

Schedule 13
Change Request for FY 10-11 Budget Request Cycle

Request Title: Decision Item FY 10-11 Base Reduction Item FY 10-11 Supplemental FY 09-10 Budget Request Amendment FY 10-11
 Department: Increase Funding for Securities Investigators
 Priority Number: Regulatory Agencies Dept. Approval by: *[Signature]* Date: 10/13/09
 DI-2 OSPB Approval: *[Signature]* Date: 10-15-09

	Fund	1	2	3	4	5	6	7	8	9	10
		Prior-Year Actual FY 08-09	Appropriation FY 09-10	Supplemental Request FY 09-10	Total Revised Request FY 09-10	Base Request FY 10-11	Decision/Base Reduction FY 10-11	November 1 Request FY 10-11	Budget Amendment FY 10-11	Total Revised Request FY 10-11	Change from Base (Column 5) FY 11-12
Total of All Line Items	Total	1,901,902	1,964,886	0	1,964,886	1,985,863	67,848	2,053,711	0	2,053,711	62,620
	FTE	20.0	22.0	0.0	22.0	22.0	1.0	23.0	0.0	23.0	1.0
	GF	0	0	0	0	0	0	0	0	0	0
	GFE	0	0	0	0	0	0	0	0	0	0
	CF	1,901,902	1,964,886	0	1,964,886	1,985,863	67,848	2,053,711	0	2,053,711	62,620
	CFE/RF	0	0	0	0	0	0	0	0	0	0
	FF	0	0	0	0	0	0	0	0	0	0
(10) Division of Securities Personal Services	Total	1,854,133	1,903,823	0	1,903,823	1,935,256	61,670	1,996,926	0	1,996,926	61,670
	FTE	20.0	22.0	0.0	22.0	22.0	1.0	23.0	0.0	23.0	1.0
	GF	0	0	0	0	0	0	0	0	0	0
	GFE	0	0	0	0	0	0	0	0	0	0
	CF	1,854,133	1,903,823	0	1,903,823	1,935,256	61,670	1,996,926	0	1,996,926	61,670
	CFE/RF	0	0	0	0	0	0	0	0	0	0
	FF	0	0	0	0	0	0	0	0	0	0
(10) Division of Securities Operating Expenses	Total	47,769	61,063	0	61,063	50,607	6,178	56,785	0	56,785	950
	FTE	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	GF	0	0	0	0	0	0	0	0	0	0
	GFE	0	0	0	0	0	0	0	0	0	0
	CF	47,769	61,063	0	61,063	50,607	6,178	56,785	0	56,785	950
	CFE/RF	0	0	0	0	0	0	0	0	0	0
	FF	0	0	0	0	0	0	0	0	0	0

Letternote revised text:
 Cash Fund name/number, Federal Fund Grant name: Division of Securities Cash Fund #244
 IT Request: Yes No
 Request Affects Other Departments: Yes No If Yes, List Other Departments Here:

CHANGE REQUEST for FY 2010-11 BUDGET REQUEST CYCLE

Department:	Department of Regulatory Agencies
Priority Number:	DI-2
Change Request Title:	Increased Funding for Securities Investigators

SELECT ONE:

- Decision Item FY 2010-11
- Base Reduction Item FY 2010-11
- Supplemental Request FY 2009-10
- Budget Request Amendment FY 2010-11

SELECT ONE:

Supplemental or Budget Request Amendment Criterion:

- Not a Supplemental or Budget Request Amendment
- An emergency
- A technical error which has a substantial effect on the operation of the program
- New data resulting in substantial changes in funding needs
- Unforeseen contingency such as a significant workload change

Short Summary of Request:

This is a request for an additional \$67,848 cash funds spending authority and 1.0 FTE in FY 2010-11 for a Securities Investigator to address a substantial increase in the number of complaints received from the citizens of Colorado, to handle a substantial increase in the number of formal enforcement actions filed, to handle a substantial increase in the length of time needed to bring enforcement actions to resolution through the investigatory and prosecutorial phases of enforcement, and to maintain an effective enforcement program dedicated to successful consumer protection. This request annualizes to \$62,620 cash funds and 1.0 FTE in FY 2011-12.

