



# House of Representatives

General Assembly

**File No. 176**

February Session, 2010

Substitute House Bill No. 5053

*House of Representatives, March 29, 2010*

The Committee on Banks reported through REP. BARRY of the 12th Dist., Chairperson of the Committee on the part of the House, that the substitute bill ought to pass.

## ***AN ACT CONCERNING TRANSPARENCY AND DISCLOSURE.***

Be it enacted by the Senate and House of Representatives in General Assembly convened:

1 Section 1. (NEW) (*Effective January 1, 2011*) (a) As used in this  
2 section, "private investment fund" means any investment company, as  
3 defined in Section 3(a)(1) of the Investment Company Act of 1940, (1)  
4 that claims an exemption under Section 3(c)(1) or Section 3(c)(7) of the  
5 Investment Company Act of 1940; (2) whose offering of securities is  
6 exempt under the private offering safe harbor criteria in Rule 506 of  
7 Regulation D of the Securities Act; (3) that offers or sells securities in  
8 this state or is located in this state; and (4) that meets any other criteria  
9 as may be established by the Banking Commissioner. A private  
10 investment fund is located in this state if such fund has an office in this  
11 state where employees regularly conduct business on behalf of the  
12 private investment fund.

13 (b) Any investment adviser to a private investment fund, regardless  
14 of whether such investment adviser is registered with the United  
15 States Securities and Exchange Commission, shall comply with the

16 disclosure requirements of Rule 204-3 under the Investment Advisers  
17 Act of 1940, provided nothing in this subsection shall require the  
18 disclosure of any information other than material conflicts of interest  
19 of the investment adviser. In the event that federal regulations or  
20 changes to the Investment Advisers Act of 1940, resulting in the  
21 regulation of investment advisers to private investment funds, are  
22 enacted on or before December 31, 2010, then no private investment  
23 fund or investment adviser to a private investment fund shall be  
24 required to comply with the provisions of this subsection.

25 Sec. 2. Section 36b-3 of the general statutes is repealed and the  
26 following is substituted in lieu thereof (*Effective January 1, 2011*):

27 As used in sections 36b-2 to 36b-33, inclusive, and section 1 of this  
28 act, unless the context otherwise requires:

29 (1) "Agent" means any individual, other than a broker-dealer, who  
30 represents a broker-dealer or issuer in effecting or attempting to effect  
31 purchases or sales of securities. "Agent" does not include an individual  
32 who represents an issuer in (A) effecting transactions in a security  
33 exempted by subdivision (1), (2), (3), (4), (6), (9), (10), (11) or (22) of  
34 subsection (a) of section 36b-21, (B) effecting transactions exempted by  
35 subsection (b) of section 36b-21, except for transactions exempted by  
36 subdivisions (10), (13) or (14) of said subsection, (C) effecting  
37 transactions with existing employees, partners or directors of the  
38 issuer if no commission or other remuneration is paid or given directly  
39 or indirectly for soliciting any person in this state, or (D) effecting  
40 transactions in any covered security, except for covered securities  
41 within the meaning of Sections 18(b)(2) or 18(b)(4)(D) of the Securities  
42 Act of 1933. "Agent" does not include such other persons not within  
43 the intent of this subdivision as the commissioner may by regulation or  
44 order determine. A general partner, officer or director of a broker-  
45 dealer or issuer, or a person occupying a similar status or performing  
46 similar functions, is an agent only if such person otherwise comes  
47 within this definition and any compensation that such person receives  
48 is directly or indirectly related to purchases or sales of securities.

49 (2) "Associated person" has the meaning given to that term in  
50 Section 3(a)(21) of the Securities Exchange Act of 1934.

51 (3) "Blank check company" means any company that (A) devotes  
52 substantially all of its efforts to establishing a new business in which  
53 planned principal operations have not commenced or, that has  
54 commenced planned principal operations, but has not derived  
55 significant revenue from such operations; and (B) has no specific  
56 business plan or purpose or has indicated that its business plan is to  
57 engage in a merger or acquisition with an unidentified company or  
58 companies, or other entity or person.

