertaken by the agency to avoid or minimize duplication.

NASAA is an organization comprised of state and provincial securities regulators in the US, Canada, and Mexico. NASAA regularly publishes model rules designed by the organization's membership to ensure consistency and uniformity among their membership's jurisdictions. Before finalizing the model rules for continuing education of investment adviser representatives and the policy and procedures final rule, NASAA requested feedback from its members, industry stakeholders, and the federal government. CSCL reviewed the model rules, the comments published on the NASAA website, and the federal law before filing a request for rulemaking for this rule set to avoid and minimize potential duplication.

4. If MCL 24.232(8) applies and the proposed rules are more stringent than the applicable federally mandated standard, provide a statement of specific facts that establish the clear and convincing need to adopt the more stringent rules.

Section 32(8) of the Administrative Procedures Act, MCL 24.232(8), does not apply.

5. If MCL 24.232(9) applies and the proposed rules are more stringent than the applicable federal standard, provide either the Michigan statute that specifically authorizes the more stringent rules OR a statement of the specific facts that establish the clear and convincing need to adopt the more stringent rules.

Section 32(9) of the Administrative Procedures Act, MCL 24.232(9), does not apply.

Purpose and Objectives of the Rule(s)

6. Identify the behavior and frequency of behavior that the proposed rules are designed to alter.

Proposed R 451.4.21 would require investment advisers registered under the Act to identify their conflicts and risks to establish, implement, and maintain policies and procedures tailored to their firm's business model. The overarching goal of the rule is to ensure that investment advisers are preventing themselves, their employees, and agents associated with investment advisers from violating their fiduciary duties and ethical obligations to their investors with minimal state oversight. Also, R 451.4.21 is designed to protect investor's confidential and sensitive information from modern cybersecurity threats and concerns, which is a prevailing issue in the securities industry. The frequency of investment advisers and investment adviser representatives violating their fiduciary duties and ethical obligations is indeterminate. The bureau becomes aware of these violations when CSCL receives complaints, when discovered on an examination of a registrant by bureau staff, and when referrals are made to the Bureau by other regulators or law enforcement.

Proposed R 451.4.29 would require investment adviser representatives annually to complete six credit hours on investment adviser representative ethics and six credit hours on investment adviser representative products and practice. An investment adviser representative who is also registered as an agent of a FINRA-member broker-dealer would not be required to also complete six hours of products and practice continuing education required by R 451.4.29(2)(b) as long as the individual complies with FINRA's continuing education requirement. This regimen will ensure that investment adviser representatives who are not dually registered as agents of broker-dealers will receive the same amount of continuing education as those who are, while minimizing regulatory overlap for individuals who are registered in both capacities.

A. Estimate the change in the frequency of the targeted behavior expected from the proposed rules.

Regarding proposed R 451.4.21 the change in frequency is indeterminate. Most investment advisers have adopted written policies and procedures addressing topics required by the rule; however, not all have done so for each topic. Each of the policy and procedure requirements in Rule 451.4.21 applies to business models for all investment advisers to some degree. The rule will require advisers to consider each topic's impact on their own businesses, and what procedures should be in place. This will ultimately foster an environment of compliance with securities laws and rules and will help advisers to better serve their clients.

Under proposed R 451.4.29 investment adviser representatives would be required to complete continuing education annually. Presently, unlike broker-dealer agents, insurance agents, certified public accountants, and many other financial service industry professionals, investment adviser representatives are not required to engage in any continuing education to maintain their registrations. The proposed rule is intended to close this existing continuing education gap in the industry.

