Department of Commerce, Community, and Economic Development
Division of Banking and Securities
(3 AAC 8), Law File Number 2018200785

Public Comment, Questions, & Answers for proposed regulations regarding financial institutions, and sale and offerings of securities in Alaska

Question: Section 5 (scope) appears to change the designation of a "state investment adviser" to an "investment adviser" throughout the Proposed Regulations. Has this change been made because ASA, unlike the Previous Act, does not use the "state" modifier thought necessary with the preemption by federal law of state securities registration law in numerous areas (including who regulates investment advisers) through enactment of the National Securities Market Improvement Act of 1996?

Response: Yes

Question: Section 10 (registration; renewal; withdrawal or termination of registration) includes an agent of the issuer in the group of persons subject to application to the administrator to operate thereby, but I do not see any exemption from the application requirement for a person under special circumstances, e.g., where the person is an officer, director or organizer of the issuer, or any limitation on the number of such persons that may be involved in making of a securities offering by the issuer. How is such a person to be treated under ASA and the Proposed Regulations? What is the limitation on the number of such officers, directors or organizers in such an offering?

Response: Section 45.56.330 of the Alaska Securities Act discusses agent registration Requirements and exemptions. There is no current limit on the number of such officers, directors, or organizers in such an offering.

Question: At several locations in the Proposed Regulations, terms used are followed by defining terms or acronyms, e.g., in Section 10, the term "Central Registration Depository," is followed by "("CRD")," and the acronym "CRD" is thereafter used in the text of the Proposed Regulations. Nevertheless, the term is again defined in Section 950 (definitions). Why is the double definition method used for some but not all defined terms in the Proposed Regulations? Use of this drafting style may confuse a reader of the regulations. Does it comply with the style guidelines used by the state as set forth in the Drafting Manual for Administrative Regulations as produced by the Legislative and Regulations Section of the Alaska Department of Law, in accordance with AS 44.62.050 of the Alaska Administrative Procedure Act? If not, why not? For clarity, I suggest that all definitions in the Proposed Regulations ought to be placed only in Section 950, even ones that are specifically set forth for a specific section, e.g., Section 26(c)(1)-(2) defining "financial institutions" and "broker-dealer services."

Response: We believe the drafting style complies with the style guidelines as set forth in The Drafting Manual for Administrative Regulations. Definitions may be specific to a chapter, section, or subsection. After adoption, the regulations will undergo a final legal review by the

Department of Law. The Department of Law may make technical edits for clarity and conformance to drafting conventions as needed. Thank you for your comments, and your suggestion is noted.

Question: Section 21(d), relating to a broker-dealer registered or required to be registered under ASA as operating solely in Alaska, is repealed. Are such persons no longer allowed to operate in Alaska? If they continue to be allowed, how are they regulated in the absence of Section 21(d)?

Response: This section was deleted because we want all broker-dealers operating in Alaska to be properly registered through the FINRA system.

Question: There are a number of new sections in the Proposed Regulations dealing with broker-dealers, their agents, agents of the issuer, investment advisers and investment adviser representatives, e.g., Section 45 (disclosure to clients for agent of issuers), Section 46 (use of internet for advertising for brokerdealers and agents), Section 47 (dishonest and unethical practices by broker dealers and agents, Section 48 (fraudulent practices of broker-dealers and agents), Section 49 (certifications and professional designations), Section 50 (best interest obligations in the brokerage business), Section 51 (electronic filing with designated entity), Section 52 (application for investment adviser and investment adviser representative registration), Section 54 (notice filing requirements for federal covered investment advisers), Section 56 (qualification requirements for registration of investment adviser representative), Section 57 (minimum financial requirements for investment advisers), Section 58 (bonding requirements for certain investment advisers), Section 59 (custody of client funds or securities by investment advisers), Section 64 (books and records of investment advisers), Section 66 (business continuity and succession planning), Section 67 (investment adviser brochure), Section 68 (contents of an investment advisory contract), Section 69 (use of internet for advertising for investment advisers and investment adviser representatives) and Section 72 (prohibited conduct in providing investment advice). Much of the text of these sections appears new and apparently relevant to the regulation of broker-dealers, their agents, agents of the issuer, investment advisers and investment adviser representatives. However, from where did the text come? Was the text organized and drafted by the Department, the Division or the Alaska Department of Law? Is the text based on regulations of other states which have securities laws similar to ASA, or is it the result of efforts of uniform law commissioners or the North American Securities Administrators Association ("NASAA")?