59 (4) "Branch office" means any location other than the main office at  
60 which an agent or investment adviser agent regularly conducts  
61 business on behalf of a broker-dealer or investment adviser, or any  
62 location that is held out as such, excluding: (A) Any location that is  
63 established solely for customer service or back-office-type functions  
64 where no sales activities are conducted and that is not held out to the  
65 public as a branch office, (B) any location that is the agent's or  
66 investment adviser agent's primary residence, provided (i) only agents  
67 or investment adviser agents who reside at the location and are  
68 members of the same immediate family conduct business at the  
69 location, (ii) the location is not held out to the public as an office and  
70 the agent or investment adviser agent does not meet with customers at  
71 the location, (iii) neither customer funds nor securities are handled at  
72 that location, (iv) the agent or investment adviser agent is assigned to a  
73 designated branch office, and such designated branch office is reflected  
74 on all business cards, stationery, advertisements and other  
75 communications to the public by such agent or investment adviser  
76 agent, (v) the agent's or investment adviser agent's correspondence  
77 and communications with the public are subject to the supervision of  
78 the broker-dealer or investment adviser with which such agent or  
79 investment adviser agent is associated, (vi) electronic communications,  
80 including e-mail, are made through the electronic system of the broker-  
81 dealer or investment adviser, (vii) all orders for securities are entered  
82 through the designated branch office or an electronic system

83 established by a broker-dealer that is reviewable at the branch office,  
84 (viii) written supervisory procedures pertaining to supervision of  
85 activities conducted at the residence are maintained by the broker-  
86 dealer or investment adviser, and (ix) a list of the residence locations is  
87 maintained by the broker-dealer or investment adviser, (C) any  
88 location, other than a primary residence, that is used for securities or  
89 investment advisory business for less than thirty business days in any  
90 one calendar year, provided the broker-dealer or investment adviser  
91 complies with the provisions of subparagraph (B)(ii), (iii), (iv), (v), (vi),  
92 (vii) and (viii) of this subdivision, (D) any office of convenience, where  
93 associated persons occasionally and exclusively by appointment meet  
94 with customers, which is not held out to the public as an office, (E) any  
95 location that is used primarily to engage in nonsecurities activities and  
96 from which the agent or investment adviser agent effects no more than  
97 twenty-five securities transactions in any one calendar year, provided  
98 any advertisement or sales literature identifying such location also sets  
99 forth the address and telephone number of the location from which the  
100 agent or investment adviser agent conducting business at the  
101 nonbranch locations is directly supervised, (F) the floor of a registered  
102 national securities exchange where a broker-dealer conducts a direct  
103 access business with public customers, (G) a temporary location  
104 established in response to the implementation of a business continuity  
105 plan, or (H) any other location not within the intent of this subdivision  
106 as the commissioner may determine. As used in this subdivision, the  
107 term "business day" does not include any partial business day,  
108 provided the agent or investment adviser agent spends at least four  
109 hours on such day at the designated branch office of such agent or  
110 investment adviser agent during the hours that such office is normally  
111 open for business.

112 (5) "Broker-dealer" means any person engaged in the business of  
113 effecting transactions in securities for the account of others or for such  
114 person's own account. "Broker-dealer" does not include (A) an agent,  
115 (B) an issuer, (C) a bank, as defined in Section 3(a)(6) of the Securities  
116 Exchange Act of 1934, when conducting activities that would except it  
117 from the definitions of "broker" or "dealer" under Sections 3(a)(4) or

118 3(a)(5) of the Securities Exchange Act of 1934, (D) a person who has no  
119 place of business in this state if such person effects transactions in this  
120 state exclusively with or through (i) the issuers of the securities  
121 involved in the transactions, (ii) other broker-dealers, or (iii) a bank  
122 and trust company, a national banking association, a savings bank, a  
123 savings and loan association, a federal savings bank, a federal savings  
124 and loan association, a credit union, a federal credit union, a trust  
125 company, an insurance company, an investment company as defined  
126 in the Investment Company Act of 1940, a pension or profit-sharing  
127 trust, or other financial institution or institutional buyer, whether  
128 acting for itself or as trustee, or (E) such other persons not within the  
129 intent of this subdivision as the commissioner may by regulation or  
130 order determine.