B. Describe the difference between current behavior/practice and desired behavior/practice.

Outside of business continuity and succession planning, proxy voting, lending and borrowing to and from related clients, and preventing the misuse of material nonpublic information, investment advisers in Michigan are not explicitly required by rule to establish written policies and procedures. The SEC has taken the position that even if not explicitly required by rule, an investment adviser is required by its fiduciary duty to clients to establish and maintain written policies and procedures. Not all investment advisers have adopted policies and procedures addressing all the topics required by the proposed rule. Some have adopted these or similar policies outlined in proposed R 451.4.21. Proposed R 451.4.21 would make the adoption of written policies and procedures mandatory for all investment advisers, clearly identifying for registrants what is required of them and enhancing uniformity with federally registered investment adviser regulatory policy. The clarity provided by the rule will benefit both investment advisers and their clients.

Investment adviser representatives who are not registered as agents of a broker-dealer currently do not take continuing education to maintain their competency in the ever-changing securities industry. R 451.4.29 would require investment adviser representatives to complete continuing education annually which in turn will raise and maintain their competency throughout their career.

C. What is the desired outcome?

R 451.4.21 ensures that investment advisers are properly overseeing their managers, employees, and agents to ensure they comply with an investment adviser firm's policy and procedures. The desired outcomes are to ensure state-registered investment adviser firms have the same policy and procedures as their federally regulated counterparts and for the investment adviser firms to enforce their policy related to their ethical obligations and fiduciary duties.

The desired outcome of R 451.4.29 is to ensure investment adviser representatives who are not registered as agents of broker-dealers have the same or similar continuing education requirement to maintain their registrations under the Act. An additional desired outcome is to raise and maintain the competency of investment adviser representatives to better protect and advise investors.

7. Identify the harm resulting from the behavior that the proposed rules are designed to alter and the likelihood that the harm will occur in the absence of the rule.

The proposed rules are intended to foster an environment of compliance with laws and rules that apply to investment advisers to prevent intentional or accidental violations of the laws and rules. Establishing, adopting, and enforcing written policies and procedures will help investment advisers minimize the risk that their staff will accidentally or intentionally violate the law and will help advisers to detect when these violations occur. Similarly, requiring investment adviser representatives to complete continuing education will ensure that individuals acting as investment adviser representatives are up to date on the most current regulatory, ethical, and investment product issues in the industry. When investment advisers and their staff make critical errors or commit fraudulent acts, investors lose money; when investors lose money, they also lose confidence in the market's ability to preserve and build wealth. Loss of investor confidence in markets reduces the public's willingness to invest, reducing the capital available to businesses. R 451.4.21 and R 451.4.29 further the goals of instilling confidence in the markets by requiring investment advisers to establish their internal policies and procedures and maintaining the competency of investment adviser representatives through continuing education.

A. What is the rationale for changing the rules instead of leaving them as currently written?

The rationale for changing the rules and not leaving them as written is to modernize the rules and bring Michigan in line with standards established by the SEC and other states. R 451.4.21 aligns state-registered investment adviser firms with those registered at the federal level. R 451.4.29 creates continuing education requirements for investment adviser representatives to more closely align with the FINRA continuing education for agents of a broker-dealer, and with states that adopt NASAA's continuing education model rule.

8. Describe how the proposed rules protect the health, safety, and welfare of Michigan citizens while promoting a regulatory environment in Michigan that is the least burdensome alternative for those required to comply.

Proposed R 451.4.21 enhances oversight in investment adviser firms with minimal oversight from the bureau, and proposed R 451.4.29 enhances the oversight over investment adviser representatives through continuing education. Both rules enhance the goals of the Act by promoting a culture of compliance with securities laws, protecting investors, and reducing fraud while ensuring the efficient allocation of capital in Michigan.

Currently, R 451.4.21 does not identify specific elements that an investment adviser must include in its policies and procedures. R 451.4.21 requires investment advisers to identify their conflicts, risks, or other unique scenarios and tailor those conflicts, risks, and scenarios to their firm's business model. This flexibility provides the least burdensome alternative while continuing to promote the goals of the Act.

