



December 6, 2018

Members of Texas Sunset Advisory Commission
Texas Sunset Advisory Commission
1501 North Congress Avenue
6th Floor
Robert E. Johnson Building
Austin, Texas 78701
sunset@sunset.texas.gov

Re: Texas State Securities Board Sunset Advisory Commission Hearing –
December 12, 2018

Dear Commissioners:

I am John R. Fahy. I chair the Securities Committee of the State Bar of Texas's Business Law Section. Wayne Whitaker, Dan Waller, Lee Polson, George Lee and Mark Pietrantone, the co-signatories, are fellow members of the Securities Committee. But, this letter is not a statement by the State Bar of Texas, the Business Law Section or the Committee as a whole. This letter expresses our own personal views. None of us are receiving any compensation or representing any party in connection with the submission of this letter. Dan Waller, Lee Polson and I are former Texas State Securities Board employees. Dan Waller also served a term as a board member of the Texas State Securities Board.

Lee Polson plans to attend the Sunset Advisory Commission hearing on December 12, 2018 in Austin. He will be available if the Commission has questions about this letter. His contact information is on page 9.

We have read the Texas Sunset Advisory Commission staff's ("Staff") report on the Texas State Securities Board and generally agree with many major points. But, we also have some disagreements with the Staff report.

- 1) Reauthorization of Texas State Securities Board. We **support** the Staff that the Texas State Securities Board should be reauthorized by the Legislature as an independent agency. Securities laws are

complex and require years of training and devotion and independent consideration. Indeed, we point out that the US Securities and Exchange Commission is also an independent agency with a governing board. Securities Committee members have not reported any operational issues and we find the Board's employees to be cooperative and responsive. We note that in other states where the securities administrator is not independent and can be elected officials - resulting in the increase in political considerations in the securities regulation and enforcement arenas. For example, Massachusetts (where the securities administrator is the elected Secretary of State) and New York (where the securities administrator is the elected state Attorney General) have been accused of having political considerations in securities regulatory actions. One prominent current example of such an approach is the New York Attorney General pursuing an investigation and case against ExxonMobil relating to climate change under the guise of securities disclosure requirements. We are confident that such political posturing will not occur with the Texas State Securities Board under its current structure.

- 2) Texas State Securities Board employees providing prosecutorial assistance. We **support** with the Staff that the Texas Securities Act should specifically authorize Texas State Securities Board employees to provide prosecutorial assistance, subject to the authority of the local District Attorney. The Board's employees have been providing such assistance for years. Indeed, I served as an appointed special assistant district attorney in the late 1990s while working for the Board. To the extent that there is any legal uncertainty about the authority to provide such assistance, such uncertainty should be cleared up. Certain securities miscreants will not be affected by securities enforcement methods other than criminal prosecution. Texas needs a robust system for prosecuting securities criminals in order to prevent harm to our residents.
- 3) Removing the requirement to pay fees to register branch offices. We **support** with the Staff's recommendation to reduce administrative burdens on registered investment advisers and broker-dealers by terminating the branch office registration requirement (and

commensurate fees) while continuing the examination authority to examine branch offices. The branch registration fee payments go to the State's General Revenue Fund and are not allocated to fund the operations of the Texas State Securities Board. So, they are not user fees. They are simply a tax on business locations.

- 4) Statutory Authority to Order Refunds. We **oppose** providing general statutory authority to order refunds for violations of the Texas Securities Act. It leads to a whole host of issues as stated below and may turn the Texas State Securities Board into a collection agency. We would support a system similar to the "Fair Funds" authorization available to the Securities and Exchange Commission pursuant to Section 929b of the Dodd-Frank Act.¹ Under Fair Funds, if the SEC obtains disgorgement or penalties in a regulatory action, the Court or the SEC can establish a fund for the benefit of all the victims of the violation. Briefly, our issues with what the Staff suggested include the following:

- a. The Staff's report does not include any research as to what other states have granted such "refund" authority to securities administrators. Given the issues stated below, Texas should not be the pilot project used to determine if such a system works.
- b. Section 33 of the Texas Securities Act authorizes specific private causes of action, including securities fraud, securities registration, broker-dealer and investment adviser registration, control person and aiding others in the commission of such violations. But, it also has limits as previously determined by the Legislature. For example, Section 33 limits broker-dealer registration liability to brokers representing the seller and provides no authority for broker-dealer registration liability for broker-dealers representing the buyer.² Also, if someone is a control person of a securities violator, that person can present a defense that he or she

¹ 15 U.S.C. 7246(a)

² Texas Securities Act Sections 33.A(1); 33.B.

fulfilled a reasonable care standard.³ “Aiders” can only be held liable if they materially aid the primary violator while having a culpable mental state.⁴

The Staff’s proposal would apparently provide a remedies for those persons who the Legislature determined should not have liability to securities transaction plaintiffs. For example, the Texas Securities Commissioner can pursue cases against unregistered broker-dealers on both the sell side and the buy side. If the Commissioner pursues a registration claim against a buyer’s broker, can a refund be ordered against that broker to be paid to a private party? There is clearly no such cause of action in the Texas Securities Act and this approach would lead to a backdoor to get around clear expressions of legislative intent. The same issue also applies to the control person and aider provisions stated above where someone who can be held liable in an administrative or civil action by the Securities Commissioner may be ordered to make a payment to a private party that would not be authorized under the private causes of action provisions of the Texas Securities Act.

Much more analysis and thought should be brought to this proposal in determining which provisions of the Texas Securities Act should be tied to a remedy in an action by the Securities Commissioner ordering payments to private parties. Should such a provision apply to minor technical provisions? Should such a provision apply to matters in which defendants in private causes of action asserted under Texas Securities Act would have zero liability or applicable defenses?

- c. We view having an alternative means of recovery through Securities Commissioner actions instead of Texas Securities Act Section 33 could potentially burden the Texas State Securities Board with a collection agency role. This could lead to every FINRA arbitration complaint touching Texas being filed with the Board and other efforts by plaintiff’s counsel to

³ Texas Securities Act Section 33.F.1.

⁴ Texas Securities Act Section 33.F.2; *Sterling Trust Co. v. Adderley*, 168 S.W.3d 835 (Tex. 2005).

leverage the Securities Commissioner's remedies – especially when there is no or a limited cause of action under Section 33.

d. Fair Funds would be appropriate. The SEC has “Fair Funds” authority under Section 929b of the Dodd-Frank Act.⁵ The Sunset Commission should consider a similar provision. Under the Staff's proposal, in a Securities Commissioner action, penalties and disgorgement or restitution go to the General Revenue Fund and there would be an additional “refund” order directing payments to private parties. Under a Fair Funds approach, the penalties and disgorgement/restitution would go to a fund for the benefit of those harmed by the violation of the Texas Securities Act and not to the General Revenue Fund. This approach avoids the issue of evading the Legislature's previous consideration of claims appropriate to result in payments to private parties under Texas Securities Act Section 33. It also may provide a more meaningful result than merely having penalties and restitution/d disgorgement being paid to the General Revenue Fund.

5) Notarization Requirements. We both **support and oppose** the elimination of notarization requirements.

We support the elimination of notarization requirements for securities issuer filings. They are unnecessary to demonstrate issuer authorizations and inconsistent with modern e-signature practice.

As to recipients of licenses granted by the Texas State Securities Board, we have experienced securities violators misrepresenting their identities and hiding their past while violating securities laws. Identity is a huge issue in the securities industry. Indeed, the SEC requires that federally-licensed securities brokers be fingerprinted by law enforcement before receiving a license.⁶ We do not think that it would be a significant burden on a Texas State Securities Board registrant to obtain a notarization, if required.

⁵ 15 U.S.C. 7246(a)

⁶ 17 CFR §17f-2, titled “Fingerprinting of Securities Industry Personnel.”

6) Complaint Tracking and Resolution. We generally **oppose** the Staff's recommendations on complaint tracking which appear to be based on experiences with other agencies.