Response: The text came from another state that has adopted the Model Act. After adoption, the regulations will undergo a final legal review by the Department of Law. The Department of Law may make technical edits for clarity and conformance to drafting conventions as needed.

Question: Section 46 (use of the internet for advertising for broker-dealers and agents) at (c) of the section makes reference to the "director," presumably the director of the Division (the term "director" is not defined in Section 950 (definitions)). However, elsewhere in the Proposed Regulations there is predominant use of the term "administrator" as the regulator of securities under ASA. My understanding is that the Division, unlike the Alaska Division of Insurance within the Department (which, pursuant to AS 21.06.010, is identified along with the position of

director of the Division of Insurance) does not have statutory existence. That is, the Division is a construct formed within the Department, and the Department can, by administrative action and without the consent of the Alaska legislature (but perhaps, prudently, with the consent of the Alaska governor), merge or eliminate the Division entirely. For example, sometime after I left the Division, the Department by administrative action carved out from the then Division its administration of the Corporations and Associations Title of the Alaska Statutes (AS 10) and placed it in a new Division of Corporations, Business and Professional Licensing within the Department. Also, ASA references the "administrator of securities" as the "administrator" (defined in ASA as the "commissioner" of the Department or a "designee" of the commissioner) of ASA. The term "director" ought to be replaced with "administrator" in Section 46(c) and elsewhere in the Proposed Regulations, should the term appear.

Response: Thank you for your comment. The Division will address this comment before adoption.

Question: Section 47 (dishonest and unethical practices by broker-dealers and agents) at (d)(6) of the section states that a broker-dealer or agent may not conduct business by telephone "at unreasonable times" but does not further describe what is meant as "unreasonable." Does the section mean no solicitation earlier than 8 am (or 9 am or 10 am?) in the solicitee's time zone? For example, an agent in New York City might place a call in the dead of winter at 11:45 am (Eastern Standard Time) to a prospective client in Anchorage (whose time is 7:45 am Alaska Standard Time). Is that call considered "unreasonable" under Section 47(d)(6)? What if the prospective client is a "morning person" and has been awake and working for several hours prior to the call? How is the caller to know what is reasonable or unreasonable? Section 47(d)(6) raises a number of questions as to its usefulness and potential for arbitrary use, and it ought to be revised or eliminated.

Response: The Division believes that it is the responsibility of the caller to determine what is reasonable given the time zone differences. Please see the SEC release on Cold Call Rules: https://www.sec.gov/fast-answers/answerscoldhtm.html#:~:text=Cold%20callers%20may%20only%20call,say%20who's%20calling%20and%20why.

Question: Section 51 (electronic filing with designated entity) uses at (e)(1)(A) of the section the phrase "unanticipated technical difficulty," but the phrase is not otherwise clarified. What does it mean or include? Is it arbitrarily to mean what the administrator rules or are there objective guidelines that can be used for its interpretation? If they exist, what are they?

Response: The Division believes that it is the responsibility of the filing entity to reach out to the Division if they are experiencing difficulties with the filing process and seek guidance.

Question: Section 72 (prohibited conduct in providing investment advice) at (a)(10) of the section makes reference to an "unreasonable" fee but does not give any further description of the term. What is meant by the term? Is it arbitrarily to mean what the administrator rules or are there guidelines for its interpretation to which one may refer? If they exist, what are they?

Response: The reasonableness of a fee is determined by the facts and circumstances in each individual case.

Question: Section 73 (exemption from qualifying examination) gives the administrator authority to exempt an applicant from passing a qualifying examination under ASA. In reference to item (2) above, there does not appear to be a clear exemption from the examination requirement when the person proposes to be involved in a securities offering by the issuer and is also an organizer, officer or director of the issuer. These persons ought to be exempt from any exam or other filing requirement with the administrator, especially should the person not receive a commission, fee or other remuneration specifically for efforts in assisting in the issuer's securities offering.

Response: The Administrator may issue exemptions upon request depending upon the facts and circumstance in each individual case. See Sec. 45.56.330. Agent registration requirement and exemptions. (b) The following individuals are exempt from the registration requirement of (a) of this section:(3) an individual who represents an issuer with respect to an offer or sale of the issuer's own securities or those of the issuer's parent or any of the issuer's subsidiaries and who is not compensated in connection with the individual's participation by the payment of commissions or other remuneration based, directly or indirectly, on transactions in those securities.