R 451.4.29 requires investment adviser representatives to complete continuing education annually to maintain their registration under the Act. However, under R 451.4.29(3), investment adviser representatives who are also registered as agents of broker-dealers and that comply with FINRA's continuing education requirements will comply with half of the continuing education requirement created by R 451.4.29. This approach removes duplication and minimizes the burden on investment adviser representatives who are also registered as an agent of a broker-dealer from completing two different continuing education programs.

9. Describe any rules in the affected rule set that are obsolete or unnecessary and can be rescinded.

There are no rules in the affected rule set that are obsolete or unnecessary. R 451.4.21 retains the business continuity and succession planning requirements in subrule (8).

Fiscal Impact on the Agency

Fiscal impact is an increase or decrease in expenditures from the current level of expenditures, i.e. hiring additional staff, higher contract costs, programming costs, changes in reimbursements rates, etc. over and above what is currently expended for that function. It does not include more intangible costs for benefits, such as opportunity costs, the value of time saved or lost, etc., unless those issues result in a measurable impact on expenditures.

10. Please provide the fiscal impact on the agency (an estimate of the cost of rule imposition or potential savings for the agency promulgating the rule).

CSCL does not anticipate any additional cost because of proposed R 451.4.21. CSCL may see indeterminate savings in enforcement costs over several years because of R 451.4.21.

CSCL will not take on an additional cost because of proposed R 451.4.29. The continuing education system will be implemented through FINRA's established registration system at no cost to the agency. CSCL may see indeterminate savings in enforcement costs over several years because of R 451.4.29.

11. Describe whether or not an agency appropriation has been made or a funding source provided for any expenditures associated with the proposed rules.

CSCL has not made an appropriation and does not plan to seek an appropriation. No funding sources have been provided.

12. Describe how the proposed rules are necessary and suitable to accomplish their purpose, in relationship to the burden(s) the rules place on individuals. Burdens may include fiscal or administrative burdens, or duplicative acts.

R 451.4.21 places an administrative burden on investment advisers by requiring these businesses to adopt policies and procedures aligned with their business practices, size of businesses, their ethical obligations, and their fiduciary duties to investors. The purpose of proposed R 451.4.21 is to adopt policy and procedural business practices for investment advisers to hold themselves accountable to their legal, regulatory, and ethical obligations, as well as the security and safety of investors' personal information.

R 451.4.29 places an administrative burden and a fiscal burden on individual investment adviser representatives. The purpose of proposed R 451.4.29 is to ensure registrants have continued competency and grow their knowledge base in the rapidly changing securities industry. NASAA developed the model rules to maximize flexibility in continuing education content available, minimize duplicative continuing education requirements to the extent practicable, minimizing compliance burdens by using existing systems and technology and minimize the costs to individuals completing continuing education. The bureau believes these fiscal and administrative burdens are appropriate and necessary to enhance investor protection as contemplated by the Act.

A. Despite the identified burden(s), identify how the requirements in the rules are still needed and reasonable compared to the burdens.

The adoption of these rules for persons and businesses regulated by the Act is necessary and reasonable to protect Michigan investors from fraudulent activities and to promote the efficient formation and allocation of capital in the state.

Impact on Other State or Local Governmental Units

13. Estimate any increase or decrease in revenues to other state or local governmental units (i.e. cities, counties, school districts) as a result of the rule. Estimate the cost increases or reductions for other state or local governmental units (i.e. cities, counties, school districts) as a result of the rule. Include the cost of equipment, supplies, labor, and increased administrative costs in both the initial imposition of the rule and any ongoing monitoring.

The bureau does not anticipate a fiscal impact on other state or local governmental units because of the proposed rules. The regulation of investment advisers and investment adviser representatives is primarily regulated at the state level and only by CSCL.

14. Discuss any program, service, duty, or responsibility imposed upon any city, county, town, village, or school district by the rules.

There will not be a program, service, duty, or responsibility imposed upon any city, county, town, village, or school district by the proposed rules.

