



STATE OF CALIFORNIA

Department of Financial Protection and Innovation

GOVERNOR **Gavin Newsom** · COMMISSIONER **Clothilde V. Hewlett**

**INITIAL STATEMENT OF REASONS
FOR REGULATIONS UNDER THE
CORPORATE SECURITIES LAW OF 1968**

The Department of Financial Protection and Innovation (“Department”) proposes to adopt Title 10 of the California Code of Regulations, Section 260.236.2 concerning continuing education requirements for investment adviser representatives (“IARs”).

PROBLEM STATEMENT

The Corporate Securities Law of 1968, Corporations Code section 25000, et seq., regulates all offers and sales of securities in California. All securities offered or sold must be either qualified with the Commissioner of the Department of Financial Protection and Innovation (“Department”) or exempted from qualification by a specific rule of the Commissioner or specific law.

The Corporate Securities Law of 1968 also requires the licensure and regulation of investment advisers. Under the Corporate Securities Law of 1968, it is unlawful for an investment adviser to conduct business without first applying for and securing a certificate from the Commissioner, as specified. An investment adviser is defined as any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing or selling securities, or who, for compensation and as a part of a regular business, publishes analyses or reports concerning securities.

Corporations Code section 25236, subdivision (a) requires that every investment adviser and all natural persons associated with such investment adviser meet such specified and appropriate standards with respect to training, experience and other qualifications as the Commissioner finds necessary or desirable. However, the section does not specify the training necessary for natural persons associated with investment advisers. For instance, the statute does not specify how many units of training are required, what type of training content is acceptable, and what the applicable reporting period is. An “investment adviser representative” or “associated person of an investment adviser” is defined as any partner, officer, director of (or a person occupying a similar status or performing similar functions) or other individual, except clerical or ministerial personnel, who is employed by or associated with, or subject to the supervision and control of, an investment adviser that has obtained a certificate or that is required to obtain a certificate under this law, and who does any of the following: (1) makes any recommendations or otherwise renders advice regarding securities, (2) manages accounts or portfolios of clients, (3) determines which recommendation or advice regarding securities should be given, (4) solicits, offers, or negotiates for the sale of or sells investment advisory services, or (5) supervises employees who perform any of the

foregoing. In other words, IARs are the employees of the registered investment advisers who provide financial advice and securities recommendations to clients.

Under California Code of Regulations, title 10, section 260.236.1, subdivision (a), all IARs that conduct advisory business with California residents must be registered. IARs are tested for knowledge before they are registered, but there is no mechanism to ensure that their level of knowledge and competence is maintained or expanded. By comparison, most other financial professionals are subject to continuing education requirements including broker-dealer agents, insurance agents, certified financial planners, and real estate agents.

Given that IARs play an important role in their clients' financial lives, the North American Securities Administrators Association ("NASAA") received significant support from state regulators and the securities industry for the creation of a continuing education program and developed the Investment Adviser Representative Continuing Education ("IAR CE") Model Rule. The model rule has a products and practices component and an ethics component and is intended to be compatible with other continuing education programs. This proposed rulemaking would implement NASAA's IAR CE Model Rule.

BENEFITS

Benefits of the proposed regulation include protecting consumers who use investment advisers to manage their funds by ensuring that IARs remain competent and knowledgeable about current industry regulations, developments, and best practices when handling their clients' life savings. The proposed regulations will also ensure that IARs are familiar with ethical issues related to investment advising. This will greatly contribute to overall investor protection.

One impact of the rulemaking will be to improve the overall quality of investment advice and professionalism provided by IARs when meeting with clients. Compliance with the proposed regulations will likely reduce the risk of investor losses due to recommendations not in the best interest of clients, failure to understand investment products, fraud, and abuse. Additionally, the regulations will likely increase regulatory compliance in examinations conducted by the Department. The Department also anticipates that consumers of investment adviser services will experience fewer instances of substandard services and will be subjected to fewer instances of unethical or illegal behavior as a result of these regulations. For example, a common violation in California is the failure of an IAR to maintain books and records as required by law. Many continuing education courses cover an IAR's responsibility to maintain certain books and records and how to comply with the requirement. The Department anticipates that refreshing IARs on these types of topics will increase compliance and result in fewer violations. Another example is the fiduciary duty that IARs owe to their clients. Many continuing education courses will cover this duty in detail. There is consensus among state regulators and NASAA that continuing education on an IAR's fiduciary duty to clients will decrease unethical behavior and increase the likelihood that IARs act in the best interest of their clients.