Background and Appropriation History:

The strategic goal of the Enforcement Section of the Division of Securities is to protect citizens by deterring investment fraud activity through timely and thorough investigations and enforcement action. The Enforcement Section seeks to protect the investing public from unethical and unlawful activities, including:

- Those committing securities fraud;
- Dishonest and unethical sales practices by licensed securities professionals;

- Sales of unregistered, nonexempt securities; and
- Sales of securities by unlicensed securities professionals.

The Enforcement Section reviews complaints and referrals, open cases, investigates the cases, refers some for enforcement action, and closes the others. The range of enforcement actions includes issuing a warning letter, obtaining a cease and desist order from the Securities Commissioner, obtaining injunctive relief and monetary damages from the Denver District Court, and referring the case to criminal prosecutors for criminal sanctions. Specific Division enforcement activities include:

- ❖ review of complaints or referrals from:
 - consumers/investors identifying alleged misconduct;
 - the Examination Section of the Division based upon their audits of licensed entities;
 - licensed securities professionals identifying alleged misconduct;
 - referrals from state and federal regulatory agencies like the Securities and Exchange Commission;
 - referrals from local, state, and federal law enforcement agencies and prosecuting agencies such as local District Attorney Offices.
- ❖ investigation of complaints against licensees and against unlicensed individuals/business entities to:
 - obtain evidence of potential violations of law,
 - identify grounds for statutory disqualification or appropriate administrative, civil and criminal sanctions, and
 - establish priorities in enforcement/investigatory matters;
- ❖ prepare and assist in litigation and post conviction appeal processes;
- ❖ provide training, expert witnesses in support of securities charges filed by local and state prosecutors, and subject matter expertise to local and state investigatory and prosecutorial agencies.

Investigators spend approximately 80% of their time on actual investigations. This involves obtaining financial information and documents through administrative

subpoenas from targets of the investigation or third parties like banks, mortgage companies, title companies, transfer agents, etc. Investigators also take sworn testimony from individuals under investigation and third parties. Investigators routinely interview consumers/investors and other witnesses to determine the events that lead to the filing of a complaint. The investigators then organize the information and either prepare a justification memorandum for referring the matter for enforcement action, or for closing the investigation. The remaining 20% of their time is spent testifying in hearings, attending training, and performing administrative tasks.

The Division is organized into two sections: Examination and Enforcement. The Enforcement Section consists of the following FTE:

Fiscal Year	Number of Investigator FTEs	Number of Auditor FTE's
From 1994 to 2005	7	1
2005-06	7	1
2006-07	7	2
2007-08	7	2
2008-09	7	2

As can be seen from the graph, the Division has not added an investigator for over fifteen (15) years, the same since 1994. In FY 2006-07, the Division added an auditor. The auditors assist the investigators with their investigation by providing expert analysis of bank records obtained in any investigation, and providing expert witness testimony at the hearings.

Subject to the investigative resources of the Division, enforcement cases are opened upon a complaint alleging misconduct. If sufficient misconduct is determined, a case is filed in court in order to obtain sanctions against the violator (including fines and restitution). The number of sanctions is a direct reflection of how sophisticated and extensive the misconduct that occurred and this in turn reflects how much investigative work is required after the case is opened.

Because of the Enforcement Section's small staff size, the Division has created a list of Priority Factors to assist the Chief Investigator with the triage and prioritization of investigations of alleged misconduct. These Priority Factors are the primary factors used to determine if a complaint identifying such misconduct is an isolated incident by one individual against one or a very small number of individuals or if the complaint is indicative of a large systemic fraud scheme perpetrated over and over against a large number of consumer/investors with larger losses. This triage and prioritization of investigations has resulted in an increase in the number of formal enforcement actions filed and the number of sanctions obtained over the past four years.

While the number of enforcement cases filed saw a dramatic drop in FY 2008 to twenty-six actions filed, these twenty-six actions resulted in sanctions against ninety individuals/business entities for violating the Act. This increase in the number of sanctions generated by a smaller number of actions filed is one indicator that the complexity of each case handled by the Division is growing in complexity with more and more fraudulent schemes seeing more than one or two individuals involved in the violative activity. The following chart illustrates this:

Enforcement Actions Filed and Sanctions Issued

Fiscal Year	Number of Enforcement Cases	Number of Enforcement Filings	Number of Sanctions Issued
2004-05	314	19	36
2005-06	260	31	38
2006-07	220	43	64
2007-08	211	50	78
2008-09	165	38	100

