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TITLE 230 - DEPARTMENT OF BUSINESS REGULATIONS

CHAPTER 50 - SECURITIES, FRANCHISES AND CHARITIES

SUBCHAPTER 05 - SECURITIES

PART 2 - Post-Licensing Requirements

2.1 Authority

This regulation is promulgated by the Director of the Department of Business Regulation pursuant to R.I. Gen. Laws § 7-11-705.

2.2 Purpose

The purpose of this regulation is to clarify and set forth practices and procedures consistent with Chapter 7-11 of the Rhode Island General Laws.

2.3 Severability Provisions

If any provision of this Part or the application thereof to any person or circumstances is held invalid or unconstitutional, the invalidity or unconstitutionality shall not affect other provisions or applications of this Part which can be given effect without the invalid or unconstitutional provision or application, and to this end the provision of this regulation are severable.

2.4 Definitions

A. In addition to the terms defined in R.I. Gen. Laws § 7-11-101, when used in this Part, the following terms shall have the following meanings:

1. “Broker-dealer services” means the investment banking or securities business as defined in paragraph (p) of Article 1 of the By-Laws of FINRA.

2. “Department” means the Securities Division of the Rhode Island Department of Business Regulation.

3. “Director” means the Director of the Rhode Island Department of Business Regulation or his or her designee.

4. “Financial institution” means federal and state chartered banks, savings and loan associations, savings banks, credit unions, and the service corporations of such institutions located in Rhode Island.

5. “FINRA” means the Financial Industry Regulatory Authority, which is a self-regulatory organization as that term is defined in R.I. Gen. Laws § 7-11-101(23).

6. “IARD” means the Investment Adviser Registration Depository, which is operated by FINRA.

7. “Networking arrangements” means a contractual or other agreement between a broker-dealer and a financial institution pursuant to which the broker-dealer conducts broker-dealer services on the premises of such financial institution where retail deposits are taken.

8. “RIUSA” means the Rhode Island Uniform Securities Act set forth in R.I. Gen. Laws § 7-11-101 *et seq*.

9. “SEC” means the United States Securities and Exchange Commission.

2.5 Expiration of Licenses

The licenses of a broker-dealer, sales representative, investment adviser or investment adviser representative expire on December 31 of each year.

2.6 Post-Licensing Filings

A. In accordance with R.I. Gen. Laws § 7-11-209(c)(1), the following information is required:

1. Each broker-dealer, whether or not subject to SEC Rule 17 C.F.R. § 240.17a-5, shall prepare an annual financial statement as directed by SEC Rule 17 C.F.R. § 240.17a-5. A copy of each annual financial statement shall be retained by the broker-dealer as prescribed in SEC Rule 17 C.F.R. § 240.17a-5 and, upon the written or verbal request of the Department anytime during that period, furnish a copy of said annual financial statement within seventy-two hours of the request.

2. Each broker-dealer shall file with the Department a copy of any complaint related to its business, transactions or operations naming the broker-dealer or any of its partners, officers or agents as defendant in any civil or criminal proceeding, or in any administrative or disciplinary proceeding by any public or private regulatory agency, within twenty (20) days of the date the complaint is served on the broker-dealer; a copy of any answer or reply thereto filed by the broker-dealer within ten (10) days of the date such is filed; and a copy of any decision, order or sanction made with respect to any such proceeding within twenty (20) days of the date the decision order or sanction is rendered

3. Each broker-dealer shall file with the Department a notice of transfer of control or change of name within thirty (30) days after the date on which the transfer of control or change of name occurs.

4. Except as provided in §§ 2.6(A)(2), (3) and (8) of this Part, all material changes in the information included in a broker-dealer's most recent application for license shall be set forth in an amendment to Form BD filed with the Director within thirty (30) days after the change occurs.

