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LEGISLATIVE RESEARCH COMMISSION

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MEMORANDUM

TO: Catherine Falconer, General Counsel, Department of Financial Institutions

FROM: Emily Caudill, Regulations Compiler

RE: Proposed Amendment or New Regulation – 808 KAR 010:440 and 808 KAR 010:450

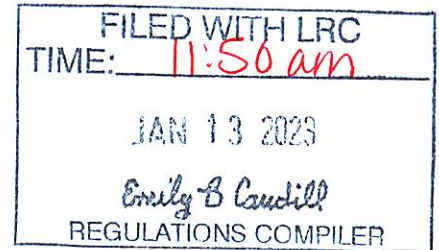
DATE: January 13, 2023

A copy of each administrative regulation listed above is enclosed for your files. These regulations are tentatively scheduled for review by the Administrative Regulation Review Subcommittee at its **APRIL 2023** meeting. We will notify you of the date and time of this meeting once it has been scheduled.

Pursuant to KRS 13A.280, **if** comments are received during the public comment period, a Statement of Consideration or a one-month extension request for these regulations is due **by noon on April 14, 2023**. Please reference KRS 13A.270 and 13A.280 for other requirements relating to the public hearing and public comment period and Statements of Consideration.

If you have questions, please contact us at RegsCompiler@LRC.ky.gov or (502) 564-8100.

Enclosures



1 PUBLIC PROTECTION CABINET

2 Kentucky Department of Financial Institutions

3 (Amendment)

4 808 KAR 10:440. Examples of dishonest or unethical practice for broker-dealers and agents.

5 RELATES TO: KRS 292.337, 292.480

6 STATUTORY AUTHORITY: KRS 292.336(5), (6), 292.500(3)

7 NECESSITY, FUNCTION, AND CONFORMITY: KRS 292.500(3) authorizes the

8 commissioner of the Department of Financial Institutions to promulgate administrative

9 regulations necessary to carry out the provisions of KRS Chapter 292. KRS 292.336(5) and (6)

10 authorize the commissioner to promulgate administrative regulations prohibiting unreasonable

11 charges, profits, commissions, or other compensation for broker-dealers and agents and

12 prescribing standards for the conduct of business by broker-dealers and agents which the

13 commissioner finds appropriate in the public interest and for the protection of investors. This

14 administrative regulation provides examples of dishonest and unethical practices by broker-

15 dealers and agents and states the consequences of engaging in unacceptable conduct or practices.

16 Section 1. Broker-dealers shall observe high standards of commercial honor and just and

17 equitable principles of trade in their dealings with customers and the conduct of their business.

18 The following acts [Aets] and practices shall constitute violations of those standards and

19 principles and [such as the following be considered contrary to these standards. Violations] may

20 result in a fine, suspension, or revocation in proportion to the seriousness of the offense, pursuant

1 to KRS 292.337(1):

2 (1) Engaging in a pattern of unreasonable and unjustifiable delays in the delivery of securities
3 purchased by any of its customers or in the payment of free credit balances reflecting completed
4 transactions of any of its customers;

5 (2) Failing or refusing to furnish a customer, upon reasonable request, information to which the
6 customer is entitled, or to timely respond to a formal written demand or complaint by a
7 customer;

8 (3) Attempting to enforce a condition, stipulation, or provision against a customer in Kentucky
9 if the result would:

10 (a) Leave the customer without the choice of a forum for dispute resolution in the state of
11 Kentucky; or

12 (b) Limit the timeliness of an action to a period less than that established in KRS 292.480;

13 (4) Failing to segregate a customer's securities held in safekeeping;

14 (5) Hypothecating a customer's securities without having a lien thereon unless the broker-dealer
15 secures from the customer a properly executed written consent promptly after the initial
16 transaction, except as permitted by rules of the Securities and Exchange Commission;

17 (6) Charging unreasonable and inequitable fees for services performed, including ~~[such as]~~:

18 (a) Collection of monies due for principal;

19 (b) Dividends or transfer of securities;

20 (c) Appraisals;

21 (d) Safekeeping; or

22 (e) Custody of securities and other services related to its securities business;

- 1 (7) Offering to buy from or sell to any person any security at a stated price unless the broker-
2 dealer is prepared to purchase or sell, as the case may be, at the price and under the conditions
3 as are stated when the offer is made;
- 4 (8) Representing that a security is being offered to a customer "at the market" or a price
5 relevant to the market price unless the broker-dealer knows or has reasonable grounds to
6 believe that a market for the a security exists other than that made, created, or controlled by the
7 broker-dealer, or by any person for whom the broker-dealer is acting or with whom the broker-
8 dealer is associated in the distribution, or any person controlled by, controlling, or under
9 common control with the broker-dealer;
- 10 (9) Failing to disclose in writing that the broker-dealer is controlled by, controls, is affiliated
11 with, or is under common control with the issuer of any security, the existence of this control
12 before entering into any binding contract with or for a customer for the purchase or sale of the
13 security;
- 14 (10) Failing to make a bona fide public offering of all the securities allotted to the broker-dealer
15 for distribution, whether acquired directly as an underwriter or a selling group member or
16 indirectly from an entity participating in the distribution as an underwriter or selling group
17 member;
- 18 (11) Inducing trading in a customer's account which is excessive in size or frequency in view of
19 the financial resources and character of the account;
- 20 (12) Switching, churning, overtrading, or reloading of a security in a customer's account for the
21 purpose of accumulating or increasing a commission;
- 22 (13) Recommending to a customer the purchase, sale, or exchange of any security without
23 reasonable grounds to believe that the transaction or recommendation is suitable for the

customer based upon a reasonable inquiry concerning the customer's investment objectives, financial situation and needs, and any other relevant information known by the broker-dealer;

(14) Failing to furnish to a customer purchasing securities in an offering, no later than the due date of confirmation of the transaction, either a formal prospectus or a preliminary prospectus and an additional document, which together include all information set forth in the final prospectus;

(15) Participating in the solicitation or offer for sale of a security without the use of an offering document or prospectus, if required, or making a statement contrary to or inconsistent with disclosure contained in the offering document or prospectus;

(16) Making a false, misleading, deceptive, or exaggerated representation or prediction in the solicitation or sale of a security, including:

(a) That the security will be resold or repurchased;

(b) That the security will be listed or traded on an exchange or established market;

(c) That the security will result in an assured, immediate, or material increase in value, future market price, or return on an investment;

(d) That there is a guarantee against risk of loss; or

(e) Any statement with respect to an issuer's financial condition, anticipated earnings, potential growth, or success not supportable by information in the offering document or prospectus;

(17) Engaging or aiding in boiler room operations such as use of high pressure tactics to promote a speculative offering or promotion of a security in an intensive campaign in which the prospective purchaser is encouraged to make a hasty decision to buy a security irrespective of the purchaser's investment needs, objectives, or understanding of the security being offered;

- 1 (18) Executing a transaction on behalf of a customer without authorization to do so;
- 2 (19) Exercising any discretionary power effecting a transaction for a customer's account
3 without first obtaining written discretionary authority from the customer, unless the
4 discretionary power relates solely to the time or price for the executing of orders;
- 5 (20) Executing any transaction in a margin account without securing from the customer a
6 properly executed written margin agreement;
- 7 (21) Entering into a transaction with or for a customer at a price not reasonably related to the
8 current market price of the security or receiving an unreasonable commission or profit;
- 9 (22) Effecting any transaction in, or inducing the purchase or sale of, any security by means of
10 any manipulative, deceptive, or fraudulent device, practice, plan, program, design or
11 contrivance, including~~[which may include any of the following]~~:
- 12 (a) Effecting any transaction in a security which involves no change in the beneficial
13 ownership thereof;
- 14 (b) Entering an order or orders of substantially the same size, at substantially the same time
15 and substantially the same price, for the sale of any security, that has been or will be entered
16 by or for the same or different parties for the purpose of creating a false or misleading
17 appearance of active trading in the security or a false or misleading appearance with respect to
18 the market for the security; except, this subsection shall not prohibit a broker-dealer from
19 entering bona fide agency cross transactions for its customers; or
- 20 (c) Effecting, alone or with one or more other persons, a series of transactions in any security
21 creating actual or apparent active trading in the security or raising or depressing the price of
22 the security, for the purpose of inducing the purchase or sale of the security by others;

1 (23) Guaranteeing a customer against loss in any securities account of the customer carried by
2 the broker-dealer or in any securities transaction effected by the broker-dealer;

3 (24) Publishing or circulating, or causing the publication or circulation of, any notice, circular,
4 advertisement, newspaper article, investment service, or communication of any kind which
5 purports to report any transaction as a purchase or sale of any security unless the broker-dealer
6 reasonably believes that the transaction was a bona fide purchase or sale of the security; or
7 which purports to quote the bid price or asked price for any security, unless the broker-dealer
8 reasonably believes that the quotation represents a bona fide bid or offer;

9 (25) Using any advertising or conducting any sales practice in a deceptive or misleading
10 manner;

11 (26) Entering into an agreement for a concession, discount, commission, or allowance as
12 consideration for a service in connection with the distribution or sale of a security in Kentucky
13 with a broker-dealer, agent, investment adviser, or investment adviser representative who is not
14 either:

15 (a) Registered in Kentucky; or

16 (b) Exempted from the registration requirements for conducting a securities business in
17 Kentucky;

18 (27) Lying to or otherwise misleading representatives of the Department of Financial
19 Institutions conducting an authorized examination or investigation;

20 (28) Failing to make requested records available to or otherwise impeding a representative of
21 the Department of Financial Institutions conducting an authorized examination or investigation;

22 (29) Failing to respond within the specified time period to a written request from an authorized
23 representative of the Department of Financial Institutions for:

1 (a) Information

2 (b) An explanation of practices or procedures;

3 (c) A response to a complaint filed with the Department of Financial Institutions; or

4 (d) A response to a written statement of findings from an examination; [and]

5 (30) Committing any act involving a customer, a customer's account, or any business records
6 which would constitute a criminal offense;

7 (31) Failing to pay and fully satisfy any final order, final judgment, or arbitration award
8 resulting from an investment-related, customer-initiated arbitration or court proceeding,
9 unless alternative payment arrangements are agreed to between the customer and the broker-
10 dealer or broker-dealer agent, in writing, and the broker-dealer or broker-dealer agent
11 complies with the terms of the alternative payment arrangement;

12 (32) Attempting to avoid payment of any final order, final judgment, or arbitration award
13 resulting from an investment-related, customer-initiated arbitration or court proceeding,
14 unless alternative payment arrangements are agreed to between the customer and the broker-
15 dealer or broker-dealer agent, in writing, and the broker-dealer or broker-dealer agent
16 complies with the terms of the alternative payment arrangements; or

17 (33) Failing to pay and fully satisfy any fine, civil penalty, order of restitution, order of
18 disgorgement, or similar monetary payment obligation imposed upon the broker-dealer or
19 agent by the Securities and Exchange Commission, the securities or other financial services
20 regulator of any state or province, or any self-regulatory organization.

21 Section 2. Broker-dealer agents shall observe high standards of commercial honor and just and
22 equitable principles of trade in their dealings with customers. The following acts and practices
23 shall constitute violations of those standards and principles and [are considered contrary to these

~~standards. Violations]~~ may result in a fine, suspension, or revocation in proportion to the seriousness of the offense, pursuant to KRS 292.337(1):

- (1) Sharing ~~[directly or indirectly]~~ in profits or losses in the account of a customer without the written authorization of the customer and the broker-dealer which the agent represents;
- (2) Establishing or maintaining an account containing fictitious information in order to execute transactions which would otherwise be prohibited;
- (3) Effecting securities transactions not recorded on the regular books and records of the broker-dealer which the agent represents, unless the transactions are authorized in writing by the broker-dealer prior to execution of the transaction;
- (4) Engaging in the practice of lending to or borrowing from a customer either money or securities;
- (5) Acting as custodian of a customer's money, securities, or an executed stock power; or ~~[and]~~
- (6) Engaging in conduct specified in Section 1(11) through ~~(33)~~~~(30)~~ of this administrative regulation.

