



Securities Bulletin

Ohio Department of Commerce, Division of Securities

Holiday Greetings from Commissioner Andrea Seidt

Happy New Year!

As we start another exciting, productive year at the Division of Securities, everyone is very curious about what changes loom on the horizon for securities regulation in 2017, particularly with a changing of the guard at the federal level.

In December, I attended the annual Consumer Federation of America (CFA) Financial Services Conference and participated on a panel offering predictions on that very question as we shared views on what the incoming administration should do to better protect investors in 2017. Here are a few highlights from that panel:

Predictions

- There will be efforts to roll back, but not repeal entirely, portions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The more vulnerable areas include the provisions that relate to the Volcker Rule, the Consumer Financial Protection Bureau and the Financial Stability Oversight Council. There have also been rumblings about eliminating federal registration requirements for hedge funds and other private funds.
- The investment industry will progress toward a fiduciary duty standard notwithstanding anticipated collateral attacks on the Department of Labor's fiduciary duty rule. Keying in on comments from the Conference keynote speaker, Labor Assistant Secretary Phyllis Borzi, that "[t]he customer-first principle that's embodied in the rule has already taken hold in the marketplace," panelists likewise believed that savvy market leaders will embrace and market the advantages of the new standard.
- There will be a continued proliferation of capital formation bills. Some believed that will result in a further darkening of the securities markets as new federal exemptions expand the reach of private markets. Panelists also commented that they expect greater reliance on the enforcement arm of state securities regulators to fill voids that might emerge in the event of more lax federal oversight.

Investor Protection Suggestions

- Unanimously, all the panelists agreed that the new administration must make it a priority to take care of our senior investors. A strong first step would be to pass pending financial exploitation and reporting legislation, but it will take a private-public commitment among all industry, regulatory and advocacy groups alike on education and intervention to fully address this challenge.
- Most panelists would urge the administration to leave the Department of Labor's fiduciary duty rule alone while simultaneously pressing the SEC to move forward with the missing piece for broker-dealers providing personalized advice to retail investors. The latter is a Dodd-Frank initiative that never gained traction from SEC leadership.

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Commissioners Column *continued from page 1*

- Another suggestion, this one from yours truly, would be to give the financial regulators a break from legislative rule mandates so that they can do a more effective job of proactively policing the markets. With thousands, if not millions, of collective agency hours devoted exclusively to rulemaking over the course of the last eight years, now is a perfect time for a regulatory pause and regrouping effort.

I want to thank CFA's own Director of Investor Protection, Barbara Roper, for inviting me to speak and moderating that excellent panel. As always, I learned a lot from her and my fellow panelists: Mercer Bullard, University of Mississippi College of Law Professor and President of Fund Democracy, Inc.; Marilyn Mohrman-Gillis, Public Policy Director of the Certified Financial Planning Board of Standards, Inc.; and Pamela Everhart, Senior Vice President for Government Relations at Fidelity Investments.

The Division would love to hear what predictions or views Ohio Securities Bulletin (OSB) subscribers have on the anticipated or desired state of investor protection and securities regulation in 2017. Please feel free to drop a line to the Editor, Dan Orzano, at Daniel.Orzano@com.state.oh.us. Submissions may be published as a follow-up in our next issue.

On behalf of everyone at the Division, thank you for support of the OSB and we hope you all have a safe and joyous new year.

Seeking Contributing Authors for the Ohio Securities Exchange

The Ohio Securities Exchange, which is occasionally published as part of the Ohio Securities Bulletin, provides a platform where views and opinions related to the securities industry can be shared from sources outside the Division of Securities. The Division encourages members of the securities community to submit articles pertaining to Ohio securities law and regulations.

If you are interested in submitting an article, contact Dan Orzano at Daniel.Orzano@com.state.oh.us for the publication schedule and submission requirements. The Division reserves the right to edit submitted articles for publication and the views and opinions expressed in the Ohio Securities Exchange solely represent those of the contributors. The Division of Securities takes no position on the material presented.

The Limits of Preemption

An Analysis of Covered Securities and Preemption in Ohio

By: John Crist, Corporate Finance Attorney

Every issuer selling securities must comply with both federal and state securities laws. This has been complicated in some ways by recent legal changes, and also by the breadth and scope of misinformation available to issuers on the Internet. Specifically, with respect to the regulation of securities in Ohio, practitioners occasionally misunderstand the role that states occupy with respect to covered securities.

The preemption of covered securities has been a relevant issue in securities law for the last 20 years, starting with the passage of the National Securities Markets Improvement Act (NSMIA) in 1996. While state preemption is far-reaching (prohibiting any state "law, rule, regulation, or order, or other administrative action" with respect to the "registration or qualification of securities"¹) prudent issuers will note that states still retain a role. NSMIA preserved the authority of the states to require notice filings and fees, and to investigate and bring enforcement actions based on fraud or deceit, or "unlawful conduct by a broker or dealer" in connection with any offering of covered securities.²

The purpose of this article is to present a brief framework that might assist issuers in determining the filing obligations required for offerings of covered securities in Ohio.

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¹Section 18(a) of the 1933 Act.