5. Every broker-dealer shall file with the Department the following reports concerning its net capital and aggregate indebtedness:

    a. Immediate electronic or written notice whenever the net capital of the broker-dealer is less than is required under § 1.14 of this Subchapter specifying the respective amounts of its net capital and aggregated indebtedness on the date of the notice:

    b. A copy of every report of notice required to be filed by the broker-dealer pursuant to SEC Rule 17 C.F.R. § 240.17a-11.

6. Each broker-dealer shall give immediate written notice to the Department of the theft or disappearance of any Rhode Island customers' securities or funds that are in the custody or control of its offices, whether within or outside this state, stating all material facts known to it concerning the theft or disappearance. However, if a broker-dealer complies with the provisions of SEC Rule 17 C.F.R. § 240.17(f)(1), such broker-dealer need not give the notice required by this paragraph.

7. Each broker-dealer shall file with the Department a copy of any subordination agreement relating to the broker-dealer, within ten (10) days after the agreement has been entered, unless prior thereto the broker-dealer has filed a copy of the agreement with a national securities exchange or association of which it is a member.

8. Each broker-dealer shall notify the Department in writing at least ten (10) days prior to opening and not more than ten (10) days after closing in this state any branch office as defined in R.I. Gen. Laws § 7-11-206(b). The notification shall include such information as the Department may request.

9. Each investment adviser shall within ninety days after its fiscal year end prepare a balance sheet in accordance with generally accepted accounting principles and retain a copy of that balance sheet for a period of not less than five years unless such retention requirement would be in violation of 15 U.S.C. § 80b-18a(b). At any time within that period, such investment adviser shall make available, within seventy-two hours of any verbal or written request of the Director, a copy of said balance sheet. Investment advisers who retain custody of any client's funds or securities must prepare and retain as above an audited balance sheet and, within

seventy-two hours, upon the verbal or written request of the Director, make said audited balance sheet available.

10. Each investment adviser shall file with the Department:

    a. A copy of any complaint related to its business, transactions, or operations naming the investment adviser or any of its partners, officers or investment adviser representatives as defendants in any civil or criminal proceeding, or in any administrative or disciplinary proceeding by any public or private regulatory agency, within twenty (20) days of the date the complaint is served on the investment adviser;

    b. A copy of any answer or reply to the complaint filed by the investment adviser within ten (10) days of the answer or reply is filed; and

    c. A copy of any decision, order or sanction made with respect to any such proceeding within twenty (20) days of the date the decision, order or sanction is rendered.

11. Each investment adviser shall file with the director a notice of transfer of control or change of name within thirty (30) days after the date on which the transfer of control or change of name occurs.

12. Except as provided in §§ 2.6(10) and (11) of this Part, all material changes in the information included in an investment adviser's most recent application for license shall be set forth in an amendment to form ADV filed with the Department within the time prescribed for filings such amendments with the SEC or for advisers who are not registered under the Investment Advisers Act of 1940, thirty (30) days after the change occurs.

2.7 Required Records

A. Every broker-dealer, whether or not subject to the Securities Exchange Act of 1934, shall make and keep current the records required by that Act and rules thereunder.

B. Every investment adviser, whether or not subject to the Investment Advisers Act of 1940, shall make and keep current the records required by that Act and rules thereunder.

2.8 Successor Firms

An applicant for licensing of a successor under R.I. Gen. Laws § 7-11-210 shall complete the same forms and fees as for initial licensing.

2.9 Inspection Fees

Licensees shall be charged a fee of one hundred dollars ($100.00) per examiner per day plus actual costs of transportation and lodging where applicable for examinations under R.I. Gen. Laws § 7-11-211.