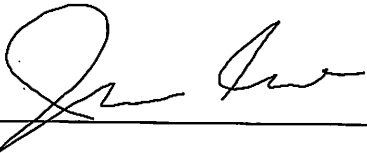
Section 3. Issuer agents shall observe high standards of commercial honor and just and equitable principles of trade in their dealings with customers. The following acts and practices shall constitute violations of those standards and principles and ~~[are considered contrary to these standards. Violations]~~ may result in a fine, suspension, or revocation in proportion to the seriousness of the offense, pursuant to KRS 292.337(1):

- (1) Engaging in conduct specified in Section 1(2), (13), (15) through (18), or (25) through ~~(33)~~~~(30)~~ of this administrative regulation; or
- (2) Engaging in conduct specified in Section 2 (3) or (4).

- 1 Section 4. The commissioner may determine that an activity not included in the examples
- 2 identified in Sections 1 through 3 of this administrative regulation constitutes a dishonest or
- 3 unethical practice if the activity is similar to an enumerated activity.

808 KAR 10:440

READ AND APPROVED BY



Justin Burse, Acting Commissioner

Department of Financial Institutions

1/13/2023

DATE



Ray Perry, Secretary

Public Protection Cabinet

1/13/2023

DATE

PUBLIC HEARING AND PUBLIC COMMENT PERIOD

Kentucky Department of Financial Institutions

808 KAR 10:440. Examples of dishonest or unethical practice for broker-dealers and agents.

A public hearing on this administrative regulation shall be held on March 28, 2023, at 1:00 PM, at 500 Mero Street, Frankfort KY 40601.

Individuals interested in being heard at this hearing shall notify this agency in writing by five workdays prior to the hearing, of their intent to attend. If no notification of intent to attend the hearing was received by that date, the hearing may be cancelled. A transcript of the public hearing will not be made unless a written request for a transcript is made.

If you do not wish to be heard at the public hearing, you may submit written comments on the proposed administrative regulation. Written comments shall be accepted through March 31, 2023. Send written notification of intent to be heard at the public hearing or written comments on the proposed administrative regulation to the contact person.

Contact Person: Catherine Falconer
Title: General Counsel
Address: 500 Mero Street, 2 SW 19
Frankfort, KY 40601
Phone: 502-782-9052
Fax: 502-573-8787
Email: Catherine.Falconer@ky.gov

Contact Person: Marni Gibson
Title: Acting Deputy Commissioner, Dept. of Financial Institutions
Address: 500 Mero Street, 2SW19
Frankfort, KY 40601
Phone: 502-782-9053
Fax: 502-573-8787
Email: Marni.Gibson@ky.gov

REGULATORY IMPACT ANALYSIS AND TIERING STATEMENT

808 KAR 10:440

Contact Person: Catherine Falconer
Title: Asst. General Counsel
Address: 500 Mero St, 2 SW 19
Frankfort, KY 40601
Phone: 502-782-9052
Fax: 502-573-8787
Email: Catherine.Falconer@ky.gov

(1) Provide a brief summary of:

(a) What this administrative regulation does:

This administrative regulation provides examples of dishonest and unethical practices by broker-dealers and agents and states the consequences of engaging in unacceptable conduct or practices.

(b) The necessity of this administrative regulation:

KRS 292.336(5) and (6) authorize the commissioner to promulgate administrative regulations prohibiting unreasonable charges, profits, commissions, or other compensation for broker-dealers and agents and prescribing standards for the conduct of business by broker-dealers and agents which the commissioner finds appropriate in the public interest and for the protection of investors. This regulation is necessary to provide examples of dishonest and unethical practices by broker-dealers and agents and share the consequences of engaging in unacceptable conduct or practices.

(c) How this administrative regulation conforms to the content of the authorizing statutes:

KRS 292.500(3) authorizes the commissioner of the Department of Financial Institutions to promulgate administrative regulations necessary to carry out the provisions of KRS Chapter 292.

(d) How this administrative regulation currently assists or will assist in the effective administration of the statutes:

This regulation prohibits unreasonable charges, profits, commissions, or other compensation for broker-dealers and agents and prescribes standards for the conduct of business by broker-dealers and agents which the commissioner finds appropriate in the public interest and for the protection of investors. Furthermore, this regulation provides for standards of conduct of broker-dealers and agents regarding their interaction with clients, the public in general, adherence to the governing laws, and honestly and transparency in their conduct in order to promote confidence in the industry.

(2) If this is an amendment to an existing administrative regulation, provide a brief summary

of:

(a) How the amendment will change this existing administrative regulation:

The amended regulation establishes an ethical violation for a broker-dealer or agent that fails to satisfy an investment-related, customer-initiated judgment or court order, attempts to avoid payment of referenced judgment or court order or fails to pay and fully satisfy any fine, civil penalty, order of restitution, order of disgorgement, or similar monetary payment obligation imposed on the broker-dealer or agent from a federal or state regulatory body.

(b) The necessity of the amendment to this administrative regulation:

The amendment is necessary to uphold ethical standards of participants in the financial industry, specifically a segment that works directly with clients and engages in transactions that involve the client's hard-earned capital. Failure to pay judgments or avoiding payment on court orders or judgments, related to investment-related activities, undermines the integrity of the securities industry, and allows for broker-dealers and agents to continue to engage with customers in a position of trust when their standards are compromised.

(c) How the amendment conforms to the content of the authorizing statutes:

KRS 292.336(6) provides for the commissioner to prescribe rules for the conduct of business by broker-dealers and investment advisers which he or she finds appropriate in the public interest and for the protection of investors. This amendment will enhance and raise standards for broker-dealers and agents regarding payments for orders or judgments.

(d) How the amendment will assist in the effective administration of the statutes:

The amended language will allow the Department to hold broker-dealers and agents accountable for failure to uphold their obligations to the court or other governing body.

(3) List the type and number of individuals, businesses, organizations, or state and local governments affected by this administrative regulation:

All broker-dealers and agent participants in the securities industry in Kentucky will be held to this standard and potentially affected by this administrative regulation.

(4) Provide an analysis of how the entities identified in question (3) will be impacted by either the implementation of this administrative regulation, if new, or by the change, if it is an amendment, including:

(a) List the actions that each of the regulated entities identified in question (3) will have to take to comply with this administrative regulation or amendment:

Broker-dealers and agents will be required to pay all fees and fines resulting from court orders, judgments or arbitration awards resulting from an investment-related customer-initiated action or enter into a written payment plan for satisfaction of the judgment. In addition, the broker-dealer will be prohibited from actively avoiding payments or purposely failing to take action to make required payments.