- a. The Texas State Securities Board is not a complaint resolution agency (cf the Better Business Bureau). It is a regulatory agency with its own purposes. Often that purpose includes prioritizing its resources to address matters harmful to Texas before any complaints are received. For example, the Texas Securities Act applies to offers of securities as well as sales. The Texas State Securities Board often takes action to shut down violative offerings before any complaints have been received. Recently the Board's Enforcement Division has shut down several cryptocurrency offerings in Texas that violated the Texas Securities Act. Also, it is common for the Texas State Securities Board to recognize an ongoing Ponzi scheme before its victims do.

The Texas State Securities Board has an independent board appointed by the Governor and confirmed by the Senate. It has a Commissioner appointed by the Board who is subject to the Board's oversight. They must be trusted to allocate the Board's resources as appropriate. We have not heard of any issues in the Texas State Securities Board not dealing with complaints.

- b. The Legislature already requires the Board to track complaints against registered persons.⁷

⁷ Texas Securities Act Section 2-6 states:

Sec. 2-6. Complaints Information.

- A. The Commissioner or the Commissioner's designee shall maintain a file on each written complaint filed with the Commissioner or Board concerning an employee, former employee, or person registered under this Act. The file must include:

- (1) the name of the person who filed the complaint;
- (2) the date the complaint is received by the Commissioner or Board;

- c. As stated above, the Texas State Securities Board should not be used as a collection agency. The Board employees should focus on complaints about serious violations of the Texas Securities Act, not annoying service issues.
 - d. The Staff appears to want complaints disclosed to the public. (See Section 1.5 on page 14). Unproved complaints should not be disclosed to the public. They may be erroneous or unmeritorious. Further such an approach appears to be directly contrary to the confidentiality provisions of Texas Securities Act Section 28. Such a process would most assuredly require a material amendment to Texas Securities Act Section 28. Even the complaint provisions of Texas Securities Act Section 2-6 limit the complaint disclosure process to the person involved and does not require public disclosure. Further, if the complaint relates to a person also registered with FINRA it must be disclosed to the public under FINRA rules through BrokerCheck if the complaint or settlement exceeds certain monetary thresholds.
- 7) Penalty Matrix. We **oppose** the Sunset Advisory Commission directing the Texas State Securities Board to develop a penalty matrix. A decision on whether to adopt a penalty matrix should be

(3) the subject matter of the complaint;

(4) the name of each person contacted in relation to the complaint;

(5) a summary of the results of the review or investigation of the complaint; and

(6) an explanation of the reason the file was closed, if the Commissioner closed the file without taking action other than to investigate the complaint.

- B. The Commissioner or the Commissioner's designee shall provide to the person filing the complaint and to each person who is a subject of the complaint a copy of the Board's policies and procedures relating to complaint investigation and resolution.
- C. The Commissioner or the Commissioner's designee, at least quarterly until final disposition of the complaint, shall notify the person filing the complaint and each person who is a subject of the complaint of the status of the investigation unless the notice would jeopardize an undercover investigation.

up to the appointed and confirmed Texas State Securities Board members and not be required by the Sunset Advisory Commission. Penalty matrices can be difficult to apply to a wide variety of facts and may involve dozens of factors, not all of which can be anticipated beforehand. The Texas State Securities Board's administrative process deals with investment advisers, broker-dealers, associated persons of investment advisers and broker-dealers, as well as unregistered securities issuers and promoters. That is a polyglot jurisdiction, similar to the SEC, and the SEC does not have a penalty matrix due to its authority over a wide variety of matters. In contrast, the Financial Industry Regulatory Authority ("FINRA") does have a penalty matrix. But FINRA has a very narrow jurisdiction (regulating only one part of the securities industry, broker-dealers and their associated persons) and the type of matters that come before it tend to repeat themselves.

It would be appropriate for the Sunset Advisory Commission to recommend to the Texas State Securities Board that the Board discuss the need for a penalty matrix as part of its own supervision of the agency. But, the Board should maintain full discretion over the matter.

- 8) Online Applications. We **support** providing means for online applications for applications that cannot currently be made through the Central Registration Depository.

We appreciate the opportunity to provide our views to the Commission on the Texas State Securities Board. Please contact John R. Fahy at (817) 878-0547 or jfahy@whitakerchalk.com if you need additional information.

Sincerely,

/s/ John R. Fahy

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