Question: Section 85 (notice filings for offerings of investment company securities) makes reference in (c) and (e) of the section to "division" and ought to be replaced with "administrator" for the reasons as expressed in item (6) above, i.e., the Department (and not the Division) has the authority to make or change regulations regarding ASA.

Response: Thank you for your comments; they are noted.

Question: In several of the "Editor's note" explanations in the Proposed Regulations, e.g., Sections 85 and 87(p), reference is made to the Division as having some authority in the regulation adoption process. However, as stated in item (6) above, the Department (and not the Division) has the authority to make or change regulations regarding ASA. The note explanations ought to be revised accordingly.

Response: Thank you for your comments; they are noted. After adoption, the regulations will undergo a final legal review by the Department of Law. The Department of Law may make technical edits for clarity and conformance to drafting conventions as needed.

Question: Section 230(c) deletes notice by mail by the administrator to an applicant regarding a termination of an application. The section further provides that such notice is to be provided in a "register" pursuant to AS 45.56.610. Is the register to be in hardcopy or electronic format? If in electronic format, is it to be available on the Division's website? While a sizeable portion of the public is wetted to the internet, I suggest that the backup procedure of notice to the applicant by U.S. mail ought to be retained in the context of the administrator's terminating or taking other action on an application. For example, neither the federal Internal Revenue Service nor the

Social Security Administration rely on internet or telephone communication with a customer. Rather, both federal agencies use U.S. mail as the means of communication with customers.

Response: Thank you for your comments; they are noted.

Question: Section 230(f) relies exclusively on notice through publication in the "register" as referenced in item (13) above. For the reasons stated in item (13) above, I suggest the prudence of a backup notice via U.S. mail as well.

Response: Thank you for your comments; they are noted.

Question: Section 501(a) contains several definitions of terms, two of which are also defined in Section 950, e.g., "accredited investor" and "aggregate offering price." Why is the double definition method used for some but not all defined terms in Section 501(a)? Use of this drafting style may confuse a reader of the Proposed Regulations. For the reasons as set forth in item (3) above, I suggest that all definitions in the Proposed Regulations ought to be placed only in Section 950.

Response: Thank you for your comments, and your suggestion is noted. After adoption, the regulations will undergo a final legal review by the Department of Law. The Department of Law may make technical edits for clarity and conformance to drafting conventions as needed.

Question: Section 503(a) states that up to five salespersons may be used as agents, all of whom are exempt from examination. Does this requirement mean that, should the issuer wish to use a greater number of salespersons, e.g., six or seven of its executive officers to be involved in the issuer's securities offering, only those persons above the five-member limit have to take an exam? Under the present Section 503(a), where is provision for waiver of any registration or other requirements on an agent of the issuer where the number is under five and no commission, fee or other remuneration is to be given to those persons relating to their efforts in the offering?

Response: See Sec. 45.56.330. Agent registration requirement and exemptions. (b) The following individuals are exempt from the registration requirement of (a) of this section:(3) an individual who represents an issuer with respect to an offer or sale of the issuer's own securities or those of the issuer's parent or any of the issuer's subsidiaries and who is not compensated in connection with the individual's participation by the payment of commissions or other remuneration based, directly or indirectly, on transactions in those securities.

Question: Section 910(14), in defining "controlling person" in the context of a transactional securities exemption from registration found at AS 45.56.120(1), uses the phrase "shares of the" in modifying "securities of a person." The statement of the underlying transactional exemption in ASA is generic as to the nature of the securities, i.e., it is not limited to "shares" of stock in a corporation. I suggest use of "shares" in Section 910(14) is confusing. I further suggest that the definition in Section 910(14) ought to read, in part, as follows— "…50 percent of the outstanding securities of a person."

Response: Thank you for your comments; they are noted.

