

NASAA Insight

The Voice of State & Provincial Securities Regulation

Summer 2011



NASAA Spotlights Dodd-Frank Investor Protections

NASAA President David Massey, North Carolina's Deputy Securities Administrator, came to Washington July 12 to testify before the Senate Banking Committee during a hearing on how the Dodd-Frank Act has enhanced investor protection as the law's one-year anniversary approaches.

Massey highlighted several critical investor protections achieved by the Dodd-Frank Act, including incorporating disqualification provisions to prevent securities law violators from conducting securities offerings under SEC Regulation D, Rule 506; strengthening the accredited investor definition; and increasing state regulatory oversight of investment advisers.

Dodd-Frank also includes a provision to safeguard senior investors from unqualified advisers and creates an investor advisory committee to advise the SEC on its regulatory priorities.



NASAA President and N.C. Deputy Securities Administrator David Massey testifies before the Senate Banking Committee on July 12.

In two other priority areas for investors, fiduciary duty and arbitration, the law authorizes the SEC to take action to provide enhanced protections and remedies for investors.

"The Dodd-Frank Act provides meaningful, tangible benefits to investors," Massey testified. "What NASAA asks of Congress is simple and clear: please continue your commitment to protecting investors and do not weaken the critical investor protections of Dodd-Frank either directly through legislative repeals or indirectly through a lack of adequate funding."

Responding to a question from Committee Chairman Tim Johnson (D-SD), Massey pressed for the full and timely implementation of Dodd-Frank investor protections because "the landscape is still littered with victims of the financial crisis."

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NASAA Issues Advisory to Retail Investors About ETFs

Exchange-traded funds (ETFs) have grown increasingly popular with retail investors during the last decade. In June, NASAA issued an advisory cautioning investors to make sure they understand ETFs before they invest and consider whether these investments are right for them.

"As with any investment, investors should know what they are investing in. They should understand the risks, costs and tax consequences before investing in ETFs. Check under the hood," said NASAA President and North Carolina Deputy Securities Administrator David Massey.

Exchange-traded funds are baskets of investments such as stocks, bonds, commodities, currencies, options, swaps, futures contracts and other derivative instruments that are created to mimic the performance of an underlying index or sector.

While ETFs are often compared to mutual funds and

marketed to investors seeking safe, stable investments, not all ETFs are the same. NASAA's advisory notes that some traditional ETFs may be appropriate for long-term holders, but others, including exotic leveraged and inverse ETFs, may require daily monitoring.

Two years ago, state securities regulators identified unsuitable ETF sales as a top threat to Main Street investors.

"We continue to actively scrutinize a variety of issues related to ETF sales practices, such as point of sale disclosures, and the suitability of these products, particularly inverse and leveraged ETFs for long-term investors," Massey said.

The NASAA advisory outlines several risks associated with ETFs, including liquidation, tax consequences and fees. The advisory is available at www.nasaa.org.

President's Message: David Massey



With the implementation phase of Dodd-Frank underway, it is important for state securities regulators and our colleagues at the Securities and Exchange Commission to engage in productive discussions about how our shared responsibilities can better protect investors.

The state-federal partnership is the critical element in an effective investor protection regulatory structure. Collaboration between regulators is vitally important because we must leverage our collective resources to protect investors.

NASAA's legislative agenda for 2011 makes a strong call for Congress to resist attempts to undermine Dodd-Frank, either directly through legislative repeals or indirectly through a lack of appropriate funding. I reiterated that position this month in my Senate Banking Committee testimony.

NASAA has urged Congress to provide the SEC with the resources it needs to fulfill all that is required under Dodd-Frank. Under the leadership of Chairman Mary Schapiro, the SEC has a renewed determination to return to our joint mission of protecting the public from investment fraud.

The combined efforts of state and federal regulators are necessary to protect the integrity of the marketplace and to shield consumers from fraud and abuse.

As the work to implement Dodd-Frank continues, I am pleased to note the Act's recognition of the strong investor protection role of state securities regulators. I commend each and every NASAA member agency for exemplifying the value added to investor protection by having a strong system of state securities regulation.

We've been doing this work for 100 years now and I am proud to see us continue building on that century-old foundation as we look forward to the next century of investor protection. We'll be celebrating our centennial anniversary at our annual conference in Wichita, Kansas, in September, and I look forward to seeing many of you there.

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Executive Director's Message: Russ Iuculano



It is sobering to see that momentum is gaining for the efforts to slow down or scale back various parts of the Dodd-Frank Act. The Republican majority in the House continues a concerted campaign to derail investor protections outlined in Dodd-Frank through multiple oversight hearings, funding roadblocks and a number of bills proposing "corrections" to the reform law.

So far this year there have been three waves of attacks on this vital investor protection legislation. The first wave consisted of the prolonged debates concerning adequate funding of the Securities and Exchange Commission and the Commodity Futures Trading Commission, two of the agencies that will implement much of Dodd-Frank.