A. Describe any actions that governmental units must take to be in compliance with the rules. This section should include items such as record keeping and reporting requirements or changing operational practices.

This question is not applicable because the obligations only apply to investment advisers and investment adviser representatives registered under the Act and not local government units.

15. Describe whether or not an appropriation to state or local governmental units has been made or a funding source provided for any additional expenditures associated with the proposed rules.

No appropriation has been made because CSCL does not anticipate an expenditure is necessary for other state or local governmental units.

Rural Impact

16. In general, what impact will the rules have on rural areas?

The bureau does not anticipate that this rule will impact rural areas. These rules apply to investment advisers and investment adviser representatives regardless of rural or urban designation and will not disproportionately impact rural communities.

A. Describe the types of public or private interests in rural areas that will be affected by the rules.

CSCL cannot identify public or private interests in rural areas that will be affected by the rules. These rules apply to investment advisers and investment adviser representatives regardless of rural or urban designation.

Environmental Impact

17. Do the proposed rules have any impact on the environment? If yes, please explain.

These proposed rules will not impact the environment.

Small Business Impact Statement

18. Describe whether and how the agency considered exempting small businesses from the proposed rules.

CSCL did not consider exempting small businesses from the proposed R 451.4.21 because the proposed rules will not disproportionately affect small businesses. A small investment adviser is no more or less likely to defraud an investor than a larger one. Therefore, the need to protect investors requires equal application across all sizes of business. CSCL understands that some investment advisers may have only one access person. Proposed R 451.4.21 (6)(i) does not require these investment advisers to submit holding and transaction reports [subrules (6)(f) and (6)(g)] to themselves if they maintain records of all relevant holdings and transactions.

The continuing education requirement in R 451.4.29, is applicable only to investment adviser representatives and not to businesses. Investment adviser representatives are the employees of a business and do not fall within the definition of a "small business" as contemplated in section 7a of the Administrative Procedures Act, MCL 24.207a. The requirements of R 451.4.29 are designed to not affect the business, but only the individual registered as an investment adviser representative.

19. If small businesses are not exempt, describe (a) the manner in which the agency reduced the economic impact of the proposed rules on small businesses, including a detailed recitation of the efforts of the agency to comply with the mandate to reduce the disproportionate impact of the rules upon small businesses as described below (in accordance with MCL 24.240(1)(a-d)), or (b) the reasons such a reduction was not lawful or feasible.

Small businesses are not specifically exempt from the requirements of the Michigan Uniform Securities Act or the proposed rules because the bureau does not believe the proposed rules will disproportionately affect small businesses. Furthermore, the Bureau believes that the application of the proposed rules to small and large businesses alike is essential to investor and consumer protection.

A. Identify and estimate the number of small businesses affected by the proposed rules and the probable effect on small businesses.

According to a report generated from FINRA's Central Registration Depository, there are 598 registered investment advisers in Michigan and 445 of the registered investment advisers have a home address in Michigan. There are 1,980 investment advisers notice-filed in Michigan with 256 of them having a home address in the state. CSCL does not collect information about these businesses' annual sales or the number of staff they employ and is unable to determine whether these businesses fall within the definition of "small business" as contemplated in section 7a of the Administrative Procedures Act, MCL 24.207a.

B. Describe how the agency established differing compliance or reporting requirements or timetables for small businesses under the rules after projecting the required reporting, record-keeping, and other administrative costs.

Proposed R 451.4.21(6)(i) does not require the investment advisers to submit holdings and transaction reports to themselves if they maintain records of all their holdings and transactions. It is unnecessary for investment advisers that are their access person or chief compliance officer to file reports to themselves for purposes of keeping track of compliance with their own business's code of ethics in subrule (6).

C. Describe how the agency consolidated or simplified the compliance and reporting requirements for small businesses and identify the skills necessary to comply with the reporting requirements.