Question: Section 920(a)(15) provides for a penalty fee for a late notice filing under Regulation D, Rule 506. However, no provision is made for waiver of the penalty. For example, the delay in filing may be because the issuer was not able to get timely response from the Securities and Exchange Commission ("SEC") in an initial application for access to the Electronic Data Gathering, Analysis and Retrieval system ("EDGAR") to in turn make a subsequent Form D filing with the SEC pursuant to federal Regulation D, Rule 506, which as you know, must be done before a notice filing is made regarding Alaska using NASAA's Electronic Filing Depository procedure on the internet ("EFD"). As you also know, Alaska now requires a notice filing only using EFD, e.g., no filing directly with the administrator, electronic or otherwise, is allowed. So, in this instance, the issuer may be late in complying with Alaska's notice filing requirement only because of a delay by the SEC in processing its application for access to EDGAR, a situation beyond the control of the issuer. In this context, I suggest waiver of the late filing fee ought to be provided in the Proposed Regulations.

Response: Thank you for your comments; they are noted.

Question: Section 950 (definitions) contains numerous new definitions as compared to the previous regulations adopted by the Department in interpreting the Previous Act. For example, the definition of "custody," "independent agent," "independent representative," "qualified custodian," "registered land surveyor," "unaffiliated institutional investor," and "unit investment trust" have been added to an already long list of definitions having an apparent counterpart in the regulations which were adopted under authority of the Previous Act. While these new definitions may be adequate as presently stated, from where did they come? Were they drafted by the Department, the Division or the Alaska Department of Law? Are they based on definitions in regulations of other states which have securities laws similar to ASA, or are they the result of efforts of uniform law commissioners or NASAA?

Response: The definitions were drafted by the Division and are commonly used by the SEC. After adoption, the regulations will undergo a final legal review by the Department of Law. The Department of Law may make technical edits for clarity and conformance to drafting conventions as needed.

Question: While not included within the current Proposed Regulations, the following Comments in items (21-(23) below are offered regarding items that I suggest ought to be considered for inclusion in the Proposed Regulations.

Response: Thank you for your comments; they are noted.

Question: Section 120(14) of ASA states that, before sale, a prospective buyer is to be furnished with information including a "statement of risks" and disclosure of "any significant negative factors that may affect the outcome of the investment…" How are these phrases different, if at all? They appear to describe the same need for full disclosure of material facts related to the

transaction. I suggest that the Department ought to clarify their meaning through additions to the Proposed Regulations.

Response: Thank you for your comments; they are noted. The disclosure regime emphasizes materiality. Information is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding how to make an investment decision. Principles-based disclosure requirements articulate an objective and look to management to exercise judgment in satisfying that objective by providing appropriate disclosure when necessary. Companies should take care not to bury the reader in generic boilerplate or laundry lists of risks that might apply to any company. In addition, companies need to keep in mind that rules also require them to disclose any further material information necessary to make the required statements, in the light of the circumstances under which they are made, not misleading. A significant negative factor would be one where the factor could be so important as to be a threat to the continued operation of the enterprise. The Division has recommended that disclosures be commensurate to the size of the deal so that a potential investor can make an informed decision to invest.

Question: Section 120(14) of ASA further provides that, before sale, a prospective buyer is to be furnished with an "income and expense statement" and "balance sheet." The exemption on its face does not exclude a startup company, with no history of operations or finances, from relying on the exemption from registration. For example, such a company may prepare a pro forma balance sheet displaying a nominal amount of cash injected into it by its organizer with the intent that the organizer is to be reimbursed from the proceeds of the issuer company's securities offering. I suggest that the Proposed Regulations could include a "safe harbor" for the issuer company to follow in reliance on Section 120(14) of ASA, setting forth in more detail what is required in the way of disclosure.

Response: Thank you for your comments; they are noted.

Question: Section 120(24) of ASA (dealing with sale by an issuer to a buyer of an enterprise or business and the assets and liabilities thereof) states at (A) of the section that the transfer of stock to the buyer "is solely incidental to the sale ... " This limitation on use of the exemption appears subjective, i.e., subject to interpretation. I suggest that the Proposed Regulations could provide a "safe harbor" for the seller to follow in reliance on the transactional exemption from registration provided at Section 120(24) of ASA.

Response: Thank you for your comments; they are noted. The exemption is self-executing and has always been one wherein buyer was purchasing the asset of the business as the primary driver of the transaction and the transfer of shares was not primary.

Question: Generally speaking, there is no source of information for entrepreneurs and issuers that provides guidance on the process for soliciting offers if an offering will not be registered. We believe it would be very helpful for entrepreneurs, and issuers, and the attorneys guiding them for the Proposed Regulations: (a) to contain more information on the process for soliciting offers in the context of an exempt transaction; and (b) provide safe harbors and more detailed

information about what the issuer/seller must do to qualify for the exemption in order to protect the issuer or seller and its agents under AS 45.56.120.