2.10 Unethical and Dishonest Practices

A. Under authority of R.I. Gen. Laws § 7-11-705(a)(3), the Director hereby defines the term “unethical or dishonest practices”, as that term appears in R.I. Gen. Laws § 7-11-212(b)(8) and without limiting the meaning to that set forth below, to mean one or more instances where a person has engaged in the conduct described below:

1. The following are deemed to be unethical or dishonest practices by a broker-dealer:

    a. Causing any unreasonable delay in the delivery of securities purchased by any of its customers, or in the payment upon request of free credit balances reflecting completed transactions of any of its customers;

    b. Inducing trading in a customer’s account which is excessive in size or frequency in view of the financial resources and character of the account;

    c. Recommending to a customer the purchase, sale or exchange of any securities without reasonable grounds to believe that the recommendation is suitable for the customer after reasonable inquiry concerning the customer’s investment objectives, financial situation and needs, and any other information known by the broker-dealer;

    d. Executing a transaction on behalf of a customer without authority to do so;

    e. Executing a transaction for the account of a customer upon instruction from a third party without first obtaining written discretionary authority from the customer, unless the discretionary power relates solely to the time or price for the execution of orders, or both;

    f. Exercising any discretionary power in effecting a transaction of a customer’s account without first obtaining written discretionary authority from the customer, unless the discretionary power relates solely to the time or price for the execution of orders, or both;

g. Extending, arranging for, or participating in arranging for credit to a customer in violation of the Securities Exchange Act of 1934 or the regulations of the Federal Reserve Board;

h. Executing any transaction in a margin account without obtaining from its customer a written margin agreement not later than fifteen (15) calendar days after the initial transaction in the account;

i. Failing to segregate customers' free securities or securities in safekeeping;

j. Hypothecating a customer's securities without having a lien thereon unless written consent of the customer is first obtained, except as permitted by rules of the SEC;

k. Charging its customer an unreasonable commission or service charge in any transaction executed as agent for the customer;

l. Entering into a transaction for its own account with a customer with an unreasonable mark-up or mark-down;

m. Entering into a transaction for its own account with a customer in which a commission is charged;

n. Entering into a transaction with or for a customer at a price not reasonable related to the current market price;

o. Executing orders for the purchase by a customer of securities not registered or exempted unless the transaction is exempted under RIUSA;

p. Representing itself as a financial or investment planner, consultant, or adviser, when the representation contains any untrue statement of material fact or omits to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; including but not limited to the nature of the services offered, the qualifications of the person offering the services, or the method of compensation for the services;

q. Violating any material rule of SEC, FINRA, any national or regional securities exchange or national securities association of which it is a member with respect to any customer, transaction or business in this state;

r. Failing to furnish to a customer purchasing securities in an offering, not later than the date of confirmation of the transaction, either a final prospectus or a preliminary prospectus and an additional

document, which together include all information set for the in the final prospectus;

s. Introducing customer transactions on “fully disclosed” basis to another broker-dealer that is not licensed under RIUSA; and

t. Recommending to a customer that the customer engage the services of an investment adviser that is not licensed or exempt from licensing under RIUSA.

2. The following are deemed unethical or dishonest practices by a sales representative:

a. Borrowing money or securities from, or lending money or securities to a customer;

b. Acting as a custodian for money, securities or an executed stock power of a customer;

c. Effecting securities transactions with a customer not recorded on the regular books or records of the broker-dealer with which the sales representative is associated, unless the transactions are disclosed to, and authorized in writing by the broker-dealer prior to execution of the transactions;

d. Effecting transactions in securities for an account operating under a fictitious name, unless disclosed to, and permitted in writing by the broker-dealer or issuer with which the sales representative is associated;

e. Sharing directly or indirectly in profits or losses in the account of any customer without first obtaining written authorization of the customer and the broker-dealer with which the sales representative is associated;

f. Dividing or otherwise spitting commissions, profits or other compensation receivable in connection with the purchase or sale of securities in this state with any person not so licensed as a sales representative associated with the same broker-dealer, or with a broker-dealer under direct or indirect common control;

g. Using advertising describing or relating to the sales representative’s securities business unless the advertising clearly identifies the name of the broker-dealer or issuer with which the sales representative is associated;

h. Misrepresenting the services of a licensed investment adviser on whose behalf the sales representative is soliciting business or accounts; and

i. Engaging in any of the practices specified in §§ 2.10(A)(1)(a) through (h), (o) through (r), or (t) of this Part.