131 (6) "Commissioner" means the Banking Commissioner or any  
132 person appointed or designated by the Banking Commissioner to  
133 administer sections 36b-2 to 36b-33, inclusive.

134 (7) "Covered security" has the meaning given to that term in Section  
135 18(b) of the Securities Act of 1933.

136 (8) "Fraud", "deceit" and "defraud" are not limited to common-law  
137 deceit.

138 (9) "Guaranteed" means guaranteed as to payment of principal,  
139 interest or dividends.

140 (10) "International banking institution" means an international  
141 financial institution, as defined in 22 USC 262r, as from time to time  
142 amended, of which the United States is a member and whose securities  
143 are exempt from registration under the Securities Act of 1933.

144 (11) "Investment adviser" means any person who, for compensation,  
145 engages in the business of advising others, either directly or through  
146 publications or writings, as to the value of securities or as to the  
147 advisability of investing in, purchasing or selling securities, or who, for  
148 compensation and as a part of a regular business, issues or

149 promulgates analyses or reports concerning securities. "Investment  
150 adviser" does not include (A) an investment adviser agent; (B) a bank,  
151 as defined in Section 202(a)(2) of the Investment Advisers Act of 1940,  
152 or a bank holding company, as defined in the Bank Holding Company  
153 Act of 1956, that is excepted from the definition of "investment  
154 adviser" in Section 202(a)(11) of the Investment Advisers Act of 1940;  
155 (C) a lawyer, accountant, engineer, or teacher whose performance of  
156 these services is solely incidental to the practice of such person's  
157 profession; (D) a broker-dealer whose performance of these services is  
158 solely incidental to the conduct of such person's business as a broker-  
159 dealer and who receives no special compensation for them; (E) a  
160 publisher of any bona fide newspaper, news magazine, or business or  
161 financial publication of general, regular, and paid circulation; (F) a  
162 person whose advice, analyses or reports relate only to securities  
163 exempted by subdivision (1) of subsection (a) of section 36b-21; (G) any  
164 insurance company under the supervision of the Insurance  
165 Commissioner or any affiliate thereof, as defined in subsection (b) of  
166 section 38a-129, when providing services to separate accounts of that  
167 insurance company or registered investment companies all of whose  
168 shares are owned by such insurance company or its insurance  
169 company affiliates or by the separate accounts of that insurance  
170 company or its insurance company affiliates; and (H) such other  
171 persons not within the intent of this subdivision as the commissioner  
172 may by regulation or order designate.

173 (12) (A) "Investment adviser agent" includes (i) any individual,  
174 including an officer, partner or director of an investment adviser, or an  
175 individual occupying a similar status or performing similar functions,  
176 employed, appointed or authorized by or associated with an  
177 investment adviser to solicit business from any person for such  
178 investment adviser in this state and who receives compensation or  
179 other remuneration, directly or indirectly, for such solicitation; or (ii)  
180 any partner, officer, or director of an investment adviser, or an  
181 individual occupying a similar status or performing similar functions,  
182 or other individual employed, appointed, or authorized by or  
183 associated with an investment adviser, who makes any

184 recommendation or otherwise renders advice regarding securities to  
185 clients and who receives compensation or other remuneration, directly  
186 or indirectly, for such advisory services.

187 (B) "Investment adviser agent" does not include an individual  
188 employed, appointed or authorized by, associated with or acting on  
189 behalf of an investment adviser exempt from registration under  
190 subdivision (1) or (2) of subsection (e) of section 36b-6, who is a  
191 "supervised person", as defined in Section 202(a)(25) of the Investment  
192 Advisers Act of 1940, unless such supervised person is an "investment  
193 adviser representative", as defined in Securities and Exchange  
194 Commission Rule 203A-3, 17 CFR 275.203A-3.