²Section 18(c)(1)- (c)(2) of the 1933 Act.



The Limits of Preemption *continued from 2*

Step One – Determine if the Sale of a Covered Security Exists

First, preemption is only applicable to “covered securities” and therefore, the first step is to determine whether there is a sale of a “covered security” at all. The major categories of covered securities are provided in Section 18 of the Securities Act of 1933 (the “1933 Act”), and are summarized as follows:

- Securities listed (or authorized for listing) on major stock and market exchanges, as further defined in Rule 146.
- Non-issuer secondary trading transactions of public reporting companies under Sections 4(a)(1) and 4(a)(3) of the 1933 Act.
- Securities issued by registered investment companies (under the Investment Company Act of 1940).
- Brokers’ transactions executed upon customers’ orders on any exchange (or in the OTC market) under Section 4(a)(4) of the 1933 Act.
- Securities offered to qualified purchasers or pursuant to a rule under Section 3(b)(2) of the 1933 Act (for example, Regulation A+).³
- Securities offered through Crowdfunding under Section 4(a)(6) of the 1933 Act.⁴
- Most exemptions under 3(a) of the 1933 Act such as certain governmental obligations, regulated financial institutions, commercial paper, bankruptcy court approved issuances or exchanges with existing investors.
- Certain accredited investor transactions, as prescribed in 4(a)(7) of the 1933 Act.
- Securities offered pursuant to Rule 506 of Regulation D (i.e. rules under Section 4(a)(2) of the 1933 Act).

Step Two – Determine Whether Ohio has any Applicable Exemptions

Second, an issuer will need to determine if its offering falls under a separate exemption in Ohio, many of which are self-executing. A “self-executing” exemption here refers to an exemption for which the Division requires no filing nor any fee.

Ohio’s exemptions for securities are in R.C. § 1707.02 (and further described in Ohio Administrative Code (“OAC”) 1301:6-3-02), and exemptions for transactions in R.C. § 1707.03 (and further described in OAC section 1301:6-3-03).

Step Three – Determine the Notice Filing Obligations

Third, assuming no self-executing exemption exists, an issuer will need to comply with Ohio’s notice filing requirements. There are three potential notice filing provisions that could apply to issuances of covered securities, restated here.

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³ Section 18(b)(3) and 18(b)(4)(d) and 17 CFR 230.256.

⁴ Not including 3(a)(4), 3(a)(10), 3(a)(11) and certain transactions under 3(a)(2).

Ohio Securities Bulletin
Issue 2016:4

The Ohio Securities Bulletin is published quarterly by the Ohio Department of Commerce Division of Securities. Past issues can be found on our website. Adobe Acrobat is needed to view all archived issues of The Bulletin.

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The Limits of Preemption *continued from page 3*

First, R.C. § 1707.092(A) prescribes the notice filings for offerings by investment companies. It states:

For the purposes of selling securities in this state... an Investment Company, as defined by the Investment Company of 1940... shall file the following with the division...:

(1) A notice filing consisting of either of the following:

- (a) A copy of the investment company's federal registration statement as filed with the securities and exchange commission;*
- (b) A form U-1 or [NASAA] form NF.*

(2) Appropriate filing fees consisting of both of the following:

- (a) A flat fee of one hundred dollars;*
- (b) A fee calculated at one-tenth of one per cent of the aggregate price at which the securities are to be sold to the public in this state, [no less than one hundred or no more than one thousand dollars.]*

R.C. § 1707.092(B)(2) further provides that:

(2) An investment company making a notice filing as provided in this section shall comply with section 1707.11 [and file a consent to service of process].

Thus, an investment company should file a copy of the offering document, or either form U-1 or NF; a fee (ranging from \$200 to \$1,100, depending on the aggregate price of securities to be sold in Ohio); and a consent to service of process (on Form U-2/U-2A or Division Form 11).

Second, R.C. § 1707.092(C) prescribes Ohio's filing requirements for covered securities without a self-executing exemption (echoing section 18(c)(2) of the 1933 Act). It states:

(1) For offerings involving covered securities, ... a notice filing shall be submitted to the division together with a consent to service of process pursuant to 1707.11... and a filing fee (from 1707.092(A), described above).

(2) The notice filing shall consist of any document filed with the securities and exchange commission ... together with annual or periodic reports of the value of the securities sold or offered to be sold to persons located in this state.

Thus, R.C. 1707.092(C) requires a fee (ranging from \$200 to \$1,100, depending on the aggregate price of securities to be sold in Ohio); a consent to service of process (on Form U-2/U-2A or Division Form 11); and any document filed with the SEC (including the final offering circular, Form 1-A, and any testing the waters materials that have been filed). Finally, issuers should also submit a statement of the value of the securities sold or offered to be sold to persons in Ohio, which information may be provided in a cover letter or on Forms U-1 or NF.⁵

Third, R.C. § 1707.03(X) requires a filing of a Form D for an offering under Rule 506 as discussed in an example that follows.

Application

For illustration, a suggested non-exhaustive application of this analysis is below. While the Division hopes this is helpful guidance, this article is not intended to constitute legal advice and sellers should refer to any specific provisions for complete compliance and seek the advice of a licensed attorney.