(b) In complying with this administrative regulation or amendment, how much will it cost

each of the entities identified in question (3):

The costs incurred will be a direct result of the actions of the broker-dealer and agent to comply with the judgment or orders and will be dependent upon their compliance. Imposing an enhanced ethical requirement will not directly incur additional business costs to the regulated entity.

(c) As a result of compliance, what benefits will accrue to the entities identified in question

(3):

Compliance with the amendment language will promote higher ethical standards throughout the industry and increase client confidence in broker-dealers and their agents.

(5) Provide an estimate of how much it will cost the administrative body to implement this administrative regulation:

(a) Initially: There will be no additional costs initially incurred by the agency for implementation.

(b) On a continuing basis: There is no anticipated additional costs other than for enforcement actions resulting from a lack of compliance with this regulation.

(6) What is the source of the funding to be used for the implementation and enforcement of this administrative regulation:

Implementation and enforcement of this regulation will be funded by the current Department budget.

(7) Provide an assessment of whether an increase in fees or funding will be necessary to implement this administrative regulation, if new, or by the change if it is an amendment:

The Department does not anticipate a need to increase funding to implement this change.

(8) State whether or not this administrative regulation establishes any fees or directly or indirectly increases any fees:

This regulation amendment does not establish new fees or imposes additional fees for compliance.

(9) TIERING: Is tiering applied? (Explain why or why not)

Tiering was not applied. The amended regulation language will not require tiering to be implemented.

FISCAL NOTE

808 KAR 10:440

Contact Person: Catherine Falconer

Phone: 502-782-9052

Email: Catherine.Falconer@ky.gov

(1) What units, parts, or divisions of state or local government (including cities, counties, fire departments, or school districts) will be impacted by this administrative regulation?
The Department of Financial Institutions

(2) Identify each state or federal statute or federal regulation that requires or authorizes the action taken by the administrative regulation.
KRS 292.336(5), (6), 292.500(3)

(3) Estimate the effect of this administrative regulation on the expenditures and revenues of a state or local government agency (including cities, counties, fire departments, or school districts) for the first full year the administrative regulation is to be in effect.

(a) How much revenue will this administrative regulation generate for the state or local government (including cities, counties, fire departments, or school districts) for the first year?
The regulation amendment will not impact the Department's budget. All revenue associated with this regulation are addressed in the current budget.

(b) How much revenue will this administrative regulation generate for the state or local government (including cities, counties, fire departments, or school districts) for subsequent years?
The regulation amendment will not impact the Department's budget in subsequent years. All revenue associated with this regulation are addressed in the current budget.

(c) How much will it cost to administer this program for the first year?
There will be no additional costs to administer this regulation amendment. All costs associated with this regulation are addressed in the current budget.

(d) How much will it cost to administer this program for subsequent years?

Note: If specific dollar estimates cannot be determined, provide a brief narrative to explain the fiscal impact of the administrative regulation. All costs associated with this regulation are addressed in the current budget. The Department does not anticipate that the regulatory amendment will have an impact on costs or revenue in the current year or subsequent years.

Revenues (+/-):

Expenditures (+/-):

Other Explanation:

- (3) Estimate the effect of this administrative regulation on the expenditures and cost savings of regulated entities for the first full year the administrative regulation is to be in effect.

Regulated entities will have no additional costs if they maintain compliance with the current regulatory provisions.

(a) How much cost savings will this administrative regulation generate for the regulated entities for the first year?

The Department does not anticipate cost savings for the regulated entities.

(b) How much cost savings will this administrative regulation generate for the regulated entities for subsequent years?

The Department does not anticipate cost savings for the regulated entities for subsequent years.

(d) How much will it cost the regulated entities for the first year?

There will be no additional costs to regulated entities.

(e) How much will it cost the regulated entities for subsequent years?

There will be no additional costs to regulated entities in subsequent years.

Note: If specific dollar estimates cannot be determined, provide a brief narrative to explain the fiscal impact of the administrative regulation.

The regulatory amendment will not have a fiscal impact on the Department or the regulated entities for regulatory compliance.

Cost Savings (+/-):

Expenditures (+/-):

Other Explanation:

(5) Explain whether this administrative regulation will have a major economic impact, as defined below. *"Major economic impact" means an overall negative or adverse economic impact from an administrative regulation of five hundred thousand dollars (\$500,000) or more on state or local government or regulated entities, in aggregate, as determined by the promulgating administrative bodies. [KRS 13A.010(13)]*

The amendment to the regulation will not have a major economic impact on the administrative regulation of these entities.

FEDERAL MANDATE ANALYSIS COMPARISON

808 KAR 10:440

Contact Person: Catherine Falconer

Phone: 502-782-9052

Email: Catherine.Falconer@ky.gov

- (1) Federal statute or regulation constituting the federal mandate. None
- (2) State compliance standards. None
- (3) Minimum or uniform standards contained in the federal mandate. N/a
- (4) Will this administrative regulation impose stricter requirements, or additional or different responsibilities or requirements, than those required by the federal mandate? N/a
- (5) Justification for the imposition of the stricter standard, or additional or different responsibilities or requirements. N/a

FILED WITH LRC TIME: <u>11:50 am</u>
JAN 13 2023
<i>Emily B Caudill</i> REGULATIONS COMPILER

1 PUBLIC PROTECTION CABINET

2 Kentucky Department of Financial Institutions

3 (Amendment)

4 808 KAR 10:450. Examples of dishonest or unethical practice for investment advisers and
5 investment adviser representatives.

6 RELATES TO: KRS Chapter 292, 17 C.F.R. 275.206(4), 15 U.S.C. 78, 80b

7 STATUTORY AUTHORITY: KRS 292.336(5), (6), 292.500(3)

8 NECESSITY, FUNCTION, AND CONFORMITY: KRS 292.500(3) authorizes the commis-
9 sioner of the Department of Financial Institutions to promulgate administrative regulations nec-
10 essary to carry out the provisions of KRS Chapter 292. KRS 292.336(5) and (6) authorize the
11 commissioner to promulgate administrative regulations prohibiting unreasonable charges or
12 other compensation of investment advisers and prescribing standards for the conduct of business
13 by investment advisers and investment adviser representatives which the commissioner finds
14 appropriate in the public interest and for the protection of investors. This administrative
15 regulation provides examples of dishonest and unethical practices by investment advisers and
16 investment adviser representatives and clarifies the consequences of engaging in unacceptable
17 conduct or practices.