Except for eliminating requirements for holdings and transaction reports for investment advisers with one access person, CSCL did not consolidate or simplify the compliance and reporting requirements. No specific skills other than the understanding of legal and regulatory requirements applicable to investment advisers are necessary for compliance with standards established by the proposed rules.

D. Describe how the agency established performance standards to replace design or operation standards required by the proposed rules.

The proposed rules are not designed to replace design or operations standards. R 451.4.21 was designed to ensure the policy and procedure can be tailored to an investment adviser's business structure and practices.

20. Identify any disproportionate impact the proposed rules may have on small businesses because of their size or geographic location.

CSCL does not anticipate that the proposed rules will have a disproportionate impact on small businesses because of their size or geographic location. The rules are intended to be flexible to allow a business to tailor them to their own business models.

21. Identify the nature of any report and the estimated cost of its preparation by small businesses required to comply with the proposed rules.

Proposed R 451.4.21(6) requires investment advisers to create holdings and transaction reports relating to an investment adviser's code of ethics under subrule (6). The cost of the reports is indeterminate, depending on how complex an access person's holdings and transactions are, how often an access person reports holdings to a compliance officer, and what information is included related to the investment adviser's policy for holdings and transaction reports. An investment adviser with only 1 access person will not be required to develop the reports as long as it maintains records of its holdings and transactions as discussed in question 19B.

22. Analyze the costs of compliance for all small businesses affected by the proposed rules, including costs of equipment, supplies, labor, and increased administrative costs.

Small businesses affected by proposed R 451.4.21 would likely not have any costs for equipment or supplies.

Small businesses affected by proposed R 451.4.21 may see an increase in labor and administrative costs associated with developing and complying with their policies and procedures. Proposed R 451.4.21 does not require investment advisers to file their policies and procedures, or reports associated with policy and procedures to be filed with or submitted to the administrator. Copies may be requested by Bureau staff in connection with routine or for-cause examinations. The costs are indeterminate and will depend upon the size and complexity of the adviser and its preferences in establishing policies and procedures.

23. Identify the nature and estimated cost of any legal, consulting, or accounting services that small businesses would incur in complying with the proposed rules.

An investment adviser may, but is not required to, hire an attorney or consultant in developing its policies and procedures. The cost of any legal or consulting fees is indeterminate given the varying sizes and complexities of the investment advisers. Furthermore, Proposed R 451.4.21 is designed to allow flexibility depending on an investment adviser's business model.

24. Estimate the ability of small businesses to absorb the costs without suffering economic harm and without adversely affecting competition in the marketplace.

All investment advisers and investment adviser representatives are held to the same standard and may avail themselves of applicable exemptions from registration requirements under federal law and the Act; no economic harm or advantage exists for large or small businesses.

25. Estimate the cost, if any, to the agency of administering or enforcing a rule that exempts or sets lesser standards for compliance by small businesses.

No additional costs for the Bureau would be incurred by the adoption of lesser standards.

26. Identify the impact on the public interest of exempting or setting lesser standards of compliance for small businesses.

There could be a large negative impact on the public if small businesses were exempt or held to a lesser standard than large businesses in the securities industry. The standards established by the proposed rules are intended to protect Michigan investors and to encourage efficient allocation of capital in the state, regardless of the size of the businesses involved. The bureau does not believe that differing requirements or a blanket exemption from the rule's application would be consistent with the investor protection purposes of the Act. Because the protections of the Act are intended to apply to investors who utilize large and small advisers, it would be inconsistent with the legislation to specifically adopt different requirements for small businesses under the proposed rules.

27. Describe whether and how the agency has involved small businesses in the development of the proposed rules.

No small businesses were directly involved in the development of the rules. The Bureau has had discussions with attorneys who are members of the State Bar of Michigan's Business Law Section about the intent to adopt the model rules but received no feedback to this point. To the extent these attorneys represent small businesses as part of their practices, they could provide insight as to the potential impact on these small business clients.