Please note that the burden of complying with state and federal provisions is upon the seller pursuant to R.C. § 1707.45.⁶

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⁵R.C. § 1707.092(C)(2)

⁶ See also, *Brown v. Earthboard Sports USA, Inc.*, 481 F.3d 901, 912 (6th Cir., 2007).



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The Limits of Preemption *continued from page 4*

| <u>Federal Provisions</u> | <u>Example Listed Securities Ohio Provisions</u> | <u>Filings and Fees in Ohio</u> |
|---|--|---------------------------------|
| 18(b)(1)(A), (B) and (C) 18(c)(2)(D) 1933 Act Rule 146(b) | R.C. § 1707.02(E) O.A.C. 1301:6-3-02(A) and (B) | No filing or fees required. |

Rule 146 of the 1933 Act defines the exchanges upon which listed securities are considered covered securities. These include those that have listing standards that are “substantially similar” to the New York Stock Exchange, the NYSE Amex, NASDAQ.⁷

Section 18(c)(2)(D) of the 1933 Act does not permit states to require a filing or fee with respect to listed securities. As a result, Ohio’s mirror exemption - R.C. § 1707.02(E) - exempts securities that are listed or authorized for listing on: (1) the NYSE, the American stock exchange, (2) exchanges that are designated by the SEC in Rule 146(b), or (3) a national securities exchange or system as designated by the Division. OAC§ 1301:6-3-02(A) deems these securities to be “exempt securities... conditioned upon the premise that “such ... exchanges’ listing standards, or segments thereof, continuing to be substantially similar to those identified in... 18(b)(1) of the [1933 Act].”

Accordingly, Ohio requires no filing or fee.

| <u>Federal Provisions</u> | <u>Example A Non-Issuer Secondary Trading Transaction Ohio Provisions</u> | <u>Filings and Fees in Ohio</u> |
|-----------------------------------|---|--|
| 18(b)(4)(A) 4(a)(1) 4(a)(3) | R.C. § 1707.03(B) R.C. § 1707.03(M) R.C. § 1707.092(C) | If the offerings meet the exemptions in R.C. § 1707.03(B) and (M), then no filing or fee required. |

Certain types of non-issuer secondary transactions are also covered securities - those exempted by Sections 4(a)(1) and 4(a)(3) of the 1933 Act. Technically, in Ohio, these transactions would be subject to the filing requirements of R.C. § 1707.092(C); however, many of these transactions fall under other self-executing Ohio exemptions.

For example, Section 4(a)(1) of the 1933 Act exempts “transactions by any person other than an issuer, underwriter, or dealer.” R.C. § 1707.03(B) exempts sales of securities “made by or a bona fide owner [that is] neither the issuer nor a dealer...”

Another example: Section 4(a)(3) exempts transactions by a dealer, with exceptions. R.C. § 1707.03(M) exempts “A sale by a licensed dealer... issued and outstanding before the sale is exempt...” in a manual, with exceptions.

Accordingly, offerings of covered securities that fall under R.C. § 1707.03(B) or (M) require no filing or fee.

| <u>Federal Provisions</u> | <u>Example A Transaction Exempted by Rule 506 of Regulation D Ohio Provisions</u> | <u>Filings and Fees in Ohio</u> |
|------------------------------------|---|--------------------------------------|
| 18(b)(4)(F) Rule 506 4(a)(2) | R.C. § 1707.03(X) R.C. § 1707.391 O.A.C. 1301:6-3-391(F) | Ohio requires both a filing and fee. |

Rule 506 of Regulation D is a safe harbor under Section 4(a)(2) of the 1933 Act. Offerings under 506(b) and (c) are covered securities, for which Ohio requires both a filing and a fee.

R.C. § 1707.03(X) mirrors the exemption to 506 offerings under Regulation D and requires the issuer to make a notice filing on Form D “within fifteen days” of the first sale in Ohio. The filing requirement is met by filing a copy or printout of the Form D within fifteen days of the date of first sale in Ohio or submission through the NASAA EFD. Note that under R.C. § 1707.011, the Division of Securities no longer requires a consent to service of process for Form D filings.⁸

Accordingly, Ohio requires a filing for 506 offerings under Regulation D, comprised of a copy of the Form D. *continued on page 6*

⁷ 17 CFR 230.146(b)

⁸ R.C. 1707.11



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The Limits of Preemption *continued from page 5*

| <u>Federal Provisions</u> | <u>Example Securities Issued by Investment Companies Ohio Provisions</u> | <u>Filings and Fees in Ohio</u> |
|---------------------------|--|--------------------------------------|
| 18(b)(2) | R.C. § 1707.092(A) R.C. § 1707.092(B)(2) | Ohio requires both a filing and fee. |

Securities issued by a registered investment company (as defined by the 1940 Act) are covered securities, as prescribed by Section 18(b)(2) of the 1933 Act. Ohio's filing requirements for Investment Companies are prescribed by R.C. § 1707.092(A), which is restated above.