18 Section 1. Definitions.

(1) "Advertisement" means any notice, circular, letter, or other written communication addressed to more than one person, or any notice or other announcement in any electronic or paper publication, by radio or television, or by any other medium, that offers any one of the following:

(a) Any analysis, report, or publication concerning securities;

(b) Any analysis, report, or publication that is to be used in making any determination as to when to buy or sell any security or which security to buy or sell;

(c) Any graph, chart, formula, or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell; or

(d) Any other advisory service regarding ~~[with regard to]~~ securities.

(2) "Investment adviser solicitor" means a person or entity that, directly or indirectly, solicits a prospective client for, or refers a prospective client to, an investment adviser.

Section 2. A person who is an investment adviser or an investment adviser representative shall be a fiduciary and shall have a duty to act primarily for the benefit of its clients. An investment adviser or investment adviser representative shall not engage, either directly or indirectly, in unethical or dishonest practices. The following acts and practices shall constitute ~~[be considered either]~~ a breach of fiduciary duty or a dishonest and unethical practice, and violations ~~[Violations]~~ may result in a fine, suspension, or revocation in proportion to the seriousness of the offense:

(1) Recommending to a client to whom investment advisory, management, or consulting services are provided the purchase, sale, or exchange of any security without reasonable grounds to believe that the recommendation is suitable for the client based on ~~[the basis of]~~ information

- 1 furnished by the client after reasonable inquiry concerning the client's investment objectives,
2 financial situation and needs, and any other information known by the investment adviser;
- 3 (2) Exercising any discretionary power in placing an order for the purchase or sale of securi-
4 ties for a client without obtaining written discretionary authority from the client within ten (10)
5 business days after the date of the first transaction placed pursuant to oral discretionary authority,
6 unless the discretionary power relates solely to the price at which, or the time when, an order
7 involving a definite amount of a specified security shall be executed, or both;
- 8 (3) Inducing trading in a client's account that is excessive in size or frequency in view of the
9 financial resources, investment objectives, and character of the account considering ~~[in light of~~
10 ~~the fact]~~ that an investment adviser or investment adviser representative may ~~[in these situations~~
11 ~~can]~~ directly benefit from the number of securities transactions effected in a client's account;
- 12 (4) Placing an order to purchase or sell a security for the account of a client without authority
13 to do so;
- 14 (5) Placing an order to purchase or sell a security for the account of a client upon instruction
15 of a third party without first having obtained a written third-party trading authorization from the
16 client;
- 17 (6) Borrowing money or securities from a client unless the client is a broker-dealer, an affli-
18 ate of the investment adviser, or a financial institution engaged in the business of loaning funds;
- 19 (7) Loaning money or securities to a client unless the investment adviser is a financial insti-
20 tution engaged in the business of loaning funds or the client is an affiliate of the investment ad-
21 viser;

- 1 (8)(a) Misrepresenting to any advisory client, or prospective advisory client, the qualifications of
2 the investment adviser or any employee of the investment adviser;
- 3 (b) Misrepresenting the nature of the advisory services being offered or fees to be charged
4 for the service; or
- 5 (c) Omitting to state a material fact necessary to make the statements made regarding quali-
6 fications, services or fees, in light of the circumstances under which they were made, not mis-
7 leading;
- 8 (9) Providing a report or recommendation to any advisory client prepared by someone other than
9 the adviser without disclosing that fact;
- 10 (10) Charging a client an unreasonable advisory fee in light of the fee charged by other in-
11 vestment advisers providing similar services;
- 12 (11) Failing to disclose to clients in writing before any advice is rendered any material conflict of
13 interest relating to the adviser, or any of its employees, including:
- 14 (a) Compensation arrangements connected with advisory services to clients which are in
15 addition to compensation from these clients for advisory services; or [and]
- 16 (b) The amount of any commissions to be received for executing transactions pursuant to
17 advice given;
- 18 (12) Failing to disclose to clients in writing all potentially conflicting divisions of loyalty in
19 connection with a transaction, and failing to obtain the written consent of the client to proceed
20 with the transaction in accordance with the following requirements:

1 (a) Any transaction in which a person acts as an investment adviser for one (1) party to that
2 transaction and in which the person (or any person controlling, controlled by, or under common
3 control with the adviser) acts as a broker-dealer for both the advisory client and another person
4 on the other side of the transaction is subject to this disclosure and consent requirement, and the
5 client shall be provided a written confirmation for each such transaction which contains the
6 following:

- 7 1. A statement of the nature of the transaction;
- 8 2. The date of the transaction;
- 9 3. An offer to furnish, upon written request, the time of the transaction; and
- 10 4. The source and amount of any other remuneration the adviser received or will receive in
11 connection with the transaction. If the investment adviser is not participating in a distribution
12 when the advisory client is purchasing the security or a tender offer when the advisory client is
13 selling the security, the confirmation may state that the investment adviser has been or will be
14 receiving other remuneration and that the source and the amount of this remuneration will be
15 furnished upon the client's written request;

16 (b) The disclosure and consent requirements of subsection (12)(a) of this section apply to each
17 contemplated transaction and shall be complied with every time the transaction occurs unless the
18 adviser complies with the provisions of subsection (12)(c) of this section;

19 (c) If the disclosure and consent requirements of subsection (12)(a) of this section prospectively
20 cover more than one transaction, the adviser is responsible for ensuring that the client receives at
21 least annually, with or as part of a written statement or summary of the client's account, written
22 disclosure of the following:

- 1 1. The total number of these transactions since the date of the last statement or summary;
- 2 2. The total amount of all commissions or other remuneration the adviser received or will
- 3 receive in connection with the transactions; and
- 4 3. A conspicuous statement that the client may revoke the written consent previously given
- 5 by providing written notice of the revocation to the adviser; and
- 6 (d) Any transaction in which the same adviser recommended the transaction to both a seller and a
- 7 purchaser of a security shall be a dishonest or unethical practice regardless of any disclosure and
- 8 consent;
- 9 (13) Failing to disclose to clients in writing before any advice is rendered any material fact
- 10 with respect to the financial and disciplinary information required to be disclosed by 17 C.F.R.
- 11 275.206(4)-4 (SEC Rule 206(4)4);
- 12 (14) Guaranteeing a client that a specific result will be achieved with advice which will be
- 13 rendered;
- 14 (15) Using any advertisement that does ~~[any of]~~ the following:
- 15 (a) Refers to any testimonial of any kind concerning any advice, analysis, report, or other
- 16 service rendered by the adviser or representative unless it meets the following
- 17 requirements:
- 18 1. The testimonial clearly discloses whether the person giving the testimonial is a client or
- 19 promoter;
- 20 2. The testimonial clearly discloses whether the person giving the testimonial is compensated;

1 3. An adviser or representative using a testimonial provided by a promoter has entered into a
2 written agreement with a promoter; and

3 4. The adviser or representative and testimonial comply with all provisions of Rule 206(4)-1 of
4 the Investment Advisers Act of 1940, commonly known as the SEC marketing rule, effective
5 December 22, 2020;

6 (b) Refers to past specific recommendations of the adviser or representative that were or would
7 have been profitable, except that an adviser or representative may furnish or offer to furnish a list
8 of all recommendations made by the adviser or representative within the immediately preceding
9 period of not less than one year if the list also includes the following:

10 1. The name of each security recommended, the date and nature of each recommendation,
11 the market price at that time, the price at which the recommendation was to be acted upon, and
12 the most recently available market price of each security; and

13 2. A legend on the first page in prominent print or type that states that recommendations
14 made in the future may not be as profitable as the securities on the list;

15 (c) Represents that any graph, chart, formula, or other device being offered can in and of itself be
16 used to determine which securities to buy or sell, or when to buy or sell them; ~~[or which~~
17 ~~represents, directly or indirectly, that any graph, chart, formula, or other device being offered~~
18 ~~will assist any person in making that person's own decisions without prominently disclosing in~~
19 ~~the advertisement the limitations and the difficulties with respect to its use;]~~

20 (d) Represents that any graph, chart, formula, or other device being offered will assist any person
21 in making that person's own decisions without prominently disclosing in the advertisement the
22 limitations and the difficulties with respect to its use;

- 1 ~~(e)~~~~(d)~~ Represents that any report, analysis, or other service will be furnished for free or without
2 charge, unless the report, analysis or other service actually is or will be furnished free and
3 without any direct or indirect condition or obligation;
- 4 ~~(f)~~~~(e)~~ Represents that the Department of Financial Institutions has approved any advertisement;
5 or
- 6 ~~(g)~~~~(f)~~ Contains any untrue statement or omission of a material fact, or that is otherwise false or
7 misleading;
- 8 (16) Disclosing the identity, affairs, or investments of any client unless required by law to do so,
9 or unless consented to in writing by the client;
- 10 (17) Taking any action, directly or indirectly, with respect to those securities or funds in which
11 any client has any beneficial interest, if the investment adviser has custody or possession of the
12 securities or funds when the adviser's action is subject to and does not comply with the
13 provisions of 808 KAR 10:020 relating to the custody;
- 14 (18) Entering into, extending, or renewing an advisory contract unless the contract is in writing
15 and discloses the following:
- 16 (a) The nature of the advisory services to be provided;
- 17 (b) The time period that the contract remains in effect;
- 18 (c) The advisory fee and the formula for computing the fee;
- 19 (d) The amount of the prepaid fee to be returned if there is contract termination or nonper-
20 formance;

- 1 (e) Whether the contract grants discretionary power to the adviser and, if so, the terms of the
2 discretionary power;
- 3 (f) Whether the contract grants custody of client funds to the adviser and, if so, the terms of
4 the custody; and
- 5 (g) That the adviser shall not assign the contract without the prior written consent of the cli-
6 ent;
- 7 (19) Including in an advisory contract any condition, stipulation, or provision binding any client
8 to waive compliance with any provision of the Securities Act of Kentucky, KRS Chapter 292,
9 808 Chapter 10, or of the Investment Advisors Act of 1940, 15 U.S.C. 80b;
- 10 (20) Paying compensation, directly or indirectly, to an investment adviser solicitor unless the
11 investment adviser makes the payment in accordance with the requirements of 17 C.F.R.
12 275.206(4)-3) (SEC Rule 206(4)-3);
- 13 (21) Engaging in any act, practice, or course of business which is fraudulent, deceptive, or
14 manipulative contrary to the provisions of Section 206(4) of the Investment Advisors Act of
15 1940, whether or not the investment adviser is registered or required to be registered under
16 Section 203 of the Act;
- 17 (22) Failing to provide all material information with respect to any dealings with or recom-
18 mendations to any advisory client in violation of KRS 292.320;
- 19 (23) Committing any act involving a client, the client's assets, or any business records which
20 would constitute a criminal offense;

- 1 (24) Lying to or otherwise misleading a representative of the Department of Financial Institu-
2 tions conducting an authorized examination or investigation;
- 3 (25) Failing to make requested records available to or otherwise impeding a representative of the
4 Department of Financial Institutions conducting an authorized examination or investigation; ~~and~~
- 5 (26) Failing to respond in a timely manner to a written request from an authorized representative
6 of the Department of Financial Institutions for:
- 7 (a) Information;
- 8 (b) An explanation of practices or procedures;
- 9 (c) A response to a complaint filed with the department; or
- 10 (d) A response to a written statement of findings from an examination.
- 11 (27) Failing to pay and fully satisfy any final order, judgment, or arbitration award resulting from
12 an investment-related, client or customer-initiated arbitration or court proceeding, unless
13 alternative payment arrangements are agreed to, in writing, and complied with between:
- 14 (a) the client and the investment adviser or investment adviser representative; or
- 15 (b) between the customer and the broker-dealer or the broker-dealer agent;
- 16 (28) Attempting to avoid payment of any final order, judgment, or arbitration award resulting
17 from an investment-related, client or customer-initiated arbitration or court proceeding, unless
18 alternative payment arrangements are agreed to, in writing, and complied with between:
- 19 (a) the client and the investment adviser or investment adviser representative; or
- 20 (b) between the customer and the broker-dealer or the broker-dealer agent; or

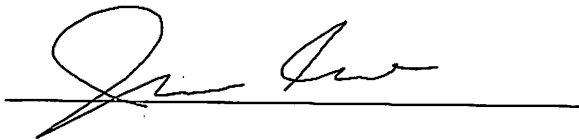
1 (29) Failing to pay and fully satisfy any fine, civil penalty, order of restitution, order of
2 disgorgement, or similar monetary payment obligation imposed upon the investment adviser or
3 investment adviser representative by the Securities and Exchange Commission, the securities or
4 other financial services regulator of any state or province, or any self-regulatory organization.