A. If small businesses were involved in the development of the rules, please identify the business(es).

No small businesses were involved in the development of the rules.

Cost-Benefit Analysis of Rules (independent of statutory impact)

28. Estimate the actual statewide compliance costs of the rule amendments on businesses or groups.

CSCL does not anticipate a significant cost or burden to be imposed upon investment advisers because of the promulgation of R 451.4.21. There may be costs associated with legal fees or consulting fees should an investment adviser retain an attorney or consultant to develop the required policies and procedures, but the bureau believes retention of an attorney or consultant may be unnecessary to comply with the rule. Also, there may be an increase in cost for the investment advisers that have not invested in cybersecurity technology or risk mitigation measure, but the cost of a cyber security breach would arguably outweigh the cost of implementing cyber security policy and procedures. Investment advisers are already under a fiduciary obligation to clients to adopt, implement, and enforce policies and procedures. The proposed rule merely clarifies which policies and procedures CSCL expects to be in place.

A. Identify the businesses or groups who will be directly affected by, bear the cost of, or directly benefit from the proposed rules.

Investment adviser firms will bear the cost of the requirements they establish from proposed R 451.4.21.

B. What additional costs will be imposed on businesses and other groups as a result of these proposed rules (i.e. new equipment, supplies, labor, accounting, or recordkeeping)? Please identify the types and number of businesses and groups. Be sure to quantify how each entity will be affected.

Investment adviser firms will see an additional cost in recordkeeping to adopt, maintain, and enforce policies and procedures, as well as any additional records they may require because of their policies that are required to be established in R 451.4.21.

Also, as mentioned, R 451.4.21 may create potential costs associated with consulting an attorney or consultant and potential cybersecurity technology cost, however, that would be a choice of the investment adviser and is not required under the rule.

29. Estimate the actual statewide compliance costs of the proposed rules on individuals (regulated individuals or the public). Include the costs of education, training, application fees, examination fees, license fees, new equipment, supplies, labor, accounting, or recordkeeping.

CSCCL anticipates some minimal costs will be imposed on investment adviser representatives for completing continuing education annually because of R 451.4.29. Courses will be created and provided by third-party course providers who have courses approved by a committee of the North American Securities Administrators Association. Courses will vary in cost, and it is anticipated that some will be provided for free. Certain FINRA or professional designation courses are expected to be considered approved continuing education content that will qualify for purposes of R 451.4.29. In these cases, the investment adviser representative will already be taking the course and would be permitted to submit it for IAR continuing education credit.

A. How many and what category of individuals will be affected by the rules?

Investment adviser representatives that are registered under the Act will bear the cost of compliance with the continuing education requirement from R 451.4.29. There are currently 14,314 investment adviser representatives registered in Michigan and among those, 11,640 are registered as investment adviser representatives and agents of broker-dealers.

B. What qualitative and quantitative impact do the proposed changes in rules have on these individuals?

R 451.4.29 will increase and maintain the competency of investment adviser representatives that are not also registered as an agent of a broker-dealer. There will be an additional cost on investment adviser representatives to complete the continuing education required to maintain their registration status under the Act.

30. Quantify any cost reductions to businesses, individuals, groups of individuals, or governmental units as a result of the proposed rules.

The proposed rules should not create large cost reductions for businesses, individuals, or governmental units. The proposed rules minimize duplication of cost on investment adviser representatives under proposed R 451.4.29. Investment adviser firms can develop their policies and procedures with the mindset of minimizing costs if the policy and procedure meet the minimum requirements of R 451.4.21.

31. Estimate the primary and direct benefits and any secondary or indirect benefits of the proposed rules. Please provide both quantitative and qualitative information, as well as your assumptions.

The proposed rules are intended to protect investors, reduce fraud in the offer and sale of securities and investment advice, and encourage efficient capital formation in the State of Michigan.