3. The following are deemed to be unethical or dishonest practices be an investment adviser or investment adviser representative:

a. Recommending to a client to whom investment supervisory, management or consulting services are provided the purchase, sale or exchange of any security without reasonable grounds to believe that the recommendation is suitable for the client based on information furnished by the client after reasonable inquiry concerning the client's investment objectives, financial situation and needs, and any other information known by the investment adviser;

b. Exercising any discretionary power in placing an order for the purchase or sale of securities for a client without obtaining written discretionary authority from the client within ten (10) business days after the date of the first transaction placed pursuant to oral discretionary power relates solely to the price at which, or the time when, an order involving a definite amount of a specific security shall be executed, or both;

c. Inducing trading in a client's account that is excessive in size or frequency in view of the financial resources, investment objectives and character of the account;

d. Placing an order to purchase or sell a security for the account of a client without authority to do so;

e. Placing an order to purchase or sell a security for the account of a client upon instruction of a third party without first having obtained a written third-party trading authorization from the client;

f. Borrowing money or securities from a client unless the client is a broker-dealer, an affiliate of the investment adviser, or a depository institution engaged in the business of loaning funds (for the purpose of this paragraph, the term borrowing does not include the issuance of an obligation that would otherwise be a security under RIUSA);

g. Loaning money to a client unless the investment adviser is a depository institution engaged in the business of loaning funds or the client is an affiliate of the investment adviser;

h. Misrepresenting a material fact to any advisory client, or prospective advisory client with regard to the qualifications of the investment adviser or any person associated with the investment adviser, or the nature of the advisory services being offered or the fees to be charged for such service, or omitting to state a material fact necessary to make the statements made regarding qualifications, services or fees, in light of the circumstances under which they are made, not misleading;

i. Providing a report or recommendation to any advisory client prepared by someone other than the adviser without disclosing that fact. (This prohibition does not apply to a situation where the adviser uses published research reports or statistical analyses to render advice or where an adviser orders such a report in the normal course of providing services;

j. Failing to disclose to clients in writing before entering into or renewing an advisory agreement with the client any material conflict of interest relating to the adviser or any person associated with the adviser which could reasonably be expected to impair the rendering of unbiased and objective advice including:

(1) Compensation arrangements connected with advisory services to clients which are in addition to compensation from such clients for such services; and

(2) Charging a client an advisory fee for rendering advice when a commission for executing securities transactions pursuant to such advice will be received by the adviser or its employees;

k. Guaranteeing a client that a specific result will be achieved (gain or no loss e.g.), with advice which will be rendered;

l. Publishing, circulating or distributing any advertisement which does not comply with SEC Rule 17 C.F.R. § 275.206(4);

m. Disclosing the identity, affairs, or investments of any client unless required by law to do so, or unless consented to by the client;

n. Taking any action, directly or indirectly, with respect to those securities or funds in which any client has any beneficial interest, where the investment adviser has custody or possession of such securities of funds when the adviser's action is subject to and does not comply with the requirements of SEC Rule 17 C.F.R. § 275.206(4)-2; and

o. Entering into, extending or renewing any investment advisory contract unless such contract is in writing and discloses, in substance, the services to be provided, the term of contract, the advisory fee, the formula for computing the fee, the amount of prepaid fee to be returned in the event of contract termination or non-performance, whether the contract grants discretionary power to the adviser and that no assignment of such contract shall be made by the investment adviser without the consent of the other party to the contract.

2.11 Adviser Custody Conditions – Federally Registered

An investment adviser registered under the Investment Advisers Act of 1940 may take or retain custody of securities or funds of a client only while the investment adviser is in full compliance with SEC Rule 17 C.F.R. § 275.206(4)-2 and while the investment adviser maintains a net worth of not less than $25,000.00.