As a result, the filing requirement would be met by filing a copy of the offering, or a form U-1, a fee (ranging from \$100 to \$1,100) and a consent to service of process.

| <u>Federal Provisions</u> | <u>Example A Sale of Securities to Qualified Purchasers Under Tier 2 of Regulation A Ohio Provisions</u> | <u>Filings and Fees in Ohio</u> |
|-------------------------------------|--|---|
| 18(b)(3) 18(c)(2)(A) Rule 256 | R.C. § 1707.092(C) | Both a filing and fee are required in Ohio. |

A Tier 2 offering under Regulation A (which, under Sections 18(b)(3) and 18(b)(4)(d) of the 1933 Act, and Rule 256, is an offering of covered securities) has no strict Ohio companion.⁹ As a result, Ohio will require a filing under R.C. § 1707.092(C).

| <u>Federal Provisions</u> | <u>Example Crowdfunding Ohio Provisions</u> | <u>Filings and Fees in Ohio</u> |
|---------------------------|---|---------------------------------|
| 18(b)(4)(C) 4(a)(6) | R.C. § 1707.092(C) | Filings are required (no fees). |

Crowdfunding is a recent innovation in securities law, with the federal regulations taking effect in May of 2016. For a summary of crowdfunding, please see the Ohio Securities Bulletin article from Issue 2016:2.¹⁰

Section 18(c)(2)(F) of the 1933 Act provides that states may require a filing only if (1) the issuer has its principal place of business in Ohio, or (2) purchasers of 50% or greater of the aggregate amount of the issue are residents of Ohio. Accordingly, the Division asserts that a filing is only required if the issuer's principal place of business is in Ohio or if purchasers of 50% or greater of the aggregate amount of the offering are residents of Ohio.

The filing requirements are dictated by R.C. § 1707.092(C). As such, additional filings may include: the initial Form C, Amendments (Form C/A), Progress Updates (Form C-U), Annual Reports (Form C-AR), Amendments to Annual Reports (Form C-AR/A), and Termination of Reporting forms (Form C-TR).¹¹

Final Considerations

This article has focused on Ohio's authority to require notice filings and fees, but has not discussed the preservation of state enforcement authority under Sections 18(c)(1)(A) and (B) of the 1933 Act, to investigate and bring enforcement actions with respect to the following:

- Fraud,
- Deceit,
- Unlawful conduct by a broker,

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⁹ Regulation A is separated into two Tiers of offerings. Tier 1 offerings are not covered securities; Tier 2 offerings are.

¹⁰ "Securities Exchange: A Summary of the SEC and Ohio Crowdfunding Provisions" by Thomas E. Geyer, Ohio Securities Bulletin, Issue 2016:2 at page 12.

¹¹ Rule 203.



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The Limits of Preemption *continued from page 6*

- Unlawful conduct by a dealer,
- Unlawful conduct by a funding portal, or
- Unlawful conduct by an issuer in connection with a transaction under Section 4(a)(6).¹²

A final word on this point: disclosure of all information material to an investor is of paramount importance, and is a necessity in the sale of securities, whether they are covered, or not.

The Division is available to assist the public in learning about Ohio securities laws, including about covered securities. The Division does not provide legal advice of any kind. The Division can, however, identify resources that may be helpful, and can serve as a resource regarding the Ohio Securities Act.

¹² Section 18(c)(1)(A) and (B).

About the Author John Crist is the Control Bid Attorney for the Division of Securities. He is responsible for reviewing registration filings and responding to inquiries on securities and exemption matters.

A to Z with L & E

The Division's Licensing and Examination Section (L & E) provides timely and important information covering a wide-range of topics from "A to Z" that affects licensees.

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Quarterly Question

I am thinking of becoming my own state-licensed Investment Adviser. What are the steps to do so? What are the requirements for compliance?

The Division receives these and similar questions on a frequent basis. The applicable statutes for investment adviser or investment adviser representative licenses appear in Ohio Revised Code 1707.151 and 1707.161, and the applicable administrative rules are located in Ohio Administrative Code 1301:6-3-15.1 and 1301:6-3-16.1.

The Division recently published "The Ohio Investment Adviser and Investment Adviser Representative Handbook," which is available on the Division's website at: http://com.ohio.gov/documents/secu_OhioAdvisoryPackage.pdf. This Handbook was recently re-written with the goal of addressing the most common questions we receive about the licensing (application) process. It also contains sections addressing the compliance obligations of licensed investment advisers, and what investment advisers can expect during their first onsite examination. While the Handbook cannot replace a full reading of the applicable statutes and rules, and does not constitute legal advice, the goal is to provide an easy-to-read overview of the Division's regulation of investment advisers in Ohio.

Welcome New Employee - Glen Sgobbo

Glen Sgobbo has joined the Licensing and Examination team as our new Examination Program Administrator. In his new role, he will manage the Division's field examinations in the Licensing section and supervise the five field examiners.

Prior to joining us, Glen was with the Ohio Department of Taxation for 11 ½ years as Tax Examiner Manager. He earned his bachelor's degree from Otterbein University in Westerville.



Enforcement Section Update

The Division's Enforcement Section is a criminal justice agency authorized to investigate and report on all complaints and alleged violations of the Ohio Securities Act and related rules. The Enforcement Section attorneys represent the Division in prosecutions and other matters arising from such complaints and alleged violations.

