

**State of California
Office of Administrative Law**

In re:
Department of Financial Protection
and Innovation

Regulatory Action:
Title 10, California Code of Regulations

Adopt section: 260.236.2

**DECISION OF DISAPPROVAL OF
REGULATORY ACTION**

Government Code Section 11349.3

OAL Matter Number: 2023-1024-03

OAL Matter Type: Regular (S)

SUMMARY OF REGULATORY ACTION

This regulatory action by the Department of Financial Protection and Innovation (Department) proposed to adopt the North American Securities Administrators Association's (NASAA) Model Rule on Investment Adviser Representative Continuing Education as the standard used for continuing education requirements for investment adviser representatives.

On October 24, 2023, the Department submitted the above-referenced regulatory action to the Office of Administrative Law (OAL) for review. On December 8, 2023, OAL notified the Department that OAL disapproved the proposed regulatory action pursuant to the Administrative Procedure Act (APA). This Decision of Disapproval of Regulatory Action explains the reasons for OAL's action.

DECISION

OAL disapproved the above-referenced action because the proposed regulation failed to comply with the clarity standard of the APA.

DISCUSSION

The Department's regulatory action must satisfy requirements established by the part of the APA that governs rulemaking by a state agency. Any regulation adopted, amended, or repealed by a state agency to implement, interpret, or

make specific the law enforced or administered by it, or to govern its procedure, is subject to the APA unless a statute expressly exempts the regulation from APA coverage. (Gov. Code, sec. 11346.) No exemption applies to this regulatory action.

Before any regulation subject to the APA may become effective, the regulation is reviewed by OAL for compliance with the procedural requirements of the APA and the standards for administrative regulations in Government Code section 11349.1. Generally, to satisfy the APA standards, a regulation must be legally valid, supported by an adequate record, and easy to understand. In this review, OAL is limited to the rulemaking record and may not substitute its judgment for that of the rulemaking agency regarding the substantive content of the regulation. This review is an independent check on the exercise of rulemaking powers by executive branch agencies intended to improve the quality of regulations that implement, interpret, and make specific statutory law, and to ensure that the public is provided with a meaningful opportunity to comment on regulations before they become effective.

1. Clarity Standard

In adopting the APA, the Legislature found that the language of many regulations was unclear and confusing to persons who must comply with the regulations. (Gov. Code, sec. 11340, subd. (b).) Government Code section 11349.1, subdivision (a)(3), requires that OAL review all regulations for compliance with the clarity standard. Government Code section 11349, subdivision (c), defines "clarity" to mean "written or displayed so that the meaning of regulations will be easily understood by those persons directly affected by them."

The "clarity" standard is further defined in section 16 of title 1 of the CCR, which provides:

In examining a regulation for compliance with the "clarity" requirement of Government Code section 11349.1, OAL shall apply the following standards and presumptions:

(a) A regulation shall be presumed not to comply with the "clarity" standard if any of the following conditions exists:

- (1) the regulation can, on its face, be reasonably and logically interpreted to have more than one meaning; or
 - (2) ...
 - (3) the regulation uses terms which do not have meanings generally familiar to those "directly affected" by the regulation, and those terms are defined neither in the regulation nor in the governing statute; or
 - (4) ...
 - (5) the regulation presents information in a format that is not readily understandable by persons "directly affected;" or
 - (6)
- (b) Persons shall be presumed to be "directly affected" if they:
- (1) are legally required to comply with the regulation; or
 - (2) are legally required to enforce the regulation; or
 - (3) derive from the enforcement of the regulation a benefit that is not common to the public in general; or
 - (4) incur from the enforcement of the regulation a detriment that is not common to the public in general.

The following provisions in the Department's proposed regulatory action do not satisfy the clarity standard.

1.1 Proposed Subsection (a)(1)

Proposed subsection (a)(1) reads:

"Approved IAR continuing education content" means the materials, written, oral, or otherwise, that have been approved by NASAA or its designee and which make up the educational program provided to an investment adviser representative under this rule.

Proposed subsection (a)(1) is unclear for two reasons. First, it is unclear what is meant by "materials, written, oral or otherwise, that have been approved by NASAA or its designee." This language could reasonably and logically be interpreted to mean existing materials that are currently approved by NASAA or its designee, without incorporation by reference, which may require statutory authority, or it could mean any materials that NASAA or its designee may approve in the future, which may cause additional clarity and/or authority

issues. (Cal. Code Regs., tit.1, sec. 16, sub. (a)(1).) Furthermore, it is unclear what criteria will be used when determining whether to approve continuing education content. Without further definition, those "directly affected" are not presented with information regarding what continuing education content is or will be approved by NASAA or its designee. Absent clarification of this requirement, regulated entities will not have a clear understanding of how NASAA or its designees will exercise this discretion.