Continuing education for the investment adviser community is needed more than ever to provide current information on evolving and complex investment products such as digital assets and more specifically, cryptocurrencies. In March 2022, CNBC reported that about 45% of financial advisors say they expect to use cryptocurrencies in the future in response to client requests, according to a survey by Cerulli Associates. Investors are curious about exposure to these assets, with 80% of financial advisors saying clients of all ages have asked them about cryptocurrencies, according to Cerulli. More than 90% of financial advisors reported that their clients asked about crypto last year, a significant increase over the previous year, according to the Bitwise/ETF Trends 2022 Benchmark Survey of Financial Advisor Attitudes Toward Crypto Assets. Financial advisors' adoption of digital assets nearly doubled in 2021, according to the Fidelity Digital Assets 2021 Institutional Investor Digital Assets Study, increasing from 23% in 2020 to 43% in 2021. However, a recent Nasdaq study showed while only 10% of financial advisors report being very knowledgeable about cryptocurrencies, almost all financial advisors (98%) expressed an interest in learning more about cryptocurrencies and digital assets.

Additionally, diversity, equity, and inclusion are continuing education topics that can be included within the Ethics and Professional Responsibility requirement of IAR CE. With more attention to DEI issues, the investment advisory industry has made small, yet significant steps towards diversity – but women and racial and ethnic minorities remain underrepresented in both management and adviser roles. Organizations such as the Investment Adviser Association (“IAA”) are committed to working collectively with their members to promote diversity, equity, and inclusion as a value for the industry and are committed to education, information, and resources to help foster significant progress.

In a profession that continues to grow, a continuing education solution that is specific to advisers' unique service and consistent with their elevated fiduciary duty of care ensures they are knowledgeable of current industry regulations, developments, and best practices when handling clients' life savings. The IAR CE program provides an opportunity to educate investment adviser representatives on timely topics such as these and many others of relevance to this profession.

PURPOSE AND NECESSITY

Subdivision (a). Definitions

The Department proposes to adopt Subdivision (a) to define certain terms used in the proposed regulation. The definitions are necessary to help IARs understand the process and requirements for fulfilling their continuing education requirements, which may help avoid misunderstandings and unnecessary delays in registration or renewal of registration as an IAR.

Subdivision (a)(1).

The purpose of Subdivision (a)(1) is to define the term “Approved IAR Continuing Education Content” to mean written, oral, or other materials approved by the North American Securities Administrators Association (“NASAA”) or its designee. The Department has determined the IAR continuing education content should be materials approved by NASAA because NASAA represents state and provincial securities regulators in the United States, Canada and Mexico. NASAA members are the closest regulators to local communities, small businesses and the investing public throughout North America. Members of NASAA have a multifaceted mission of protecting investors from fraud and abuse, conducting investor education, providing guidance and assistance via the established regulatory framework, and ultimately helping power the North American economy by ensuring the integrity of the financial markets.

Subdivision (a)(2).

The purpose of Subdivision (a)(2) is to define the term “Authorized Provider” to mean a person that NASAA or its designee has authorized to provide continuing education content. This provision is necessary to ensure that authorized providers offer continuing education with uniform minimum content on ethics, professional responsibility, and products and practices by requiring NASAA’s authorization.

Subdivision (a)(3).

The purpose of Subdivision (a)(3) is to define the term “CE Inactive” to mean a registration status that indicates the IAR has not satisfied the continuing education requirement for the previous reporting period. CE Inactive is a status in the Investment Adviser Registration Depository (“IARD”), the national depository for investment advisers used by the states including California. This registration status is necessary because it serves as a notice to stakeholders, including customers and regulators, that the IAR will not be eligible for registration renewal at the close of the calendar year unless all continuing education requirements are brought current. CE Inactive status is notice to the IAR that if continuing education is not completed by the end of year, the IAR will be unable to renew his or her registration. An IAR that is CE Inactive will hold that status in all states that have adopted the model rule.