Based on triage and prioritization of investigative resources toward the most egregious violative conduct, the Division, while striving to review every complaint received, does not have the resources to adequately investigate every complaint received and/or to support the additional formal enforcement actions filed as a result. Full investigative resources from the filing of a complaint through the resolution of a complaint by imposed sanctions during the past 4 plus fiscal years have been devoted to approximately the percentage of complaints received as identified in the following chart:

Percentage of Open Enforcement Cases Worked Through Issuance of Sanctions

Fiscal Year	Number of Open Enforcement Cases	Number of Case Filings	Percentage of Cases worked through Issuance of Sanctions
2004-05	314	19	6%
2005-06	260	31	12%
2006-07	220	43	20%
2007-08	211	50	24%
2008-09	165	38	23%

As previously stated, subject to the investigative resources of the Division, enforcement cases are opened upon a complaint alleging misconduct. If sufficient misconduct is determined, a case is filed in court in order to obtain sanctions against the violator (including fines and restitution). The number of sanctions is a direct reflection of how sophisticated and extensive the misconduct that occurred and this in turn reflects how much investigative work is required after the case is opened.

The chart above shows that less enforcement cases can be opened, and less case filings are being made as a result. However, this is not the result of less misconduct, particularly in these economic times; rather, an increasing complexity of cases being investigated is resulting in an investigative bottleneck. This trend is evidenced through increasing numbers of sanctions for each open case (see table on previous page).

FY 2008-09 Performance	Number of Open Enforcement Cases	Number of Case Filings	Percentage of Cases worked through Issuance of Sanctions
With 7 Investigators (status quo)	165	38	23%
With 8 Investigators (decision item)	173	46	27%

The addition of a single investigator through this decision item request is expected to enable the number of case filings to increase by 8 cases. Given the current climate and the fact that Division resources have prevented opening more cases (rather than less misconduct), the Division believes that this will in turn generate 8 cases filed. Using FY 2008-09 numbers, the positive affect of the added investigator can be illustrated (see above). While the resulting increased percentage of the total amount of complaints worked through the imposition of sanctions (27%) may seem small at a 4% increase, this represents a significant improvement in that it is expected to return the ability to investigate cases to FY 2006-07 and FY 2007-08 levels even as the number of sanctions on each case has grown dramatically.

General Description of Request:

The Division requests one additional FTE Criminal Investigator to address a substantial increase in the number of complaints of alleged misconduct received by the Division, a substantial increase in the number of filed formal enforcement actions, a substantial increase in the number of respondents/defendants against whom sanctions are imposed for behavior in violation of the Act and to achieve necessary staffing levels to maintain effective consumer/investor protection through continued successful enforcement actions.

Complaints and New Investigations Volume. The volume of complaints received and investigatory matters generated as a result has seen a steady increase over the past four years, eleven months and is projected to continue to increase through June 2008, the end of FY 2008-09. This indicator is useful for understanding the Enforcement Section's activities, but should not be considered a performance measure and does not include a target that the Division will strive to reach in future years.

Fiscal Year	No. of Complaints Received	No. of New Investigations
2004-05	Did not Track	123
2005-06	175	129
2006-07	203	132
2007-08	179	137
2008-09	183	139

Complexity of Investigative Matters. Since FY 2004-05 the Division has seen a steady rise in the number of months it has taken to handle a complaint from the month the complaint was received through the imposition of sanctions and a steady rise in the total ordered restitution as a result of ever increasingly complex fraudulent schemes the Division must unravel before sanctions can be imposed as indicated by the following chart:

Fiscal Year	No. of Case Filings	Length of Time from Complaint Received To Sanctions Imposed (Average)	Total Ordered Restitution
2004-05	19	29 Months	\$ 15,421,278
2005-06	31	43 Months	\$ 1,930,000
2006-07	43	45 Months	\$ 2,650,000
2007-08	50	50 months	\$ 3,097,549
2008-09	38	52 Months	\$ 8,697,758

Consequences if Not Funded:

If this request is not funded, there are insufficient resources available to conduct an effective investigation into every complaint filed. The Division employs a triage and prioritization process to determine the most egregious complaints/fact patterns to then focuses its resources on these complaints. Lower level violative conduct is rarely investigated due to the limited enforcement resources available to the Division, which in turn, creates a “selective enforcement” aura in Colorado. This type of environment may create a perception that enforcement against securities violators is lax in Colorado and potentially lead to further abuses and fraudulent schemes designed to separate consumers/investors from their hard earned savings.