195 (C) "Investment adviser agent" does not include such other  
196 individuals not within the intent of this subdivision as the  
197 commissioner may by regulation or order designate.

198 (13) "Issuer" means any person who issues or proposes to issue any  
199 security; except that (A) with respect to a certificate of deposit, a  
200 voting-trust certificate, or a collateral-trust certificate, or with respect  
201 to a certificate of interest or a share in an unincorporated investment  
202 trust not having a board of directors or persons performing similar  
203 functions or of the fixed, restricted management, or unit type, "issuer"  
204 means any person performing the acts and assuming the duties of  
205 depositor or manager pursuant to the provisions of the trust or other  
206 agreement or instrument under which the security is issued; (B) with  
207 respect to an equipment trust certificate or similar security serving the  
208 same purpose, "issuer" means any person who uses or will use the  
209 property, any person to whom the property or equipment is or will be  
210 leased or conditionally sold or any person who is otherwise  
211 contractually responsible for assuring payment of the certificate; and  
212 (C) with respect to a fractional undivided interest in oil, gas or other  
213 mineral leases or in payments out of production under a lease, right or  
214 royalty, "issuer" means any owner of an interest in the lease or in  
215 payments out of production under a lease, right or royalty, whether  
216 whole or fractional, who creates fractional interests for the purpose of

217 sale.

218 (14) "Nonissuer" means not directly or indirectly for the benefit of  
219 the issuer.

220 (15) "Person" means an individual, a corporation, a limited liability  
221 company, a partnership, a limited partnership, a limited liability  
222 partnership, an association, a joint-stock company, a trust where the  
223 interests of the beneficiaries are evidenced by a security, an  
224 unincorporated organization, a government or a political subdivision  
225 of a government.

226 (16) (A) "Sale" or "sell" includes every contract of sale of, contract to  
227 sell, or disposition of, a security or interest in a security for value. (B)  
228 "Offer" or "offer to sell" includes every attempt or offer to dispose of, or  
229 solicitation of an offer to buy, a security or interest in a security for  
230 value. (C) Any security given or delivered with, or as a bonus on  
231 account of, any purchase of securities or any other thing shall be  
232 conclusively presumed to constitute a part of the subject of such  
233 purchase and to have been sold for value. (D) Nothing in this  
234 subdivision shall limit or diminish the full meaning of the terms "sale",  
235 "sell", "offer" or "offer to sell" as construed by the courts of this state.  
236 (E) A purported gift of assessable stock is considered to involve an  
237 offer and sale. (F) Every sale or offer of a warrant or right to purchase  
238 or subscribe to another security of the same or another issuer, as well  
239 as every sale or offer of a security which gives the holder a present or  
240 future right or privilege to convert into another security of the same or  
241 another issuer, is considered to include an offer of the other security.  
242 (G) The terms defined in this subdivision do not include: (i) Any bona  
243 fide pledge or loan; (ii) any stock dividend, whether the corporation  
244 distributing the dividend is the issuer of the stock or not, if nothing of  
245 value is given by stockholders for the dividend other than the  
246 surrender of a right to a cash or property dividend when each  
247 stockholder may elect to take the dividend in cash or property or in  
248 stock; (iii) any act incident to a class vote by security holders on a  
249 merger, exchange of securities for securities, consolidation,

250 reclassification of securities, or sale of assets in consideration of the  
251 issuance of securities or securities and cash of another person other  
252 than an individual; or (iv) any security which is issued in exchange for  
253 one or more bona fide outstanding securities, claims or property  
254 interests, or partly in such exchange and partly for cash, where the  
255 terms and conditions of such issuance and exchange are approved by  
256 any state or federal court.

257 (17) "Securities Act of 1933", "Securities Exchange Act of 1934",  
258 "Public Utility Holding Company Act of 1935", "Investment Advisers  
259 Act of 1940" and "Investment Company Act of 1940" mean the federal  
260 statutes of those names, as from time to time amended.

261 (18) "Securities and Exchange Commission" means the United States  
262 Securities and Exchange Commission.