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Administrative and Criminal Appeals

Timothy K. Fife v. State of Ohio, Department of Commerce

Case No. CV-16-862093, Cuyahoga County Court of Common Pleas
Appeal from Division Order No. 16-012
January 12, 2017 (Oral Arguments)

Administrative Hearings

In Re: Thomas P. Gilmartin, Jr. and Capital Finance Group, LLC

Division Order No. 16-021
January 17-18, 2017

In Re: Michael W. Weisemann, Sr. CRD No. 4918499

MAH Investment Management, LLC CRD No. 155092 Prime Conservative Fund, L.P.
Division Order No. 16-023
January 30-February 2, 2017

Criminal Trials and Arrangements

For additional information regarding the cases below, please see: <http://www.com.ohio.gov/documents/secuBulletin2016ThirdQuarter.pdf>

State of Ohio v. Bruce Durr

Case No. 16 CR I 07 0368
Delaware County Court of Common Pleas
January 19, 2017 (Jury Trial)

State of Ohio v. Jon Patrick Horvath

Case No. B1307440
Hamilton County Court of Common Pleas
January 23, 2017 (Sentencing)

Christopher O. Hodge

Case No. CR 16 10 0288
Logan County Court of Common Pleas
May 2, 2017 (Jury Trial)

Mary Hackney, Philip Curtis, Lovell Jones

Franklin County Court of Common Pleas
16CR004771
After failing to appear for the arraignment on October 28, 2016, a capias was issued for Mary Hackney and Lovell Jones. Philip Curtis is scheduled for jury trial February 9, 2017.

Jeremy Moser

Case No. 16 CR 502
Miami County Court of Common Pleas
February 15, 2017 (Jury Trial)



Enforcement Section Update

Criminal Cases

Peter A. Beck

Case No. C 1500539

Ohio Court Of Appeals

First District, Hamilton County

On December 14, 2106, the Ohio Court of Appeals for the First District of Ohio upheld three counts of theft by deception and reversed three counts of securities fraud, finding that the statute of limitations had elapsed prior to the date the indictment was returned. The Court of Appeals further reversed second counts of perjury, finding that the evidence did not demonstrate that defendant's answers to the questions were clearly false or where defendant's answer was to a vague and ambiguous question. The case was remanded back to the trial court for further proceedings.

Christopher O. Hodge

Case No. CR 16 10 0288

Logan County Court of Common Pleas

On October 12, 2016, following a criminal referral by the Ohio Division of Securities, a Logan County grand jury returned a four-count indictment against Christopher O. Hodge of Phoenix, Arizona. Hodge was charged with one count of securities fraud and one count of misrepresentation in the sale of a security, both felonies of the second degree, one count of grand theft, a felony of the fourth degree, and one count of telecommunications fraud, a felony of the third degree. The indictment stems from Hodge's sale of an investment in a company called Intellicore Solutions, which purportedly engaged in small-business consulting services. The indictment alleges that Hodge solicited and sold an investment in Intellicore Solutions to a Logan County resident. Instead of using the money for investment purposes, the indictment alleges that Hodge used the investor's funds for personal expenses. Logan County Prosecutor William T. Goslee is prosecuting this case and it is being presented by Eric C. Stewart, Chief Assistant Prosecutor.

Jon Patrick Horvath

Case No. B1307440

Hamilton County Court of Common Pleas

On October 7, 2016, Jon Patrick Horvath pled guilty to one count of securities fraud, a felony of the third degree, one count of selling an unregistered security, a felony of the third degree, two counts of theft, both felonies of the fourth degree and one count of forgery, a felony of the fifth degree in the Hamilton County Court of Common Pleas. The sentencing hearing is scheduled for January 23, 2017. The conviction stems from the sale of \$95,000 in unregistered securities to two Ohio investors. Horvath told investors that they would be investing in various ventures, including an oil rig and a local car dealership, which would yield significant returns. Instead of investing the funds, Horvath used their money to pay for private school tuition and personal expenses and to purchase a BMW automobile. The forgery conviction stems from Horvath altering the payee information on a check written to a licensed securities dealer and depositing it into his personal bank account. This case is being prosecuted by the Office of the Hamilton County Prosecutor, Joseph T. Deters and is being presented by Bill Anderson, Supervising Assistant Prosecuting Attorney with the White Collar Crime Unit. For additional information, see: http://www.com.ohio.gov/documents/secu_Bulletin2014ThirdQuarter.pdf

Frank N. Kautzmann (Dr. Frank Kautzmann III)

Case No. 2016CR041333

Warren County Court of Common Pleas

On November 4, 2016, Frank N. Kautzmann, formerly of Springboro, Ohio, was sentenced by the Warren County Common Pleas Court to 11 months in prison, suspended, and three years' community control. Kautzmann was also ordered to pay \$30,000 in restitution to the victims of his crime. On September 21, 2016, Kautzmann pled guilty to theft for selling investments in the amount of \$30,000 related to a merger and formation of a new company, ANTS Software, Texas. Kautzmann misrepresented the investment and used investor funds for personal expenses. The case was prosecuted by Assistant Prosecutor Christopher Delnicki with the Office of the Warren County Prosecutor David P. Fornshell. For additional information, see: http://www.com.ohio.gov/documents/secu_Bulletin2016FirstQuarter.pdf