Subdivision (a)(4)

The purpose of Subdivision (a)(4) is to define the term “Credit” to mean a unit that has been designated by NASAA or its designee as at least 50 minutes of educational instruction. The definition is necessary to quantify the amount of time IARs are required to spend on continuing education. Reading this definition in combination with the requirements under Subdivision (a) clarifies that IARs will be required to complete approximately ten hours of continuing education per reporting period (50 minutes x 12 Credits).

Subdivision (a)(5).

The purpose of Subdivision (a)(5) is to define the acronym “FINRA.” Subdivision (a)(5) defines “FINRA” to mean the Financial Industry Regulatory Authority. FINRA is a not-for-profit organization authorized by Congress to protect investors by overseeing U.S. broker-dealers. The definition is necessary to identify the organization that is being referred to under Subdivision (c) of the proposed regulation.

Subdivision (a)(6).

The purpose of Subdivision (a)(6) is to define the term “Home State.” Subdivision (a)(6) defines “Home State” to mean the state in which the IAR has its principal office and place of business. The definition is necessary to help IARs identify which state is their home state for the purposes of Subdivision (i), which allows IARs to meet the minimum continuing education requirements of their home state, as provided. This definition of “home state” is necessary because it is consistent with constitutional principles for a person to be regulated where the person is primarily located.

Subdivision (a)(7).

The purpose of Subdivision (a)(7) is to define the phrase “IAR Ethics and Professional Responsibility Content.” Subdivision (a)(7) defines the phrase “IAR Ethics and Professional Responsibility Content” to mean Approved IAR Continuing Education Content that addresses an IAR’s ethical and regulatory obligations. The definition is necessary to specify the topics that must be covered within the educational content to satisfy the minimum continuing education requirements under Subdivision (b)(1) of the proposed rule.

Subdivision (a)(8).

The purpose of Subdivision (a)(8) is to define the term “IAR Products and Practice Content.” Subdivision (a)(8) defines the phrase “IAR Products and Practice Content” to mean Approved IAR Continuing Education Content that addresses an IAR’s continuing skills and knowledge regarding financial products, investment features, and practices in the investment advisory industry. The definition is necessary to specify the topics that must be covered within the educational content to satisfy the minimum continuing education requirements under Subdivision (b)(2) of the proposed rule.

Subdivision (a)(9).

The purpose of Subdivision (a)(9) is to define the terms “investment adviser representative” and “IAR.” Subdivision (a)(9) defines “investment adviser representative” and “IAR” to mean an individual who meets the definition of “investment adviser representative” under Corporations Code section 25009.5. The definition is necessary for consistency between persons subject to the Corporate Securities Law of 1968 and persons subject to these rules.

Subdivision (a)(10).

The purpose of Subdivision (a)(10) is to define the acronym “NASAA.” Subdivision (a)(10) defines “NASAA” to mean the North American Securities Administrators Association or a committee designated by its Board of Directors. The definition is necessary to identify the organization that is being referred to under Subdivision (a), (c), and (i) of the proposed regulation.

Subdivision (a)(11).

The purpose of Subdivision (a)(11) is to define the term “Reporting Period.” Subdivision (a)(11) defines “Reporting Period” to mean one twelve (12) month period. Subdivision (a)(11) also states that an IAR’s initial Reporting Period with this state commences the first day of the first full Reporting Period after the individual is registered or required to be registered with this state. The definition is necessary to specify the period of time during which continuing education must be completed and clarify when the first Reporting Period begins.

Subdivision (b).

The purpose of Subdivision (b) is to specify the categories of continuing education instruction required by the Department and to specify the required number of hours of instruction for each category. The continuing education requirements of Subdivision (b) mirror NASAA’s Model Rule which represents the culmination of years of work by state securities regulators and industry to develop a relevant and responsive continuing education program. The NASAA 2018 Investment Adviser Representative Continuing Education (IAR CE) Survey generated useable data from 1,200 respondents which included IARs, state securities regulators, consultants, and compliance officers. According to the data, 75 percent of the industry felt IAR CE was “somewhat” to “very” “important and needed” and 72 percent of the industry supports a continuing education program.

Subdivision (b)(1).