263 (19) "Security" means any note, stock, treasury stock, security future,  
264 bond, debenture, evidence of indebtedness, certificate of interest or  
265 participation in any profit-sharing agreement, interests of limited  
266 partners in a limited partnership, collateral-trust certificate,  
267 preorganization certificate or subscription, transferable share,  
268 investment contract, voting-trust certificate, certificate of deposit for a  
269 security, fractional undivided interest in oil, gas or other mineral  
270 rights, put, call, straddle, option, or privilege on any security or group  
271 or index of securities, including any interest in or based on the value of  
272 such security, group or index, put, call, straddle, option or privilege  
273 entered into on a national securities exchange relating to foreign  
274 currency, or, in general, any interest or instrument commonly known  
275 as a "security", or any certificate of interest or participation in,  
276 temporary or interim certificate for, receipt for, guarantee of, or  
277 warrant or right to subscribe to or purchase, any of the foregoing.  
278 "Security" includes (A) a certificated and an uncertificated security,  
279 and (B) as an "investment contract", an interest in a limited liability  
280 company or limited liability partnership, but does not include any  
281 insurance or endowment policy or annuity contract issued by an  
282 insurance company that is subject to regulation by the Insurance

283 Commissioner.

284 (20) "Self-regulatory organization" means a national securities  
285 exchange, a national securities association of broker-dealers or a  
286 clearing agency registered under the Securities Exchange Act of 1934  
287 or the Municipal Securities Rulemaking Board established under the  
288 Securities Exchange Act of 1934.

289 (21) "Shell company" or "dormant company" means any company  
290 which does not pursue nor has the financial capacity to pursue a  
291 business plan or purpose.

292 (22) "State" means any state, territory or possession of the United  
293 States, the District of Columbia and Puerto Rico.

This act shall take effect as follows and shall amend the following sections:		
Section 1	January 1, 2011	New section
Sec. 2	January 1, 2011	36b-3

**BA** Joint Favorable Subst.

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The following Fiscal Impact Statement and Bill Analysis are prepared for the benefit of the members of the General Assembly, solely for purposes of information, summarization and explanation and do not represent the intent of the General Assembly or either chamber thereof for any purpose. In general, fiscal impacts are based upon a variety of informational sources, including the analyst's professional knowledge. Whenever applicable, agency data is consulted as part of the analysis, however final products do not necessarily reflect an assessment from any specific department.

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***OFA Fiscal Note***

***State Impact:*** None

***Municipal Impact:*** None

***Explanation***

Requiring investment advisers of private investment funds to comply with the disclosure requirements regarding conflicts of interest of Rule 204-3 of the federal Investment Advisers Act of 1940 has no fiscal impact upon the Department of Banking.

***The Out Years***

***State Impact:*** None

***Municipal Impact:*** None

**OLR Bill Analysis****sHB 5053*****AN ACT CONCERNING TRANSPARENCY AND DISCLOSURE.*****SUMMARY:**

This bill requires investment advisers to private investment funds to comply with the disclosure requirements regarding conflicts of interest of Rule 204-3 of the federal Investment Advisers Act of 1940, regardless of whether the adviser is registered with the federal Securities and Exchange Commission (SEC) (see BACKGROUND). However, these disclosure requirements will not apply if federal regulation or amendment to the Investment Advisers Act is enacted by December 31, 2010 that regulates investment advisers to private investment funds.

The bill uses the definition of “investment adviser” currently found in the Uniform Securities Act. It defines an investment adviser as a 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 the advisability of investing in, purchasing, or selling securities, or who, for compensation and as a part of a regular business, issues or promulgates analyses or reports concerning securities. This definition excludes several individuals and entities, such as (1) certain banks; (2) lawyers, accountants, engineers, or teachers whose performance of these services is solely incidental to the practice of their profession; (3) publishers of bona fide newspapers, news magazines, or business or financial publications of general, regular, and paid circulation; and (4) various others.