5 Section 3. The provisions of this administrative regulation shall apply to federally covered
6 advisers operating in Kentucky to the extent that the conduct alleged is fraudulent, deceptive, or
7 as otherwise permitted by the National Securities Market Improvement Act of 1996, 15 U.S.C.
8 78, and the Investment Advisors Act of 1940, 15 U.S.C. 80b.

9 Section 4. The commissioner may determine that an activity not included in the examples
10 identified in Section 2 of this administrative regulation constitutes a dishonest or unethical
11 practice if the activity is similar to an enumerated activity.

808 KAR 10:450

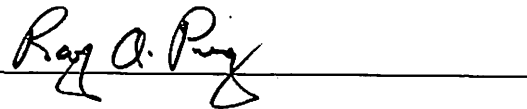
READ AND APPROVED BY

A handwritten signature in black ink, appearing to read "Justin Burse", written over a horizontal line.

Justin Burse, Acting Commissioner
Department of Financial Institutions

1/13/2023

DATE

A handwritten signature in black ink, appearing to read "Ray A. Perry", written over a horizontal line.

Ray Perry, Secretary
Public Protection Cabinet

1/13/2023

DATE

PUBLIC HEARING AND PUBLIC COMMENT PERIOD

Kentucky Department of Financial Institutions

808 KAR 10:450 Examples of Dishonest or unethical practice for investment advisers and investment adviser representatives.

A public hearing on this administrative regulation shall be held on March 28, 2023, at 1:00 PM, at 500 Mero Street, Frankfort KY 40601.

Individuals interested in being heard at this hearing shall notify this agency in writing by five workdays prior to the hearing, of their intent to attend. If no notification of intent to attend the hearing was received by that date, the hearing may be cancelled. A transcript of the public hearing will not be made unless a written request for a transcript is made.

If you do not wish to be heard at the public hearing, you may submit written comments on the proposed administrative regulation. Written comments shall be accepted through March 31, 2023. Send written notification of intent to be heard at the public hearing or written comments on the proposed administrative regulation to the contact person.

Contact Person: Catherine Falconer
Title: General Counsel
Address: 500 Mero Street, 2 SW 19
Frankfort, KY 40601
Phone: 502-782-9052
Fax: 502-573-8787
Email: Catherine.Falconer@ky.gov

Contact Person: Marni Gibson
Title: Acting Deputy Commissioner, Dept. of Financial Institutions
Address: 500 Mero Street, 2SW19
Frankfort, KY 40601
Phone: 502-782-9053

Fax: 502-573-8787
Email: Marni.Gibson@ky.gov

REGULATORY IMPACT ANALYSIS AND TIERING STATEMENT

808 KAR 10:450

Contact Person: Catherine Falconer
Title: General Counsel
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Frankfort, KY 40601
Phone: 502-782-9052
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(1) Provide a brief summary of:

(a) What this administrative regulation does:

This administrative regulation provides examples of dishonest and unethical practices by investment advisers and investment adviser representatives and states the consequences of engaging in unacceptable conduct or practices.

(b) The necessity of this administrative regulation:

KRS 292.336(5) and (6) authorize the commissioner to promulgate administrative regulations prohibiting unreasonable charges, profits, commissions, or other compensation for Investment Advisers and Investment Adviser Representatives, and prescribing standards for the conduct of business by Investment Advisers and Investment Adviser Representatives which the commissioner finds appropriate in the public interest and for the protection of investors. This administrative regulation is necessary to provide examples of dishonest and unethical practices by investment advisers and investment adviser representatives and clarify the consequences of engaging in unacceptable conduct or practices.

(c) How this administrative regulation conforms to the content of the authorizing statutes:

KRS 292.500(3) authorizes the commissioner of the Department of Financial Institutions to promulgate administrative regulations necessary to carry out the provisions of KRS Chapter 292.

(d) How this administrative regulation currently assists or will assist in the effective administration of the statutes:

This regulation prohibits unreasonable charges, profits, commissions, or other compensation for Investment Advisers and Investment Adviser Representatives, and prescribes standards for the conduct of business by Investment Advisers and Investment Adviser Representatives which the commissioner finds appropriate in the public interest and for the protection of investors. Furthermore, this regulation provides for standards of conduct of Investment Advisers and Investment Adviser Representatives regarding their interaction with clients and the public in

general, for adherence to the governing laws, and for honestly and transparency in their conduct, in order to promote confidence in the industry.

(2) If this is an amendment to an existing administrative regulation, provide a brief summary of:

(a) How the amendment will change this existing administrative regulation:

The amended regulation establishes an ethical violation for a broker-dealer or agent that fails to satisfy an investment-related, customer-initiated judgment or court order, attempts to avoid payment of a judgment or court order, or fails to pay and fully satisfy any fine, civil penalty, order of restitution, order of disgorgement, or similar monetary payment obligation imposed on the broker-dealer or agent from a federal or state regulatory body.

(b) The necessity of the amendment to this administrative regulation:

The amendment is necessary to uphold ethical standards of participants in the financial industry, specifically a segment that works directly with clients and engages in transactions that involve the client's hard-earned capital. Failure to pay judgments or avoiding payment on court orders or judgments related to investment related activities undermines the integrity of the securities industry and allows for Investment Advisers and Investment Adviser Representatives to continue to engage with customers in a position of trust when their standards are compromised.