The purpose of Subdivision (b)(1) is to specify the number of hours of instruction required for the Ethics and Professional Responsibility category. Subdivision (b)(1) requires IARs to complete six credits of regulatory and ethics content with at least three of those hours covering the topic of ethics. This is necessary to promote heightened regulatory compliance by IARs and ensure IARs better serve their clients by remaining knowledgeable of ethical and professional obligations, current regulatory requirements, and best practices. NASAA chose six credits of regulatory and ethics content because it represents enough coursework to provide IARs with regulatory developments and best practices while not being overly burdensome, and California is proposing six credits for this same reason.

Subdivision (b)(2).

The purpose of Subdivision (b)(2) is to specify the number of hours of instruction required for the Products and Practice category. Subdivision (b)(2) requires IARs to complete six credits of products and practices content. This is necessary to ensure IARs are knowledgeable about current industry products and practices and reduce the risk of investor losses due to recommendations not in a client's best interests, and a failure to understand investment products and their associated risks. NASAA chose six credits of products and practice content because it represents sufficient coursework to provide IARs with industry developments and best practices while not being overly burdensome, and California is proposing six credits for this same reason.

Subdivision (c).

According to the 2021 NASAA Investment Adviser Section report, 81 percent of Investment Adviser firms are one- or two-person shops and many of these persons are dually registered as a broker-dealer agent and an IAR. The purpose of Subdivision (c) is to specify when an IAR can use compliance with FINRA continuing education requirements applicable to broker-dealer agents to satisfy the proposed minimum continuing education requirements for IARs.. FINRA continuing education content will satisfy the requirements in Subdivision (b)(2) if it meets the criteria listed in Subdivisions (c)(1), (c)(2), and (c)(3).

Subdivision (c)(1).

The purpose of Subdivision (c)(1) is to specify the subject matter that the FINRA continuing education content must cover in order to meet the continuing education requirements for an IAR. Subdivision (c)(1) is necessary to ensure that an IAR's compliance with FINRA continuing education requirements will only be deemed to satisfy the continuing education requirements of this regulation if the content covers compliance, regulatory, ethical, and sales practice standards. Otherwise, the continuing education will not achieve the goal of increasing regulatory compliance by IARs and ensuring IARs better serve their clients by remaining knowledgeable of current regulatory requirements and best practices.

Subdivision (c)(2).

The purpose of Subdivision (c)(2) is to specify the laws and regulations that the FINRA continuing education content must be derived from in order to meet the continuing education requirements for an IAR. Subdivision (c)(2) is necessary to ensure that an IAR's compliance with FINRA continuing education requirements will only be deemed to satisfy the continuing education requirements of this regulation if the content is derived from state and federal investment advisory statutes and regulations, securities industry rules and regulations, and accepted standards and practices in the financial services industry. Otherwise, the continuing education will not achieve the goal of increasing

regulatory compliance by IARs and ensuring IARs better serve their clients by remaining knowledgeable of current regulatory requirements and best practices.

Subdivision (c)(3).

The purpose of Subdivision (c)(3) is to specify that the FINRA continuing education content must require participants to demonstrate proficiency in the subject matter of the educational materials in order to meet the continuing education requirements for an IAR. Subdivision (c)(3) is necessary to ensure that an IAR's compliance with FINRA continuing education requirements will only be deemed to satisfy the continuing education requirements of this regulation if the content requires that participants demonstrate proficiency in the subject matter of the educational materials. Otherwise, there is a risk that IARs may view continuing education courses without acquiring an understanding of the material. If the content requires participants to demonstrate proficiency, there is a higher likelihood that IARs will understand and retain the educational material and therefore, better serve their clients by remaining knowledgeable about current regulatory requirements and best practices.

Subdivision (d).

The purpose of Subdivision (d) is to specify when an IAR can use compliance with the continuing education requirements associated with a credential to satisfy the minimum continuing education requirements for IARs set forth in Subdivisions (b)(1) and (b)(2). Continuing education associated with a credential that qualifies for an examination waiver under Title 10 of the California Code of Regulations, Section 260.236, subdivision (b) will satisfy the requirements in Subdivisions (b)(1) and (b)(2) if it meets the criteria listed in Subdivisions (d)(1), (d)(2), and (d)(3).

Subdivision (d)(1).