Second, the proposed regulation uses the term "designee" but does not define it, and it is not a term generally familiar to those affected by the regulation. (Cal. Code Regs., tit.1, sec. 16, sub. (a)(3).) In addition, it is unclear what criteria will be used by NASAA in designating additional entities that can approve continuing education content. Absent clarification of how designees are selected, the regulation presents information in a format that is not readily understandable by persons "directly affected." (Cal. Code Regs., tit. 1, sec. 16, sub. (a)(5).)

1.2 Proposed Subsection (a)(2)

Proposed subsection (a)(2) reads:

"Authorized provider" means a person that NASAA or its designee has authorized to provide continuing education content required by this rule.

Proposed subsection (a)(2) is unclear for two reasons. First, it is unclear because it presents information in a format that is not readily understandable by persons "directly affected." (Cal. Code Regs., tit.1, sec. 16, sub. (a)(5).) It is unclear what criteria NASAA or its designee will use when authorizing a provider. Absent clarification of this provision, regulated entities will not readily understand how NASAA or its designees will exercise this discretion to authorize providers.

Second, the term "designee" is unclear, as discussed in issue 1.1 above, resulting in lack of clarity in this definition.

1.3 Proposed Subsection (a)(4)

Proposed subsection (a)(4) reads:

"Credit" means a unit that has been designated by NASAA or its designee as at least 50 minutes of educational instruction.

Proposed subsection (a)(4) is unclear for three reasons. First, it is unclear because it presents information in a format that is not readily understandable by persons "directly affected." (Cal. Code Regs., tit.1, sec. 16, sub. (a)(5).) It is unclear what criteria would be used to determine that a unit of at least 50 minutes of educational instruction is inadequate and would not be designated as a unit for purposes of a credit. Absent clarification of this provision, regulated entities will not have a clear understanding of what type of educational instruction is acceptable and qualifies for credit.

Second, the term "designee" is unclear, as discussed in issue 1.1 above, resulting in lack of clarity in this definition.

Third, this definition presents clarity issues similar to those discussed in issue 1.1. It is unclear if the Department is referring to only units currently designated by NASAA as credits, without incorporation by reference, or if is also referring to any such NASAA designations in the future. (Cal. Code Regs., tit. 1, sec. 16, sub. (a)(1).)

1.4 Proposed Subsection (a)(6)

Proposed subsection (a)(6) reads:

"Home state" means the state in which the investment adviser representative has its principal office and place of business.

Proposed subsection (a)(6) is unclear because "principal office and place of business" could reasonably and logically be interpreted to have more than one meaning. (Cal. Code Regs., tit.1, sec. 16, sub. (a)(1).) The "principal office and place of business" could be considered the office that has the most employees, does the most sales, or where the business is registered. It is unclear from the proposed regulation what criteria should be used in determining the investment adviser representative's "principal office and place of business."

1.5 Proposed Subsection (a)(7)

Proposed subsection (a)(7) reads:

"IAR ethics and professional responsibility content" means approved IAR continuing education content that addresses an investment adviser representative's ethical and regulatory obligations.

The definition of "approved IAR continuing education content" is unclear, as discussed in issue 1.1 above, resulting in lack of clarity in this definition.

1.6 Proposed Subsection (a)(8)

Proposed subsection (a)(8) reads:

"IAR products and practice content" means approved IAR continuing education content that addresses an investment adviser representative's continuing skills and knowledge regarding financial products, investment features, and practices in the investment advisory industry.

The definition of "approved IAR continuing education content" is unclear, as discussed in issue 1.1 above, resulting in lack of clarity in this definition.

1.7 Proposed Subsection (b)(1)

Proposed subsection (b)(1) reads:

IAR Ethics and Professional Responsibility Requirement. An investment adviser representative must complete six (6) Credits of IAR ethics and professional responsibility content offered by an authorized provider, with at least three (3) credits covering the topic of ethics; and

The definition of "authorized provider" is unclear, as discussed in issue 1.2 above, resulting in lack of clarity in this provision.

1.8 Proposed Subsection (b)(2)

Proposed subsection (b)(2) reads:

IAR Products and Practice Requirement. An investment adviser representative must complete six (6) credits of IAR products and practice content offered by an authorized provider.

The definition of "authorized provider" is unclear, as discussed in issue 1.2 above, resulting in lack of clarity in this provision.