Enforcement Section Update

Carl D. Moss

Case No. 2016 CR 041333

Summit County Court Of Common Pleas

On January 3, 2017, following an indictment and guilty plea entered in the Summit County Common Pleas Court, Carl Dellreco Moss was sentenced to two years of community control and ordered to pay \$5,500 in restitution to his victim. The Division investigation revealed that Moss solicited a client to invest in Moss One Entertainment, Inc. for the purpose of organizing a musical concert to be held in Columbus, Ohio. At the time of the solicitation, Moss was on probation through Cuyahoga County for multiple counts of theft and unauthorized use of property/computer system. At the time of his indictment, Moss was subject to outstanding warrants issued by the Akron Municipal Court for allegations of passing bad checks. This case was prosecuted by the Office the Summit County Prosecutor, Sherri Bevan Walsh.

Administrative Actions

Division Order No 16-026

Binary Trading Experts

Mason, Ohio

On October 5, 2016, the Division issued a Notice of Opportunity and Notice of Intent to issue a Cease and Desist Order against Binary Trading Experts based on allegations that they engaged in fraudulent activity and made material misrepresentations related to the sale of securities through their internet-based trading platform at www.binarytradingexperts.com ("Website"). The website guarantees a daily profit of \$250 without providing any material disclosures related to the risk of investment.

Division Order No. 16-027

Jason M. Orsky Wealth Management, LLC CRD No. 170277

Jason M. Orsky CRD No. 5652030

Westlake, Ohio

On October 6, 2016, the Division issued a Termination of Division Order No. 5652030 against Jason M. Orsky Wealth Management, LLC and Jason M. Orsky. For additional information, see: http://www.com.state.oh.us/documents/secu_Bulletin2016ThirdQuarter.pdf

Division Order No. 16-028

Joseph Mersnik

Stow, Ohio

On October 27, 2016, the Division issued a Cease and Desist Order against Joseph Mersnik based on his withdrawal of a request for administrative hearing for Division Notice Order 16-017. The Division previously issued Cease and Desist Order No. 16-025 against the co-respondents, Hidalgo Alfalfa Company, LLC, Rancho Hidalgo, LLC, Firewater Hydrogen Fuel, LLC and Timothy Edward McShane, who did not request an administrative hearing in this matter. The Mersnik Cease and Desist Order was issued based on findings that Mersnik, acting as an unlicensed securities dealer or salesperson, sold unregistered securities to an Ohio investor without disclosing that the investor's funds would be used to pay commissions to Mersnik, as well as to pay expenses incurred by McShane's construction business in Ohio.

Did You Know?



Charles Ponzi, the man for whom the Ponzi scheme was named, was convicted in 1909 of forgery at a Montreal banking firm and served 20 months in prison. Then in 1911 he served two years in prison for smuggling illegal aliens from Italy into the United States.

After his release in 1913, Ponzi operated the Securities Exchange Company in Boston where the infamous Ponzi scheme occurred from 1919 to 1920. He later sold Florida real estate that was under water...literally!

At the time his Ponzi scheme collapsed in 1920, Charles Ponzi was estimated to be earning about \$1 million each week.

Ponzi's investors lost between \$7 million and \$15 million when the scheme collapsed.



2016 Ohio Securities Conference Roundup

Materials from the Ohio Securities Conference Available Online

If you missed the annual conference held October 21 or didn't remember to download the presentations by our speakers, you can access all of the materials on our conference website at: <http://com.ohio.gov/secu/Conference.aspx>

Planning for the 2017 conference is already underway, so look for an announcement in a future edition of The Ohio Securities Bulletin for the date and conference details

Minutes from the Securities Conference Advisory Group Meetings

Enforcement

On October 21, 2016, the Enforcement Advisory Group Meeting was held at the Renaissance Hotel in downtown Columbus, Ohio. Members of the Division Enforcement Section provided an update on the criminal and administrative cases initiated and resolved during the previous year.

There was a discussion about the types of products and schemes the Division has encountered frequently in the prior year, including Exchange-Traded Funds and Complex Products, Ponzi Schemes, Oil and Gas Offerings with cold calls to elderly investors, Affinity Fraud and Unregistered/Unlicensed sales activity.

Corporate Finance

The Division update of the Corporate Finance section began with the positive development of the addition of new attorneys joining the section. The Division believes that, with the addition of Jessica Brown, Jeff Coleman and John Crist, the Division will be better able to respond to inquiries and review filings more promptly after having experienced vacancies over the past few years.

The Division conference materials provided references to various Division issues of compliance. Most notable has been the failure to file or inadequacy of filing for "covered securities." The Division noted that some covered securities offerings are more compliance-oriented. Investment companies and issuers of Rule 506 offerings seem to make the requisite filing and pay the associated fee. However, problems do exist with respect to timeliness of the filings, although such problems represent a small percentage of filers. The Division also noted that Rule 506(c) offerings appear to represent only a small percentage of filers, approximately 100 per year, compared to 506(b) offerings which may be closer to 2000 in annual filings.