The purpose of Subdivision (d)(1) is to specify the time period the continuing education associated with the credential must be completed in order to meet the continuing education requirements for an IAR. Subdivision (d)(1) is necessary to ensure that the continuing education reporting period for maintaining a credential is equivalent to the reporting period otherwise required for IARs under the rule, so that the obligations are equitable and achieve the purpose of ensuring the education is received within the designated 12-month period. If the continuing education for a credential was taken prior to the relevant reporting period under the rule, the IAR's recollection and mastery of the educational material may be diminished or may have become stale.

Subdivision (d)(2).

The purpose of Subdivision (d)(2) is to specify that the continuing education credits must be mandatory to maintain the credential in order to meet the continuing education requirements for an IAR. Subdivision (d)(2) is necessary because the purpose of this rule is to save IARs who hold other credentials from having to comply with two sets of

continuing education requirements. Therefore, only a mandatory course should substitute for IAR CE.

Subdivision (d)(3).

The purpose of Subdivision (d)(3) is to specify that the continuing education content associated with the credential must be Approved IAR Continuing Education Content in order to meet the continuing education requirements for an IAR. Subdivision (d)(3) is necessary to ensure that the continuing education associated with a qualifying credential is relevant to IARs and the services they provide their clients. Otherwise, an IAR would not be receiving content that helps them remain knowledgeable about current industry regulations, developments, and best practices. The proposed rule provides that credits from continuing education courses taken to maintain professional designations can apply to the IARCE program so long as the provider and course have been approved for IAR CE purposes.

Subdivision (e).

The purpose of Subdivision (e) is to specify the reporting requirements for completed continuing education courses. Each IAR will be responsible for ensuring that Authorized Providers report the IAR's completion of courses to FINRA. FINRA operates the Investment Adviser Registration Depository, or IARD, an electronic filing system for investment advisers that collects and maintains the registration, reporting and disclosure information for investment advisers and IARs, and California uses IARD for oversight of investment advisers and IARs. Subdivision (e) is necessary to ensure that IARs have satisfied their continuing education requirements. The reporting by Authorized Providers to FINRA will ensure the information is available to states, including California, through IARD. Requiring IARs to be responsible for ensuring that a continuing education provider has reported the IAR's completion of courses is the least burdensome and effective way of ensuring that IARs have satisfied their continuing education requirements.

Subdivision (f).

The purpose of Subdivision (f) is to specify that excess credits from one reporting period cannot be carried forward to a later reporting period. Subdivision (f) is necessary because one of the goals of the proposed rule is to ensure that IARs remain competent and knowledgeable about *current* industry regulations, developments, and best practices when handling client funds. If excess credits from one reporting period were allowed to be carried forward to a subsequent reporting period, it could result in an IAR taking fewer continuing education credits during the later reporting period. To ensure that IAR knowledge and competency remains current and up to date, it is necessary to require IARs to take the twelve credits specified in Subdivision (b) during each reporting period. The term "reporting period" is defined by Subdivision (a)(11).

Subdivision (g).

The purpose of Subdivision (g) is to specify the consequences for failing to comply with the requirements in the proposed regulation. IARs who fail to comply with this rule will be designated “CE Inactive” in IARD at the close of the calendar year. An IAR who is “CE Inactive” at the close of the next calendar year will not be eligible for registration or renewal of registration. Subdivision (g) is necessary to ensure there are consequences for the failure to comply with the continuing education requirements set forth by the proposed regulation. By tying the continuing education requirement directly with the ability to register or renew registration, subdivision (g) increases the likelihood that continuing education will be satisfied and prevents IARs who have not met the continuing education requirement from continuing to serve investors.

Subdivision (h).

The purpose of Subdivision (h) is to specify when an IAR who is registered in both California and the IAR’s Home State may be considered to be in compliance with the proposed regulation. This is necessary to decrease the burden on IARs registered in multiple states by ensuring they are not required to take continuing education that is duplicative.

Subdivision (h)(1).

The purpose of Subdivision (h)(1) is to specify that the Home State’s continuing education requirements must be at least as stringent as the NASAA Model Rule, upon which California’s rule is based. Subdivision (h)(1) is necessary to ensure that the Home State’s continuing education requirements are comparable to California’s requirements. Otherwise, an IAR’s compliance with continuing education in the Home State may not achieve the goal of increasing regulatory compliance by IARs and ensuring IARs better serve their clients by remaining knowledgeable of current regulatory requirements and best practices.