Calculations for Request:

Summary of Request FY 2010-11	Total Funds	General Fund	Cash Funds	Reappropriated Funds	Federal Funds	FTE
Total Request	\$67,848	\$0	\$67,848	\$0	\$0	1.0
<u>Division of Securities</u>						
Personal Services	\$61,670	\$0	\$61,670	\$0	\$0	1.0
Operating Expenses	\$6,178	\$0	\$6,178	\$0	\$0	0.0

Summary of Request FY 2011-12	Total Funds	General Fund	Cash Funds	Reappropriated Funds	Federal Funds	FTE
Total Request	\$62,620	\$0	\$62,620	\$0	\$0	1.0
<u>Division of Securities</u>						
Personal Services	\$61,670	\$0	\$61,670	\$0	\$0	1.0
Operating Expenses	\$950	\$0	\$950	\$0	\$0	0.0

Assumptions for Calculations:

FTE and Operating Costs					Grand Total		
Fiscal Year(s) of Request		FY 10-11	FY 11-12	FY 12-13	FY 10-11	FY 11-12	FY 12-13
PERSONAL SERVICES	Title:	Criminal Investigator I					
Number of PERSONS / class title		1	1	1			
Number of months <u>working in</u> FY 09-10, FY 10-11 and FY 11-12		12	12	12			
Number months <u>paid in</u> FY 09-10, FY 10-11 and FY 11-12 ¹		12	12	12			
Calculated FTE per classification		1.0	1.0	1.0	1.0	1.0	1.0
Annual base salary		\$55,260	\$55,260	\$55,260			
Salary		\$55,260	\$55,260	\$55,260	\$55,260	\$55,260	\$55,260
PERA	10.15%	\$5,609	\$5,609	\$5,609	\$5,609	\$5,609	\$5,609
Medicare	1.45%	\$801	\$801	\$801	\$801	\$801	\$801

FTE and Operating Costs					<i>Grand Total</i>		
Fiscal Year(s) of Request		FY 10-11	FY 11-12	FY 12-13	FY 10-11	FY 11-12	FY 12-13
Subtotal Personal Services at Division Level		\$61,670	\$61,670	\$61,670	\$61,670	\$61,670	\$61,670
OPERATING EXPENSES							
Supplies @ \$500/\$500 ²	\$500	\$500	\$500	\$500	\$500	\$500	\$500
Computer @ \$900/\$0	\$900	\$900	\$0	\$0	\$900	\$0	\$0
Office Suite Software @ \$330/\$0	\$330	\$330	\$0	\$0	\$330	\$0	\$0
Office Equipment @ \$3,998/\$0 (includes cubicle and chair)	\$3,998	\$3,998	\$0	\$0	\$3,998	\$0	\$0
Telephone Base @ \$450/\$450 ²	\$450	\$450	\$450	\$450	\$450	\$450	\$450
Leased Space (150 SF/FTE estimated at \$25.00/SF)					\$0	\$0	\$0
Hardware/Software Maintenance (\$155/FTE)					\$0	\$0	\$0
					\$0	\$0	\$0
Subtotal Operating Expenses		\$6,178	\$950	\$950	\$6,178	\$950	\$950
GRAND TOTAL ALL COSTS		\$67,848	\$62,620	\$62,620	\$67,848	\$62,620	\$62,620

- Assumptions included in the above table can be found in the Governor’s Office of State Planning and Budgeting FY 2010-11 Budget Instructions.
- This request assumes that the 1.0 FTE increase can be accommodated within the Department’s current quantity of leased space.

Cash Funds Projections:

Cash Fund Name	Cash Fund Number	FY 2008-09 Expenditures	FY 2008-09 End of Year Cash Balance	FY 2009-10 End of Year Cash Balance Estimate	FY 2010-11 End of Year Cash Balance Estimate	FY 2011-12 End of Year Cash Balance Estimate
Division of Securities	213	\$3,268,298	\$287,452	\$287,452	\$287,452	\$287,452

Cash Fund						
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Impact on Other Government Agencies: Not Applicable.