Issuers must not ignore the filing requirements of the new "covered securities" (Regulation A, Tier 2, and crowdfunding). Regulation A, Tier 2 offerings are frequently prepared by outside counsel and the notice filings have been received by the Division. Delays or failures to file under Regulation A, Tier 2 are less frequent than in crowdfunding offerings. Federal crowdfunding rules went into effect on May 16, 2016, and to date, the Division has not received any crowdfunding filings. Federal provisions are detailed in preserving a filing requirement and payment of fee to the state of the issuer's principle place of business and in any state where 50% or more of the offering is sold. The Division has reviewed the SEC's EDGAR database and has noted that there are several issuers that meet this filing requirement but have failed to make the filing with the Division.

The Division also noted the new exemption and covered security provision for resales exclusively to "accredited investors" under section 4(a)(7). The provision contains a prohibition on general solicitation and general advertising, specific information requirements and bad actor disqualifications. The Division believes that many of these transactions may fall within R.C. section 1707.03(B) which is used frequently for private resales.



Douglas Squires, assistant U.S. attorney for the Southern District of Ohio, makes a point during his keynote presentation about how his office litigates public corruption and federal securities cases.

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The Division also noted the proposal to increase the offering amount in Rule 504 to \$5 million, delete Rule 505, and revise Rule 147 for section 3(a)(11) - the intrastate offering exemption.

[Division note: Subsequent to the conference, the final revisions were adopted in SEC Release No. 33-10238 and are available at <https://www.sec.gov/rules/final/2016/33-10238.pdf>. The offering amount under Rule 504 will be expanded to \$5 million effective January 20, 2017. Rule 505 will be repealed as of May 22, 2017. Modifications to existing Rule 147 and a new Rule 147A, measuring purchaser residence and concentrating on the local character of the fundraising, will become effective April 20, 2017. Rule 147 and 147A will consider an issuer to be doing business within a state if one of four conditions can be satisfied as it relates to percentage of revenues, assets, use of proceeds or location of employees.]

The Division reminded conference attendees of required compliance with any carve outs under section 12(g) of the Securities Exchange Act of 1934 for these offerings where assets exceed \$10 million and purchasers of securities reach more than 500 non-accredited investors.

The Division concluded with an overview of private offering case law developments. The burden of proof continues unchanged by case law and is frequently referenced when an exemption is not properly claimed. Additional cases focused on restrictions on advertising, information to non-accredited investors, and that the exemption under Rule 506 or 4(a)(2) is available for “issuers” only.

Licensing and Registration

On October 21, 2016, in connection with the Ohio Securities Conference, the Division held a meeting of the Licensing Advisory Committee. You can view the PowerPoint slides here: <http://com.ohio.gov/documents/2016%20Securities%20Conference%20Licensing%20Update.pdf>.

Approximately 22 participants attended the meeting. Licensing Chief Anne Followell provided an update on Licensing section staff members as well as fiscal year-end licensee and examination statistics. She also addressed examination initiatives conducted in 2016. Ms. Followell then discussed the new “Ohio Investment Adviser and Investment Adviser Representative Handbook” (http://com.ohio.gov/documents/secu_OhioAdvisoryPackage.pdf) that the Division published to help new applicants and licensees navigate the licensing and compliance obligations.

The next topic addressed at the meeting was business continuity plans (a/k/a succession plans) and disaster recovery plans. Attendees discussed the Division’s requirements for these plans under its compliance program requirement. Also discussed was the NASAA Model Rule adopted in April 2015 (<http://com.ohio.gov/documents/NASAAModelRuleBusinessContinuitySuccessionPlanning.pdf>) and the SEC’s Proposed Rule adopted in June 2016 (<http://com.ohio.gov/documents/SECProposedRuleAdvisorBusinessContinuityTransitionPlans.pdf>).

Attendees next discussed recent Cybersecurity developments. Ms. Followell discussed recent federal enforcement actions against financial firms for lapses in cybersecurity policies and procedures. She also discussed the administrative rule adopted in Vermont involving cybersecurity requirements for securities professionals conducting business in that state. She also discussed Ohio Attorney General Mike DeWine’s CyberOhio Initiative (<http://www.ohioattorneygeneral.gov/Business/CyberOhio>). Included in the written materials was an alert about Ransomware attacks and a resource document for preparing an Incident Response Plan (<http://com.ohio.gov/documents/2016%20Cybersecurity%20Ransomware%20Alert.pdf>).

Ms. Followell then reminded attendees of the Division’s Fall 2015 rule change wherein the Division now requires state-registered investment advisers to file an Annual Updating Amendment to the Form ADV within 90 days of the end of their fiscal year. She reminded attendees that the amendment is required even if the firm believes it has no changes to make, as the Form itself may have changed during the year. She also reminded attendees of the importance of complying with the Division’s books and records requirements, as a few firms’ failure to do so resulted in Division action against their license.

Ms. Followell then opened up the meeting for additional discussion items. Hearing none, the meeting was then adjourned.



