

February 1, 2016

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**VIA EMAIL**

The Honorable Mia Costello  
Chair, Senate Labor and Commerce Committee  
Alaska State Senate  
State Capitol Room 510  
Juneau AK, 99801  
[Senator.Mia.Costello@akleg.gov](mailto:Senator.Mia.Costello@akleg.gov)

The Honorable Kurt Olson  
Chair, House Labor and Commerce Committee  
Alaska State House of Representatives  
State Capitol Room 24  
Juneau AK, 99801  
[Representative.Kurt.Olson@akleg.gov](mailto:Representative.Kurt.Olson@akleg.gov)

**Re: Alaska Senate Bill 108 and House Bill 194  
Alaska Securities Act**

Dear Senator Costello and Representative Olson:

I am writing to offer my written testimony on Alaska Senate Bill 108 and House Bill 194, the proposed Alaska Securities Act. I am an attorney and member of the bars of Oregon, Washington, Wisconsin and Massachusetts. I have practiced law for 34 years, mostly in the area of securities. I speak frequently to state and federal regulators and securities lawyers around the country on issues of securities law. I am a member of the FINRA (Financial Industry Regulatory Authority) National Arbitration and Mediation Committee, which advises FINRA on rules governing disputes between savers and investors and securities brokerage firms. I do not practice in Alaska and have nothing personally to gain from commenting on SB 108/HB 194. I offer my testimony in hopes that it may be of some assistance to the Alaska Senate and House and the people of the great State of Alaska.

In my view, the bills before you are significant improvements, and Alaska legislature should amend Alaska's Securities Act. Today there are terms of art and concepts that did not exist when your existing law was enacted, and the proposed legislation recognizes them. By enacting a modernized securities act, Alaska will be a national leader in the blue sky laws community. That attention alone is likely to generate national recognition and interest. It should result in increased opportunities for entrepreneurs and others seeking to raise capital in Alaska. Equally important, the proposed bill will afford needed protections for investors and retirement savers.

There are a few sections of the proposed Act where my direct experience might be of some assistance.

**Crowdfunding.** The proposed new exemption to allow for crowdfunding is good for Alaska. By enacting Section 45.56.220, Alaska will join those states that permit crowdfunding. I was on the special committee that reviewed and commented on Oregon's crowdfunding rules. While on that committee, I reviewed the crowdfunding statutes and regulations of all states that had enacted new crowdfunding rules. The challenge with crowdfunding is to strike the appropriate balance between allowing investment in grassroots businesses while providing safeguards for investors. The key provisions in SB 108 in my view are subsections (3) and (4) which limit the amount of money to be raised to \$1,000,000, and limit the amount that a single unaccredited investor can invest to \$5,000. In Oregon, our maximum investment is \$2,500, and other states allow more than \$5,000. Your proposed legislation falls in the middle and strikes a fair balance. Additionally, I like that there is a bad actor provision (25.56.230), and that no commissions may be paid on crowdfunding investments.

**Variable Annuities.** Section 45.56.605(f) is another key improvement in SB 108. It provides that variable annuities are securities and subject to the new Act. This is one of the most important features of the bill. Variable annuities have been a *major* source of investor abuse over the last decade. FINRA has issued warnings about these investments on its website. See, for example, *Variable Annuities: Beyond the Hard Sell*, at <https://www.finra.org/sites/default/files/InvestorDocument/p125846.pdf>. I would encourage your committee to read that alert, keeping in mind that it is the financial industry itself that is issuing this warning.

Perhaps the biggest problem with variable annuities is the fees associated with these products. In my experience, these fees are rarely less than 3% per year, meaning that the investment must grow 3% annually just to break even. And, the fees are more often considerably higher. If the investor needs to sell the investment anytime within 6 – 7 years of purchasing it (to pay unforeseen medical expenses, for example), there are sales charge penalties for selling the investment, which can drive the annual fees well above 3%.

One reason the fees are so high is that the commissions paid to the salesperson are among the very highest of any investment product available. The insurance companies have to pay those commissions to convince the salesperson to sell them, and then the companies need to recoup those commission charges from the purchasing investors. They do that from charging deferred sales charges, administrative fees, sub account management fees, and others.

Another problem with variable annuities is that they are complex and extremely difficult for anyone to understand. If you have any doubt about that, I would encourage you to have your staff obtain a copy of a variable annuity contract. Then, read it, and see how much of it you can understand. I have been in FINRA hearings where a full day of testimony was devoted to

explaining how the products work. Not only do the purchasers not understand what it was that they bought, but in my experience the person selling the product did not understand it either.