Subdivision (h)(2).

The purpose of Subdivision (h)(2) is to specify that the IAR must be in compliance with the Home State’s IAR continuing education requirements. Subdivision (h)(2) is necessary to ensure that the IAR has actually fulfilled the continuing education requirements of the Home State. Otherwise, an IAR’s registration in the Home State would not represent a meaningful alternative to satisfying the requirements of this rule.

Subdivision (i).

The purpose of Subdivision (i) is to specify the continuing education requirements for IARs who became unregistered for any period of time. If an IAR becomes unregistered for a period of time, the IAR must complete continuing education for all reporting periods that occur between the time the IAR became unregistered and when the IAR becomes registered again, unless the IAR passes the examination or receives an examination

waiver in connection with a subsequent application for registration. Subdivision (i) is necessary to ensure that IARs complete an adequate amount of continuing education courses per reporting period, and to maintain a certain level of expertise even during unregistered periods. Otherwise, an IAR's knowledge may become stale and outdated. The only alternative is for an IAR to pass the examination, or receive an examination waiver, in connection with an application for registration, which shows the IAR has the appropriate level of knowledge and competence to be registered.

Subdivision (j).

The purpose of Subdivision (j) is to specify that continuing education requirements will not apply to an IAR employed by or engaged by an investment adviser only to offer or negotiate for the sale of investment advisory services of an investment adviser. California IARs employed by or engaged by an investment adviser whose activity is limited to offering or negotiating for the sale of investment advisory services of an investment adviser are exempt from examination requirements under Title 10 of the California Code of Regulations, Section 260.236, subdivision (c)(2). For the same reason that they are exempt from examination—because they only perform very limited functions—it is necessary to exempt them from continuing education requirements in order to avoid unnecessarily burdensome requirements to these IARs.

NON-DUPLICATION STANDARD [Title 1, California Code of Regulations, Section 12, Subdivision (b)(1)]

The proposed rule does not duplicate state statutes.

BENEFITS ANTICIPATED FROM REGULATORY ACTION [Government Code Section 11346.2, Subdivision (b)(1)]

The benefits anticipated from this regulatory action include an improvement in the overall quality of investment advice and services provided by IARs and a reduced risk of investor losses due to inappropriate recommendations by IARs or a failure to understand investment products. This stems from the fact that continuing education requirements provide the opportunity for IARs to stay current on industry and regulatory developments, new products and practices, ethical obligations, and new laws and regulations. Another anticipated benefit is an increase in regulatory compliance from IARs during examinations conducted by state and federal regulators. Relatedly, the Department anticipates that clients of IARs will experience fewer instances of substandard service from IARs and will be subject to fewer instances of unethical or illegal behavior as a result of the proposed rule. These improvements will benefit consumers but also enhance the public's perception of IARs and as a result, bring more business to each IAR and benefit to the overall investment adviser industry.

Furthermore, the regulatory action increases transparency in government and encourages public participation in adopting balanced regulations through compliance with California's administrative rulemaking requirements.

POTENTIAL FOR ADVERSE ECONOMIC IMPACT ON BUSINESS AND INDIVIDUALS
[Government Code Section 11346.3, Subdivision (a)]

The Department has determined that the proposed regulatory action likely will not have an adverse economic impact or potential for an adverse economic impact on individuals or on business, including the ability of California businesses to compete with businesses in other states. The proposed rule imposes continuing education requirements on IARs to be eligible for registration or renewal of registration. Several states are in the process of implementing the same continuing education requirements which are based on NASAA's model rule. This reflects the significant support that NASAA received from state regulators and the securities industry for the creation of a continuing education program and the development of the IAR Continuing Education Model Rule. Therefore, the Department expects that IARs will be subject to continuing education requirements by most states within the next few years.