We specifically request safe harbors for the following exempt transactions:
AS 45.56.120(1): The "isolated nonissuer transaction."
AS 45.56.120(12): The "transaction by an executor, administrator of an estate, etc."
AS 45.56.120(14): The "intra-state offering to not more than 25 purchasers."

Response: Thank you for your comments; they are noted.

Question: For purposes of AS 45.56.120(14)(F), the Proposed Regulations should:

- Clarify the distinction between "statement of risks" and "significant negative factors." Is there a difference between these terms or do they refer to the same information?
- Provide more guidance for newly formed entities that do not have a balance sheet, or income and expense statement on what information a newly formed entity needs to provide. In most cases, a new entity does not have income, expense, a balance sheet, or any history of operations. How can a newly formed entity comply with the requirements set forth in this section?

Response: The disclosure regime emphasizes materiality. Information is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding how to make an investment decision. Principles-based disclosure requirements articulate an objective and look to management to exercise judgment in satisfying that objective by providing appropriate disclosure when necessary. Companies should take care not to bury the reader in generic boilerplate or laundry lists of risks that might apply to any company. In addition, companies need to keep in mind that rules also require them to disclose any further material information necessary to make the required statements, in the light of the circumstances under which they are made, not misleading. A significant negative factor would be one where the factor could be so important as to be a threat to the continued operation of the enterprise. The Division has recommended that disclosures be commensurate to the size of the deal so that a potential investor can make an informed decision to invest.

Question: For purposes of AS 45.56.120(24)(A), the regulations should provide a definition for " .... solely incidental to the sale of the enterprise or business .... " As drafted, the phrase appears to be subject to interpretation. What is "incidental" to the sale of a business versus "solely incidental" to the sale of a business?

Response: This exemption is self-executing and has been used in transactions wherein the buyer was purchasing the assets of the business as the primary driver of the transaction and the transfer of shares was not primary.

Question: 3 AAC 08.125(e): Should the first sentence of this subsection say " ... .limit the sales of securities to accredited investors and investors described in this subsection below" (emphasis added)?

Response: Thank you for your comments; they are noted.

Question: 3 AAC 08.125 and 222: The same standards for a non-accredited investor that may participate in an offering are described in both of these sections. We suggest implementing a defined term for these standards.

Response: Thank you for your comments; they are noted.

Question: 3 AAC 08.501 (a) and 3 AAC 08.950: The term "accredited investor" is defined in both of these sections. We suggest one definition for the term. 3 AAC 08.120(1): Instead of using "shares" in defining "controlling person," the regulation should refer to "outstanding securities" to capture all entities (not just corporations). 3 AAC 08.920(a)(15): We suggest providing for a waiver of the penalty fee in the event a late filing notice is the result of a circumstance beyond the control of the issuer. 3 AAC 08.950(41): Should "promoter" include every officer and director of the corporation? Should it include every person that owns 5% or more of an issuer's securities? That seems like a very low threshold. What if the officer director, or 5% shareholder was not involved in the offering? Doesn't this proposed definition subject persons who may not be involved in an offering to regulation and liability?

Response: 3 AAC 08.501 (a) and 3 AAC 08.950. Thank you for your comments; they are noted.
3 AAC 08.120(1). Thank you for your comments; they are noted.
3 AAC 08.920(a)(15). Thank you for your comments; they are noted.
3 AAC 08.950(41). Please see the definition of control person. That is a person who owns more than 50% of the issuer.

Question: Can you please explain the intent of repealing 3 AAC 08.504 and 3 AAC 08.505 regarding registration of Rule 504 and Rule 505 offerings, respectively?

Response: The Securities and Exchange Commission repealed Regulation D 505 offerings effective May 22, 2017. The Division of Banking & Securities has not received a Regulation D 504 offering in over 15 years. With the adoption of the Alaska Securities Act in 2019, small offerings can be done under AS.45.56.130.

Question: Can you please explain the intent of repealing 3 AAC 08.600-.650 regarding small corporate offerings?

Response: The Division of Banking & Securities believes that with the Alaska Securities Act in 2019, small offerings can be done under AS.45.56.130.