(c) How the amendment conforms to the content of the authorizing statutes:

KRS 292.336(6) authorizes the commissioner to prescribe rules for the conduct of business by Investment Advisers and investment advisers which he or she finds appropriate in the public interest and for the protection of investors. This amendment will enhance and raise standards for Investment Advisers and Investment Adviser Representatives regarding payments for orders or judgments.

(d) How the amendment will assist in the effective administration of the statutes:

The amended language will allow the Department to hold Investment Advisers and Investment Adviser Representatives accountable for failure to uphold their obligations to the court or other governing body.

(3) List the type and number of individuals, businesses, organizations, or state and local governments affected by this administrative regulation:

All Investment Advisers and agent participants in the securities industry in Kentucky will be held to this standard and potentially affected by this administrative regulation.

(4) Provide an analysis of how the entities identified in question (3) will be impacted by either the implementation of this administrative regulation, if new, or by the change, if it is an amendment, including:

(a) List the actions that each of the regulated entities identified in question (3) will have

to take to comply with this administrative regulation or amendment:
Investment Advisers and Investment Adviser Representatives will be required to pay all fees and fines resulting from court orders, judgments, or arbitration awards resulting from an investment-related customer-initiated action, or to enter into a written payment plan for satisfaction of the judgement. In addition, the broker-dealer will be prohibited from actively avoiding payments or purposefully failing to take action to make required payments.

(b) In complying with this administrative regulation or amendment, how much will it cost each of the entities identified in question (3):

The costs incurred will be a direct result of the actions of the broker-dealer and agent to comply with the judgement or orders and will be dependent upon their compliance. Imposing an enhanced ethical requirement will not directly result in additional business costs to the regulated entity.

(c) As a result of compliance, what benefits will accrue to the entities identified in question (3):

Compliance with the amendment language will promote higher ethical standards throughout the industry and increase client confidence in Investment Advisers and their Investment Adviser Representatives.

(5) Provide an estimate of how much it will cost the administrative body to implement this administrative regulation:

(a) Initially: There will be no additional costs initially incurred by the agency for implementation.

(b) On a continuing basis: There is no anticipated additional costs other than for enforcement actions resulting from a lack of compliance with this standard.

(6) What is the source of the funding to be used for the implementation and enforcement of this administrative regulation:

Implementation and enforcement of this regulation will be funded by the current Department budget.

(7) Provide an assessment of whether an increase in fees or funding will be necessary to implement this administrative regulation, if new, or by the change if it is an amendment:

The Department does not anticipate a need to increase funding to implement this change.

(8) State whether or not this administrative regulation establishes any fees or directly or indirectly increases any fees:

This regulation amendment does not establish new fees or imposes additional fees for compliance.

(9) TIERING: Is tiering applied? (Explain why or why not)

Tiering was not applied. The amended regulation language will not require tiering to be implemented.

FISCAL NOTE

808 KAR 10:450

Contact Person: Catherine Falconer

Phone: 502-782-9052

Email: Catherine.Falconer@ky.gov

(1) What units, parts, or divisions of state or local government (including cities, counties, fire departments, or school districts) will be impacted by this administrative regulation?
The Department of Financial Institutions

(2) Identify each state or federal statute or federal regulation that requires or authorizes the action taken by the administrative regulation.
KRS 292.336(5), (6), 292.500(3)

(3) Estimate the effect of this administrative regulation on the expenditures and revenues of a state or local government agency (including cities, counties, fire departments, or school districts) for the first full year the administrative regulation is to be in effect.

(a) How much revenue will this administrative regulation generate for the state or local government (including cities, counties, fire departments, or school districts) for the first year?
The regulatory amendment will not impact the Department's budget.

(b) How much revenue will this administrative regulation generate for the state or local government (including cities, counties, fire departments, or school districts) for subsequent years?
The regulatory amendment will not impact the Department's budget in subsequent years.

(c) How much will it cost to administer this program for the first year?
There will be no additional costs to administer this regulatory amendment.

(d) How much will it cost to administer this program for subsequent years?

Note: If specific dollar estimates cannot be determined, provide a brief narrative to explain the fiscal impact of the administrative regulation. The Department does not anticipate that the regulatory amendment will have an impact on costs or revenue in the current year or subsequent years.

Revenues (+/-):

Expenditures (+/-):

Other Explanation:

- (3) Estimate the effect of this administrative regulation on the expenditures and cost savings of regulated entities for the first full year the administrative regulation is to be in effect.

Regulated entities will have no additional costs if they maintain compliance with the current regulatory provisions.

- (a) How much cost savings will this administrative regulation generate for the regulated entities for the first year?

The Department does not anticipate cost savings for the regulated entities.

- (b) How much cost savings will this administrative regulation generate for the regulated entities for subsequent years?

The Department does not anticipate cost savings for the regulated entities for subsequent years.

- (d) How much will it cost the regulated entities for the first year?

There will be no additional costs to regulated entities.

- (e) How much will it cost the regulated entities for subsequent years?

There will be no additional costs to regulated entities in subsequent years.

Note: If specific dollar estimates cannot be determined, provide a brief narrative to explain the fiscal impact of the administrative regulation.

The regulation amendment will not have a fiscal impact to the Department or the regulated entities for regulatory compliance.

Cost Savings (+/-):

Expenditures (+/-):

Other Explanation:

- (5) Explain whether this administrative regulation will have a major economic impact, as defined below. *"Major economic impact" means an overall negative or adverse economic impact from an administrative regulation of five hundred thousand dollars (\$500,000) or more on state or local government or regulated entities, in aggregate, as determined by the promulgating administrative bodies. [KRS 13A.010(13)]*

The amendment to the regulation will not have a major economic impact on the administrative regulation of these entities.

FEDERAL MANDATE ANALYSIS COMPARISON

808 KAR 10:450

Contact Person: Catherine Falconer

Phone: 502-782-9052

Email: Catherine.Falconer@ky.gov

(1) Federal statute or regulation constituting the federal mandate. None

(2) State compliance standards. None

(3) Minimum or uniform standards contained in the federal mandate. N/a

(4) Will this administrative regulation impose stricter requirements, or additional or different responsibilities or requirements, than those required by the federal mandate? N/a

(5) Justification for the imposition of the stricter standard, or additional or different responsibilities or requirements. N/a