The bill defines “private investment fund” as any investment company, as defined under the federal Investment Company Act of 1940:

1. that claims an exemption under Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act;
2. whose offering of securities is exempt under the private offering safe harbor criteria in Rule 506 of Regulation D of the Securities Act;
3. that (a) offers or sells securities in Connecticut or (b) has a Connecticut office where employees regularly conduct business on the fund's behalf; and
4. that meets any other criteria the banking commissioner sets.

EFFECTIVE DATE: January 1, 2011

## **BACKGROUND**

### ***SEC Rule 204-3 Disclosures***

Rule 204-3 requires an investment adviser registered or required to be registered under the Investment Advisers Act to provide each advisory client and prospective advisory client with a written disclosure statement.

The disclosure statement can be either a copy of Part II of the adviser's Form ADV (the form investment advisers use to register with the SEC) or a document that contains the information required by Part II of the ADV. Part II requires information on the adviser's advisory services and fees; types of clients; types of investments; methods of analysis, sources of information, and investment strategies; education and business standards and background; other business activities; other financial industry activities or affiliations; participation or interest in client transactions; conditions for managing accounts; review of accounts; investment or brokerage discretion; additional compensation; and balance sheet.

These investment advisers must deliver the statement (1) not less than 48 hours before entering into an investment advisory contract with the client or prospective client or (2) at the time of entering into

any such contract, if the advisory client has a right to terminate the contract without penalty within five business days after signing it. Advisers must also annually deliver or offer in writing to deliver upon written request to each of their advisory clients the required information without charge. These requirements do not apply in connection with entering into an investment company contract or certain contracts for impersonal advisory services.

If an investment adviser renders substantially different types of services to different advisory clients, any information required by Part II of Form ADV may be omitted from the statement furnished to a client or prospective client if it is applicable only to a type of investment advisory service or fee which is not rendered or charged, or proposed to be rendered or charged, to that client or prospective client.

### ***Investment Company Registration Exemptions***

Under Section 3(c)(1) of the Investment Company Act, an issuer (1) whose outstanding securities are beneficially owned by 100 or fewer persons and (2) who does not plan to make public offerings is exempt from registering as an investment company.

Issuers are exempt from registering under Section 3(c)(7) of the Investment Company Act if (1) their outstanding securities are owned by “qualified purchasers” at the time of acquisition and (2) they do not make a public offering of such securities. “Qualified purchasers” are defined as (1) individuals and certain companies that own \$5 million worth of investments, (2) certain other trusts, or (3) certain entities that own \$25 million worth of investments.

### ***Offering Registration Exemption and the Regulation D “Safe Harbor”***

Since hedge fund and other private investment fund interests are considered securities under the Securities Act of 1933, they would ordinarily be subject to SEC regulation. However, the Securities Act provides an exception to its registration requirements if the interests are not sold in a “public offering.” Under federal regulations, offers

and sales of securities by an issuer that satisfy certain conditions are deemed to be transactions not involving a public offering, and are therefore exempt from registration requirements.

To meet the “safe harbor” in Rule 506 of Regulation D, hedge funds and other private investment funds may sell their interests to an unlimited number of “accredited investors.” This term includes:

1. a natural person whose net worth, or whose joint net worth with the person’s spouse, exceeds \$1 million at the time of purchase;
2. a natural person with income exceeding \$200,000 in each of the two most recent years, or joint income with a spouse exceeding \$300,000 for those years, and a reasonable expectation of the same income level in the current year;
3. a director, executive officer, or general partner of the company selling the securities, or any director, executive officer, or general partner of a general partner of the company;
4. various entities and institutional investors including banks, insurance companies, charitable organizations, and employee benefit plans (restrictions apply to certain types of institutional investors);
5. certain trusts with assets exceeding \$5 million; and
6. a business in which all the equity owners are accredited investors.

Regulation D also allows an issuer to sell its interests to a limited number of non-accredited investors (up to 35) if they have sufficient financial knowledge.

## **COMMITTEE ACTION**

Banks Committee

Joint Favorable Substitute

Yea 12 Nay 5 (03/11/2010)