In Oregon, variable annuities are securities under our securities act. I was one of the people who testified in favor of that change to our legislature. I can tell you that from the perspective of an attorney who represents senior citizens, the change has been 100% positive. It allows our securities division to protect investors from unscrupulous salespeople, and it has allowed investors to use the securities laws when they have been victimized by unsuitable sales.

Adding variable annuities to the definition of securities in Oregon was not easy, because the insurance lobby fought the change. They argued that it would result in “too much regulation” and that insurance companies would pull out of Oregon if the change was made. That was several years ago, and the sky has not fallen. I would encourage you to check with Oregon’s Division of Consumer and Business Services to ask them what the effect has been.

The insurance lobby argues that these products are insurance products, not securities. In my years of speaking with investors (many of whom are seniors), I can report that they always report that they were sold variable annuities as *investments*. In fact, investors often are surprised to learn that there is an insurance component wrapped into the variable annuity. I have *never* seen an investor who was sold a variable annuity believing it was primarily an insurance product. Variable annuities are a hybrid product that has features of both insurance and securities. They feature a death benefit like a life insurance policy, but the value of the investment is variable, because the performance and value are based on one or more sub-accounts that are part of the investment. The sub-accounts act like mutual funds; they are comprised of securities investments. The differences between a sub account in a variable annuity and a regular mutual fund are that you can sell a mutual fund, and you can choose to buy no-load and low load funds. Sub-accounts in variable annuities have higher fees associated with them, the choices of funds available are limited, and getting rid of the product is expensive.

#### **Civil Liability Provisions.**

I generally favor the civil liability provisions found at section 45. 56.660. They are very similar to the civil liability provisions of other states with blue sky statutes. Under your proposed law, there are appropriate liability sections for sellers, broker-dealers, officers, employees, control persons and investment advisors involved in unlawful transactions. However, there is one section where an amendment would benefit Alaskan citizens. Section 56.660(g)(4) limits the liability of a person who “materially aids” in the sale of a security to those who are broker-dealers, agents, investment advisors and their representatives. Often times, those who materially aid an illegal securities transaction do not fit into one of those narrow categories. For example, I have seen many cases over the years where outside professionals materially aided a securities sale. Frequently, lawyers are material aiders. They should not be treated any more favorably than others who materially aid an illegal sale. Thus I would

recommend that the Alaska statute provide for liability for *any* person who materially aids an unlawful sale. That is the law in Oregon, *see* ORS 59.115, and it works well.

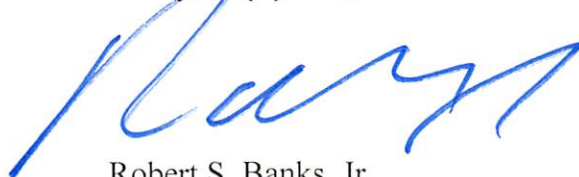
**Administrative Remedies.** These provisions are also well drafted and are an improvement over existing law. They permit the Administrator to seek a court order that would seize assets, impose substantial penalties, and order restitution to victims of unlawful transactions, among other remedies. It is often the state regulators that first learn of a large scale securities fraud. It is critical that the Department of Banking and Securities be given the authority to file a court case and, upon a proper showing, obtain adequate relief for victims. Not only does this make it possible to stop a fraud before additional Alaskans become victims, but it can obviate the need for victims to hire private lawyers to represent them. Lawyers are expensive, and if the state can recover losses for victims, victims are relieved of the need to find, hire, and pay for a competent attorney. Not all attorneys who are hired are competent, and most of them are expensive. It makes more sense to allow the state in appropriate circumstances to prosecute the victims' claims.

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I should close by recognizing your Director of Securities and Banking, Kevin Anselm. She was the Director of Oregon's Securities Enforcement Division before she came to Alaska. Oregon's loss was Alaska's gain. Kevin was highly regarded here, and she has a national reputation among regulators as smart, effective and hard-working. I think she has done an excellent job for Alaska in drafting the updated Alaska Securities Act. I hope that the Alaska legislature has the foresight to take advantage of the work that she, Enforcement Director Kristy Naylor and others have done to make Alaska's blue sky law a shining example for other states to follow.

Please feel free to contact me if you have any questions or if I can provide any additional information.

Very truly yours,



Robert S. Banks, Jr.

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