Furthermore, according to a NASAA 2021 Investment Adviser Section Annual Report, 81% of Investment Adviser firms are one to two person shops and many of these persons are dually registered as a broker-dealer agent and an IAR. An IAR who is also a registered broker-dealer agent and complies with FINRA's Continuing Education requirements for broker-dealer agents will also be in compliance with the requirement to report six credits of Products and Practices content under Subdivision (b)(1) of the proposed rule. IARs who hold other professional designations may also be in compliance with the IAR continuing education requirements under Subdivision (d) of the proposed rule. The NASAA 2018 Investment Adviser Representative Continuing Education (IAR-CE) Survey generated useable data from 1,200 respondents which included IARs, state securities regulators, consultants, and compliance officers. According to the survey 61% of the respondents excluding state regulators said they are already subject to continuing education. Therefore, many IARs who are dually registered as broker-dealer agents or hold other professional designations will already meet some or all of the continuing education requirements of this regulatory proposal.

ECONOMIC IMPACT ASSESSMENT [Government Code Section 11346.3, Subdivision (b)]

(A) The Creation or Elimination of Jobs Within the State

The Department has determined this regulatory proposal will not result in the creation of new jobs within the state. The proposed rule imposes continuing education requirements on IARs registered in this state. Therefore, existing providers of continuing education may experience an increase in demand for services but not significantly enough to create new jobs.

The Department does not anticipate an elimination of jobs due to the regulation or a reduction in the number of IAR jobs. According to the NASAA Investment Adviser Section Annual Report, 81 percent of Investment Adviser firms are one to two person

shops and many of these persons are dually registered as a broker-dealer agent and an investment adviser representative. An IAR who is also a registered broker-dealer agent and who complies with FINRA's Continuing Education requirements (on the broker-dealer side) complies with the IAR requirement to report six credits of Products and Practices content. IARs who hold other acceptable professional designations may also be considered in compliance with the continuing education requirements. The NASAA 2018 Investment Adviser Representative Continuing Education (IAR-CE) Survey generated useable data from 1,000 IARs. According to the survey 61% of the respondents said they are already subject to continuing education. Therefore, many of the IARs who are dually registered or hold other professional designations will already meet the IAR continuing education requirements and may not require as much time for compliance review.

Furthermore, some existing continuing education courses offered through FINRA have modest enrollment fees (less than \$100) and NASAA has stated its intent to engage a "wide range of vendors" including state regulatory agencies to offer approved continuing education courses for IARs. (See NASAA's Frequently Asked Questions: Investment Adviser Continuing Education, available at <https://www.nasaa.org/industry-resources/investment-advisers/resources/iar-ce-faq>.) In fact, based on vendor information collected by NASAA, there are low-cost options including packages for as low as \$60 which satisfy the entire continuing education requirement.¹ Additionally, NASAA will be offering free ethics courses. Given the anticipated availability of low- or no-cost course options to satisfy these requirements, and the fact that many IARs already take advantage of educational course offerings even without a state mandate, this rule is not expected to have a material economic impact on IARs.

This regulatory proposal will create a small number of jobs, and will not eliminate jobs, within state government. The continuing education requirement imposed on IARs by the proposed rule will require additional compliance reviews by the Department's Broker-Dealer/Investment Adviser program. If an IAR is found deficient, the IAR may not be able to renew registration in California and may not conduct investment related activities as an IAR in California. The Department will need additional staff resources to process IAR compliance reviews and to protect investors from dealing with IARs who may be deficient or not registered to conduct investment adviser activities. There is a database in place, developed by NASAA in partnership with FINRA, to track and monitor continuing education credits completed by IARs in states that have adopted the Model Rule. The Department will use the database to check for continuing education compliance in examinations and annually.

The table below identifies the breakout of IARs who are estimated as potentially meeting continuing education through other means and those who may not. The table represents IAR compliance with continuing education at 75%. This scenario determines

¹ The IAR CE course reporting fee, also referred to as the roster fee, is \$3 per credit hour. When the course vendor/provider submits an IAR's completed course for credit, the \$3 per credit hour is due upon submission. For twelve credits, the roster fee will total \$36.

the financial institutions examiner (“FIE”) positions required to track and monitor compliance with the IAR CE program.