Cost Benefit Analysis:

The fundamental philosophy behind securities regulation is the goal of investor protection and establishing the “rules of the game” so as to maintain the integrity of the market. When the rules are obeyed, the securities markets work and drive investment in the economy. When rules are disobeyed, the markets lose credibility and people stop investing.

Given that Division resources have not been sufficient to maintain caseload of the last several years, the additional cases made possible by the added investigatory staff are expected to produce violations. If increasing the number of complaints investigated will result in an increase of sanctions imposed annually per new investigator, the Division will be able to take a giant step forward in enhancing investor protection and investor confidence. The additional presence of having more “cops on the beat” in the regulated community will foster a heightened awareness by both licensed and unlicensed individuals that the Division is here to enforce is Securities Laws.

Simply stated, the benefit of hiring one criminal investigator is the handling of an additional 7-8 new complaints from receipt through the imposition of sanctions per new investigator hired. This increase in the number of new complaints handled through to imposed sanctions for violative conduct will potentially increase the number of sanctions imposed from 100 during FY 2008-09 to approximately one hundred fourteen (114) at the end of the first twelve months from date of hire. For FY 2008-09, an average of \$86,978 in restitution was ordered per sanction (\$8.6 million actual in FY 2008-09 divided by 100 actual sanctions in FY 2008-09). In FY 2007-08, an average of \$39,712 in restitution was ordered per sanction (\$3.1 million actual FY 2007-08 divided by 78 sanctions in FY 2007-08). Although restitution varies in a given year, at either rate the additional 14 sanctions are expected to greatly exceed the costs of adding an investigator.

Even more conservatively, the cost benefit also looks positive comparing restitution simply with case filings, regardless of the number of sanctions involved. Restitution values per case filed, on average, have been \$134,034 over the most recent two years. If increasing the number of investigations of complaints and cases filed results in even one successful enforcement action with restitution ordered, the cost benefit of the additional investigator is positive. The following table illustrates this cost benefit calculation:

Restitution values per case filed, on average, have been \$134,034 over the past two years. If the increase of investigations conducted of filed complaints results in even one successful enforcement action in which restitution is ordered, the cost benefit of the additional one investigator is positive.				
Benefit	Dollars	Cost	Net Savings	Ratio
One successful restitution order at average-per-case of \$134,034	\$134,034	\$67,848	\$66,186	0.98

The costs are justified and can be reasonably absorbed by the industry. Phenomenal growth in the industry has lead to very low fees in Colorado, and the Division presently has the lowest fees in the nation. A one dollar increase in fees can fund \$157,666. The Division can meet its priorities and still limit the cost of regulation.

Implementation Schedule:

Task	Month/Year
FTE Hired	July 1, 2010, or as soon as possible thereafter

Statutory and Federal Authority:

Colorado Securities Act 11-51-101 through 908 (includes the Local Government Investment Pool Trust Fund Administration and Enforcement Act); the Colorado Municipal Bond Supervision Act 11-59-101 through 120; and the Colorado Commodity Code 11-53-101 through 210

11-51-101, C.R.S. (2008): (1) This article shall be known and may be cited as the "Colorado Securities Act". (2) The purposes of this article are to protect investors and maintain public confidence in securities markets while avoiding unreasonable burdens on participants in capital markets. This article is remedial in nature and is to be broadly construed to effectuate its purposes. (3) The provisions of this article and rules made under this article shall be coordinated with the federal acts and statutes to which references are made in this article and rules and regulations promulgated under those federal acts and statutes, to the extent coordination is consistent with both the purposes and the provisions of this article.

11-59-104, C.R.S. (2008): (1) The securities commissioner is hereby empowered to administer and enforce all provisions of this article and to provide the division with such books, records, files, and printing and other supplies and such officers and clerical and other assistance as may be necessary in the commissioner's discretion to perform the duties required of the securities commissioner under this article, subject to appropriations made by the general assembly.

Performance Measures:

There are two applicable Strategic Objectives that have a direct strategy nexus with this request. The first, that citizens of Colorado are protected from investment fraud through fair and just enforcement of licensure standards for stockbrokers and investment advisors, depends on sufficient investigatory resources to examine complaints. The second, that citizens are protected by deterring investment fraud activity through timely and thorough investigations and enforcement actions, is more specifically relevant to this request. Investigations are opened when a complaint has been reviewed and assessed for violations of the Colorado Securities Act. This request will directly facilitate the existing strategy to meet this important measure by providing sufficient investigative resources.