2.12 Adviser Custody Conditions – Federally Exempt

An investment adviser licensed under RIUSA, but exempt from registration under the Investment Advisers Act of 1940, may take or retain custody of securities or funds of a client only while the investment adviser is in full compliance with SEC Rule 17 C.F.R. § 275.206(4)-2, and the provisions of the RIUSA and all relevant rules promulgated thereunder; the investment adviser must maintain a net worth of not less than $25,000.00 and have filed with the Director a surety bond in the amount set by order of the director with a minimum of $100,000 and a maximum or $1,000,000; and the investment adviser must insure that every investment adviser representative associated with the investment adviser has filed with the director a surety bond in the amount set by order of the Director with a minimum of $10,000 and a maximum of $100,000.

2.13 Senior-Specific Certification and Professional Designations

A. The use of a senior specific certification or designation by any person in connection with the offer, sale, or purchase of securities, or the offering of advice as to the value of or the advisability of investing in, purchasing, or selling securities, either directly or indirectly or through publications or writings, or by issuing or promulgating analyses or reports relating to securities, that indicates or implies that the user has special certification or training in advising or servicing senior citizens or retirees, in such a way as to mislead any person shall be a dishonest and unethical practice in the sale of securities as defined in this Regulation. The prohibited use of such certifications or professional designation includes, but is not limited to, the following:

1. Use of a certification or professional designation by a person who has not actually earned or is otherwise ineligible to use such certification or designation;

2. Use of a nonexistent or self-conferred certification or professional designation;

3. Use of a certification or professional designation that indicates or implies a level of occupational qualifications obtained through education, training, or experience that the person using the certification or professional designation does not have; and

4. Use of a certification or professional designation that was obtained from a designating or certifying organization that:

   a. Is primarily engaged in the business of instruction in sales and/or marketing;

   b. Does not have reasonable standards or procedures for assuring the competency of its designees or certificants;

   c. Does not have reasonable standards or procedures for monitoring and disciplining its designees or certificants for improper or unethical conduct; or

   d. Does not have reasonable continuing education requirements for its designees or certificants in order to maintain the designation or certificate.

B. There is a rebuttable presumption that a designating or certifying organization is not disqualified solely for purposes of § 2.13(A)(4) of this Part above when the organization has been accredited by:

1. The American National Standards Institute; or

2. The National Commission for Certifying Agencies; or

3. An organization that is on the United States Department of Education's list entitled "Accrediting Agencies Recognized for Title IV Purposes" and the designation or credential issued therefrom does not primarily apply to sales and/or marketing.

C. In determining whether a combination of words (or an acronym standing for a combination of words) constitutes a certification or professional designation indicating or implying that a person has special certification or training in advising or servicing senior citizens or retirees, factors to be considered shall include:

1. Use of one or more words such as "senior," "retirement," "elder," or like words, combined with one or more words such as "certified," "registered," "chartered," "adviser," "specialist," "consultant," "planner," or like words, in the name of the certification or professional designation; and

2. The manner in which those words are combined.

D. For purposes of this rule, a certification or professional designation does not include a job title within an organization that is licensed or registered by a state or federal financial services regulatory agency, when that job title:

1. Indicates seniority or standing within the organization; or

2. Specifies an individual's area of specialization within the organization

E. For purposes of this subsection, financial services regulatory agency includes, but is not limited to, an agency that regulates broker-dealers, investment advisers, or investment companies as defined under the Investment Company Act of 1940.

F. Nothing in this rule shall limit the Director's authority to enforce existing provisions of law.

2.14 Sale of Securities at Financial Institutions

A. Applicability

1. § 2.14 of this Part applies exclusively to broker-dealer services conducted by broker-dealers on the premises of a financial institution where retail deposits are taken.

2. § 2.14 of this Part does not alter or abrogate a broker-dealer's obligation to comply with other applicable laws, rules, or regulations that may govern the operations of broker-dealers and their agents, including but not limited to, supervisory obligations.