**Table: Financial Institutions Examiner Workload:
Investor Education Monitoring – IARs Who May Not Meet Continuing
Education Through Other Means 75% Compliance**

Activity	Total Investment Adviser Representatives	Estimated average number of Staff hours per review	Total workload hours
Review, track, monitor investment adviser representative continuing education requirements for individuals who may not meet continuing education through other means; review and process registration renewals -75% Compliance (13,708 x 75%)	10,281	0.10	1,028
Review, track, monitor investment adviser representative continuing education requirements for individuals who may not meet continuing education through other means; review and process registration renewals - 25% Non-compliance(13,708 x 25%)	3,427	1.5	5,141
Review, track, monitor investment adviser representative continuing education requirements for individuals who may meet continuing education through other means; review and process registration renewals	44,032	0.10	4,403
Total IARs as of 3/25/2022	57,740		
Training			100
Total Hours			10,672
Number of positions needed (1,760 hours per year position)			6.06
Number of current positions			0.0
Financial Institutions Examiners Requested			6.0

(B) The Creation of New Businesses or the Elimination of Existing Businesses Within the State

The Department has determined this regulatory proposal will not result in the creation of new businesses in the state. The proposed rule imposes continuing education requirements on IARs registered in California. This will cause an increase in demand for continuing education courses, but the Department anticipates that existing providers of continuing education will fill this demand. The Department does not anticipate an elimination of existing businesses due to the regulation.

(C) The Expansion of Businesses Currently Doing Business Within the State

The Department has determined this regulatory proposal may result in the expansion of businesses currently doing business in the state. The proposed rule imposes continuing education requirements on IARs registered in California. Therefore, the proposed rule may cause existing businesses that provide continuing education to expand their products and services to IARs who must fulfill the new requirements.

(D) The Benefits of the Regulations to the Health and Welfare of California Residents, Worker Safety and the State's Environment

The Department has determined this regulatory proposal will benefit the health and welfare of California consumers by protecting them and improving the overall quality of investment advice and services provided by IARs and reducing the risk of investor losses due to inappropriate recommendations by IARs or a failure to understand investment products. The Department also anticipates that clients of IARs will experience fewer instances of substandard service from IARs and will be subject to fewer instances of unethical or illegal behavior as a result of the proposed rule. The regulatory proposal will not benefit worker safety or the state's environment.

TECHNICAL, THEORETICAL AND/OR EMPIRICAL STUDIES, REPORTS OR DOCUMENTS [Government Code Section 11346.2, Subdivision (b)(3)]

The Department relied on the following documents in proposing the adoption of the proposed rule:

- 2021 NASAA Investment Adviser Section Annual Report
- NASAA Survey Results Summary (2018)

The documents are available and on file with the Department. The Department did not rely on any other technical, theoretical, or empirical study, report, or other similar document in proposing this regulatory action.

REASONABLE ALTERNATIVES AND REASONS FOR REJECTING THOSE ALTERNATIVES [Government Code Section 11346.2, Subdivision (b)(4)(A)]

The Department has considered and determined there are no other reasonable alternatives to this regulation that would be more effective in carrying out the purpose for which the action is proposed, as effective and less burdensome to affected private persons, or more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposal described in this Initial Statement of Reasons.

REASONABLE ALTERNATIVES THAT WOULD LESSEN ANY ADVERSE IMPACT ON SMALL BUSINESSES AND REASONS FOR REJECTING THOSE ALTERNATIVES
[Government Code Section 11346.2, Subdivision (b)(4)(B)]

No reasonable alternative considered by the Department, or that have otherwise been identified and brought to the attention of the Department, would be as effective and less burdensome to affected private persons, or would lessen any adverse impact on small businesses. Under Government Code Section 11342.610, subdivision (b), an investment adviser is not a small business, and therefore no alternatives would lessen the impact of this rulemaking action on small businesses.

FACTS, EVIDENCE, DOCUMENTS, TESTIMONY OR OTHER EVIDENCE RELIED ON BY AGENCY [Government Code Section 11346.2, Subdivision (b)(5)(A)]

The Department relied on the 2021 NASAA Investment Adviser Section Annual Report and the NASAA Survey Results Summary (2018) to support the initial determination that this rulemaking action will not have a significant adverse economic impact on business.

The Department has also relied upon NASAA's Frequently Asked Questions: Investment Adviser Continuing Education, available at <https://www.nasaa.org/industry-resources/investment-advisers/resources/iar-ce-faq>.

The Department has not relied on any other facts, evidence, documents, or testimony in reaching that determination.