Reducing the occurrences of fraud in the securities markets reduces the amount of capital lost to fraud; this increases the amount of capital available for legitimate businesses to operate and grow and allows for increased investor confidence in Michigan's securities markets. Increased confidence leads to greater investments, which leads to greater economic growth in the state. These benefits are immeasurable but are particularly important to efficient capital formation and economic growth in Michigan.

32. Explain how the proposed rules will impact business growth and job creation (or elimination) in Michigan.

The bureau does not anticipate a significant impact on business growth, job creation, job elimination in Michigan because of the proposed rules.

33. Identify any individuals or businesses who will be disproportionately affected by the rules as a result of their industrial sector, segment of the public, business size, or geographic location.

The proposed rules will apply equally to all individuals and businesses that fall within their scope, regardless of the industry, sector, segment of the public, business size, or geographic location.

34. Identify the sources the agency relied upon in compiling the regulatory impact statement, including the methodology utilized in determining the existence and extent of the impact of the proposed rules and a cost-benefit analysis of the proposed rules.

The bureau looked to rules and regulations promulgated by the SEC, available for free online through www.gpoaccess.gov; the bureau reviewed NASAA model rules and commentary related to those rules, which are also available online for free, at www.nasaa.org. The bureau reviewed rule releases published by the SEC in situations where the rule was based on or like an SEC rule.

A. How were estimates made, and what were your assumptions? Include internal and external sources, published reports, information provided by associations or organizations, etc., that demonstrate a need for the proposed rules.

The bureau reviewed rule releases published by the SEC in situations where the rule was based on or like an SEC rule. The bureau also reviewed industry information published by the Investment Adviser Association. The bureau also generated a report from FINRA to identify how many investment advisers and investment adviser representatives are registered in Michigan.

Alternative to Regulation

35. Identify any reasonable alternatives to the proposed rules that would achieve the same or similar goals.

The bureau does not believe that there are “reasonable” alternatives to the proposed rules. R 451.4.21 was designed to require investment advisers to establish policies and procedures internally within their business model and does not require investment advisers to submit their policy and procedure to the department unless requested in the course of an examination or investigation.

R 451.4.29 was designed to maximize the flexibility in continuing education content available, minimize duplicative continuing education requirements to the extent practicable, minimize compliance burdens by using existing systems and technology, and minimize the costs to individuals completing continuing education.

A. Please include any statutory amendments that may be necessary to achieve such alternatives.

There are no statutory amendments that may be necessary to achieve the alternatives.

36. Discuss the feasibility of establishing a regulatory program similar to that proposed in the rules that would operate through private market-based mechanisms. Please include a discussion of private market-based systems utilized by other states.

The bureau is not aware of any private market-based mechanisms in other states and does not believe it would be feasible to establish such a regulatory program in Michigan.

37. Discuss all significant alternatives the agency considered during rule development and why they were not incorporated into the rules. This section should include ideas considered both during internal discussions and discussions with stakeholders, affected parties, or advisory groups.

The bureau did not consider significant alternatives to the proposed rules. As discussed in Questions 1 through 7, the bureau based its proposed rules on a combination of SEC administrative rules and NASAA model rules. The proposed rules are intended to be reasonably like the model rules adopted by other securities regulators and to be consistent with current practices in Michigan. As noted in multiple responses to previous questions, there are certain changes from current practices; however, the Bureau believes the changes are necessary for the protection of investors and the efficient allocation of capital in Michigan.

Additional Information

38. As required by MCL 24.245b(1)(c), please describe any instructions regarding the method of complying with the rules, if applicable.

The securities industry is a heavily regulated area of business in Michigan, the United States, and across the world. The bureau provides as much information as it possibly can, including rules on its website, www.michigan.gov/securities; however, where issues of compliance with the Michigan Uniform Securities Act or rules or orders promulgated under the Act are unclear, it is suggested that the person affected by those changes speak with a competent securities law attorney.