1.9 Proposed Subsection (c)

Proposed subsection (c) reads:

Agent of FINRA-Registered Broker-Dealer Compliance. An investment adviser representative who is also registered as an agent of a FINRA member broker-dealer and who complies with FINRA's continuing education requirements is considered to be in compliance with the subdivision (b)(2) IAR products and practice requirement for each applicable reporting period so long as FINRA continuing education content meets all of the following baseline criteria as determined by NASAA:

- (1) The continuing education content focuses on compliance, regulatory, ethical, and sales practices standards.
- (2) The continuing education content is derived from state and federal investment advisory statutes, rules and regulations, securities industry rules and regulations, and accepted standards and practices in the financial services industry.
- (3) The continuing education content requires that its participants demonstrate proficiency in the subject matter of the educational materials.

Proposed subsection (c) is unclear because it presents information in a format that is not readily understandable by persons "directly affected." (Cal. Code Regs., tit.1, sec. 16, sub. (a)(5).) Subsection (c)(3) includes a requirement that the continuing education content "requires that its participants demonstrate proficiency in the subject matter of the educational materials." The proposed

regulation does not provide criteria or standards that are adequate for either continuing education content providers or participants to understand what is required to “demonstrate proficiency.” Subsection (c) presents clarity issues similar to those discussed in issue 1.1. It is unclear if the Department is referring to NASAA’s current FINRA-related determinations regarding subsections (c)(1) through (c)(3), without incorporation by reference, or if it is also referring to any such NASAA determinations on these three factors in the future. (Cal. Code Regs., tit. 1, sec. 16, sub. (a)(1).)

1.10 Proposed Subsection (h)

Proposed subsection (h) reads:

Home State. An investment adviser representative registered or required to be registered in this state who is registered as an investment adviser representative in the individual’s home state is considered to be in compliance with this rule provided that both of the following are true:

- (1) The investment adviser representative’s home state has continuing education requirements that are at least as stringent as the NASAA Model Rule on Investment Adviser Representative Continuing Education.
- (2) The investment adviser representative is in compliance with the home state’s investment adviser representative continuing education requirements.

Proposed subsection (h) is unclear for four reasons.

First, the definition of “home state” is unclear, as discussed in issue 1.4 above, resulting in lack of clarity in this provision.

Second, it is unclear because it presents information in a format that is not readily understandable by persons “directly affected.” (Cal. Code Regs., tit.1, sec. 16, sub. (a)(5).) The requirement that continuing education requirements be “at least as stringent as the NASAA Model Rule on Investment Adviser Representative Continuing Education” is unclear because it does not inform those directly affected by the regulation as to the criteria that will be used when determining whether their home state’s requirements are “at least as stringent”

as the NASAA Model Rule on Investment Adviser Representative Continuing Education (NASAA Model Rule).

Third, it is ambiguous as to what entity will make the determination as to whether the home state's requirements are "at least as stringent" as the NASAA Model Rule and whether the home state is in compliance with subsections (h)(1) and (h)(2). As a result, this information is not readily understandable by persons "directly affected." (Cal. Code Regs., tit.1, sec. 16, sub. (a)(5).)

Fourth, "NASAA Model Rule" is unclear because the term is not defined in the regulation or in the governing statute, and it does not have a meaning that is generally familiar to those "directly affected" by the regulation. (Cal. Code Regs., tit.1, sec. 16, sub. (a)(3).)

CONCLUSION

For the foregoing reasons, OAL disapproved the above-referenced regulatory action. Pursuant to Government Code section 11349.4, subdivision (a), the Department may resubmit revised regulations within 120 days of its receipt of this Decision of Disapproval of Regulatory Action. A copy of this Decision will be emailed to the Department on the date indicated below.

The Department must make any substantive regulatory text changes, which are sufficiently related to the originally noticed text, available for public comment for at least 15 days pursuant to subdivision (c) of Government Code section 11346.8 and section 44 of title 1 of the CCR. Additionally, any supplement to the Initial Statement of Reasons or other document the Department may create or propose to add to the rulemaking record to address the issues discussed above must be made available for public comment for at least 15 days pursuant to Government Code section 11347.1. Any comments containing objections or recommendations must be summarized and responded to in the Final Statement of Reasons. The Department must resolve all issues raised in this Decision of Disapproval of Regulatory Action prior to the resubmittal of this regulatory action. OAL reserves the right to review any modifications to the text and/or record to ensure the modifications comply with the procedural and substantive standards of the APA.

If you have any questions, please contact me at (916) 324-0358.

Date: December 15, 2023



Anna Thomas
Attorney

For: Kenneth J. Pogue
Director

Original: Clothilde V. Hewlett,
Commissioner

Copy: Pamela Hernandez, Senior
Counsel