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The opening session featured representatives from FINRA, the SEC, NASAA and the Ohio Division of Securities discussing concerns, trends and programs that the regulatory organizations focused on in 2016. From left, panel moderator Attorney Steve Irwin, Leech, Tishman, Fuscaldo & Lampl; David Glockner, Regional Director, SEC Chicago Regional Office; Laura Trotz, Deputy Director, FINRA Chicago District Office; Joey Brady, NASAA Executive Director; and Andrea Seidt, Ohio Securities Commissioner.



From left: Attorney Thomas Geyer, Bailey Cavalieri LLC; Attorney Michael Wible, Thompson Hine; and Professor Eric Chaffee, University of Toledo College of Law, discuss the complex products that have come into the securities market.



Division News

Investor Alerts Added to Securities Website

A new addition to the Division's website was launched recently that provides a series of Investor Alerts for the public. The alerts are designed to educate Ohioans about investment fraud, scams and other issues.

You can view the new information on our website at: <http://com.ohio.gov/secu> and look for the Read Our Investor Alerts section. New alerts will be added monthly, so be sure to visit our site for updates.

The alerts are also sent to Ohio media outlets to spread our messages about staying safe, sound and financially secure.

NASAA Waives 2017 IARD System Fees for Investment Adviser Firms

The North American Securities Administrators Association (NASAA) announced in late October the waiver of Investment Adviser Registration Depository (IARD) system fees for investment adviser firms, and the continuation of substantially reduced initial set-up and annual system fees paid by investment adviser representatives (IARs).

"As a member of NASAA, we are pleased to see a waiver of system fees while maintaining a quality IARD system," said Ohio Securities Commissioner Andrea Seidt. "Many Ohio advisers work for themselves or for small firms, and the cost of doing business can be a challenge. Waivers like this help us maintain a balance of safeguarding Ohioans while also providing a regulatory environment where businesses can grow."

For 2017, the initial IARD set-up and renewal fee will continue to be \$10 for IARs, an amount reduced significantly from the \$45 charged when the IARD system first became operational. NASAA's Board of Directors will monitor the IARD system's revenues and, if warranted, make future adjustments to ensure the effective and efficient operation of the system.

"The Department of Commerce interacts daily with thousands of small businesses across the state," said Jacqueline T. Williams, director of the Ohio Department of Commerce. "Although our operations are funded through fees, we strive to keep costs low for

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small businesses, which helps them put their profits right back into their businesses.”

The IARD system is an online national database sponsored by NASAA and the Securities and Exchange Commission (SEC) that provides investment advisers and their representatives a single source for filing state and federal registration and notice filings. The IARD serves state and federal regulators as a nationwide database for the collection and dissemination of information about individuals and firms in the investment advisory field. IARD system fees fund user and system support and for enhancements to the system.

The system contains the employment and disciplinary histories of more than 29,000 investment adviser firms and more than 330,000 individual investment adviser representatives. This information is used to help the public research an investment adviser’s background through the Investment Adviser Public Disclosure (IAPD) database, which provides instant access to registration documents filed by SEC- or state-registered investment advisers.

Success By The Numbers

The Division had another busy year, which is reflected in the following statistics*:

- Enforcement investigations resulted in seven separate criminal indictments on a total of 74 combined counts. Four separate convictions were secured on a combined total of 144 counts. In addition, 17 administrative cases were initiated and 16 were successfully resolved. As part of the criminal sentencing, the courts ordered \$5,741,232 in restitution be paid to victims, some of whom lost their entire savings.
- 8,138 securities products – both new and renewals – were registered.
- 206,181 professionals were licensed.

**From January 1 through December 15, 2016*

American Law Institute hosting Regulation D Offerings and Private Placements Conference

The American Law Institute Continuing Legal Education (CLE) is pleased to announce the return of Regulation D Offerings and Private Placements 2017, from March 16-18 in Scottsdale, Arizona.

The conference will examine changes to Regulation D and exempt offerings, and how these changes are affecting the financial industry. The faculty includes experienced practitioners and industry experts, current and former SEC, FINRA and state regulators including Ohio Securities Commissioner Andrea Seidt.

The program’s faculty will analyze the SEC rules and how market practice has responded, review current federal and state laws and regulations, and examine timely topics such as:

- Rule 506(c) as a tool to use “general solicitation” to raise money from qualified investors
- Federal crowdfunding exemptions for startups and small businesses
- Reg A+ as an alternative to private placements
- Expanded Rule 504 and the new feasibility of intrastate and regional offerings
- Best practices for the integration of exempt and other offerings
- Redefining the accredited investor
- Marketing of private equity funds through pre-offerings, seminars, parallel marketing and private placement publicity
- Requirements for delayed and continuous offerings
- Ethical issues and pitfalls involving EB-5 offerings
- Internet-based capital formations; portals and broker-dealers

This program is designed for securities and in-house lawyers who provide advice on capital-raising and private placements. It will also benefit compliance officers and other principals of financial firms, as well as entrepreneurs, angel financiers/investors, venture capitalists, business finders and bankers engaging in private placements and raising capital.

To learn more and register for the conference, visit: https://www.ali-cle.org/index.cfm?fuseaction=courses.course&course_code=CY012