B. Standards for Broker-Dealer Conduct. No broker-dealer shall conduct broker-dealer services on the premises of a financial institution where retail deposits are taken unless the broker-dealer complies initially and continually with the following requirements:

1. Setting. Wherever practical, broker-dealer services shall be located in a physical location distinct from the area in which the financial institution's retail deposits are taken. In those situations where there is sufficient space to allow separate area, the broker-dealer has a heightened responsibility to distinguish its services form those of the financial institution. In all situations, the broker-dealer shall identify its services in a manner that clearly distinguishes those services from the financial institution's retail deposit–taking activities. The broker-dealer's name shall be clearly displayed in the areas in which the broker-dealer conducts its services.

2. Networking Arrangements. Networking arrangements shall be governed by a written agreement that sets forth the responsibilities of the parties and the compensation arrangements. Networking arrangements must provide that supervisory personnel of the broker-dealer and representatives of state securities authorities, where authorized by state law will be permitted access to the financial institution's premises where the broker-dealer conducts broker-dealer services in order to inspect the books and records and other relevant information maintained by the broker-dealer with respect to its broker-dealer services. Management of the broker-dealer shall be responsible for ensuring that the networking responsibilities of all parties, including those of financial institution personnel.

3. Customer Disclosure and Written Acknowledgement.

    a. At or prior to the time that a customer's securities brokerage account is opened by a broker-dealer on the premises of a financial institution where retail deposits are taken, the broker-dealer shall:

        (1) Disclose, orally and in writing, that the securities products purchased or sold in a transaction with the broker-dealer:

            (AA) Are not insured by the Federal Deposit Insurance Corporation ("FDIC");

            (BB) Obligations of the financial institution and are not guaranteed by the financial institution; and

            (CC) Are subject to investment risks, including possible loss of the principal invested.

        (2) Make reasonable efforts to obtain from each customer during the account opening process a written acknowledgement of the disclosures required by § 2.14(B)(3)(a)(1) of this Part.

    b. If broker-dealer services include any written or oral representations concerning insurance coverage, other than FDIC insurance coverage, then clear and accurate written or oral explanations of the coverage must also be provided to the customers when such representations are first made.

4. Communications with the Public

    a. All of the broker-dealer's confirmations and account statements must indicate clearly that the broker-dealer services are provided by the broker-dealer.

b. Advertisements and sales literature that announce the location of a financial institution where broker-dealer services are provided by the broker-dealer, or that are distributed by the broker-dealer on the premises of a financial institution, must, unless subject to § 2.14(B)(4)(d) of this Part, disclose that securities products:

(1) Are not insured by the FDIC;

(2) Are not deposits or other obligations of the financial institution and are not guaranteed by the financial institution; and

(3) Are subject to investment risks, including possible loss of the principal invested.

c. Recommendations by a broker-dealer concerning non-deposit investment products with a name similar to that of a financial institution must only occur pursuant to policies and procedures reasonable designed to minimize risk of customer confusion.

d. The following shorter logo format disclosure may be used by a broker-dealer in advertisements and sales literature, including but not limited to material published, or designed for use in, radio or television broadcasts, Automatic Teller Machine ("ATM") screens, billboards, signs, posters and brochures, to comply with the requirements of § 2.14(B)(4)(b) of this Part, provided that the following disclosures are displayed in a conspicuous manner:

(1) Not FDIC Insured;

(2) No Bank Guarantee; and

(3) May Lose Value.

e. As long as the omission of the disclosures required by § 2.14(B)(4)(b) of this Part would not cause the advertisement or sales literature to be misleading in light of the context in which the material is presented, such disclosures are not required with respect to messages contained in:

(1) Radio broadcasts of 30 seconds or less;

(2) Electronic signs, including billboard-type signs that are electronic, time, and temperature signs and ticker tape signs, but excluding messages contained in media such as television, online computer services, or ATMs; and

(3) Signs, such as banners and posters, when only used as location indicators.

5. Notification of Termination. The broker-dealer must promptly notify the financial institution if any agent of the broker-dealer who is employed by the financial institution is terminated for cause by the broker-dealer.