The second wave crashed on the Consumer Financial Protection Bureau with the nomination of former Ohio Attorney General Richard Cordray to lead the agency

as Senate Republicans promised to block any nominee unless changes were made to various aspects of the CFPB.

The third wave threatens to swamp provisions in the law that would restrict the use of derivatives.

We are even waging a fight against preemption following the approval by the House Financial Services Committee of a bill (H.R. 1070) that seeks to exempt securities offerings of up to \$50 million from SEC registration and includes language preempting state authority to review a new class of offerings similar to Regulation A offerings.

But as this month's Senate Banking Committee hearing proved, there is room for hope. Dodd-Frank is working to protect investors (see page 7). The committee appears ready to fight those who seek to derail Dodd-Frank's implementation. I agree with committee Chair Tim Johnson's view that "we must give these provisions a chance to work to protect investors and American families who depend on our financial system."

Dodd-Frank Updates

SEC Proposes Rule 506 Bad Actor Disqualifications

The SEC has voted to propose rules mandated by the Dodd-Frank Act to deny certain securities offerings from qualifying for exemption from registration if they involve certain “felons and other bad actors.”

Under the proposal, an offering would be unable to rely on an exemption from registration if the company issuing the securities or any other person covered by the rule had a “disqualifying event.”

NASAA has long advocated disqualification provisions for securities offerings under Rule 506 and commends the SEC for proposing provisions that are in line with many of the comments made by NASAA in a November 2010 comment letter, NASAA President David Massey said.

“While the SEC’s proposed rule is a good starting point, some adjustments are needed to provide adequate investor protection and to provide for greater uniformity,” Massey said.

For example, the disqualification provisions should, among other requirements, apply to all private offerings under Regulation D, not just those offered under Rule 506.

Bill Could Boost Risky Reg A Offerings; Preempt State Authority to Review

The House Financial Services Committee in June approved the Small Company Capital Formation Act, which would increase the offering threshold for companies exempted from SEC registration under Regulation A to \$50 million from the current level of \$5 million.

The bill also could preempt state authority to review Regulation A offerings.

“The changes proposed by H.R. 1070 would give small, untested companies all of the benefits of a public offering, but would strip the Regulation A exempt offerings of all investor protections,” NASAA President David Massey said. “As currently drafted, H.R. 1070 focuses entirely on the desires of the small business issuer and ignores the need for reasonable investor protections that are currently contained in existing law.”

Given the speculative nature of the businesses that would take advantage of the changes proposed by H.R. 1070, NASAA is concerned that the legislation would open up a quasi-public market without the market integrity and investor protections that currently exist in both the public offering and exempted offering setting. “It would result in the broad marketing and sale of the riskiest, most speculative securities to the least sophisticated investors,” Massey said.

Bill Offers Vague Language on Private Equity Fund Adviser Exemption

The House Financial Services Committee in June approved H.R. 1082, the Small Business Capital Access and Job Preservation Act, which would exempt private equity fund advisers from SEC registration requirements.

“While NASAA understands the desire to facilitate job creation, creating exemptions from important investor protection statutes may not be the best option,” Massey wrote in a letter to the committee’s leadership.

NASAA is concerned that at least two fundamental components of the proposed legislation are so vague that they undermine any benefits the bill purports to confer on small business.

For example, the legislation does not define “private equity fund” but instead delegates this task to the SEC, which is required within six months after enactment of the legislation to define the term. “It seems unwise to establish an exemption before defining what is covered by the exemption,” Massey said.

The bill also is unclear about what, if any, reporting requirements are required for private equity fund advisers.

In a related development, NASAA is reviewing comments received on its proposed model rule that would exempt certain advisers to private funds from state registration. A revised draft has been published on the NASAA website at www.nasaa.org.

As published, the proposal would exempt advisers to 3(c)(7) funds from registration with the states but require those funds to file reports to the states. The reports would include the same information required by the SEC for advisers to private funds.

NASAA Brings Investor Education Resources to Capitol Hill



NASAA distributed a variety of investor education resources to congressional staff at the annual Financial Literacy Day on Capitol Hill.

Will Washington Choose Investors?

NASAA Hosts Spring Public Policy Conference in Washington, D.C.

State and provincial securities regulators convened in Washington, D.C. this spring to discuss the ongoing implementation of financial regulatory reform and encourage lawmakers to maintain a strong system of state and federal investor protection.

Following the signing of the Dodd-Frank Wall Street Reform and Consumer Protection Act in July 2010, lawmakers and federal regulators turned their attention to writing the more than 200 rules that will determine whether the Act's investor protection goals are realized.

The North American Securities Administrators Association (NASAA) hosted its annual Spring Public Policy Conference to ask the question, "Will Washington choose investors?"

"The passage of Dodd-Frank was just the beginning," said NASAA President and North Carolina Deputy Securities Administrator David Massey. "State securities regulators are working to ensure that the investor protections promised in Dodd-Frank are not weakened or delayed by funding constraints."

The conference opened with a keynote luncheon featuring noted political commentator Norman Ornstein, resident scholar at the American Enterprise Institute.

The conference also featured two panel discussions. The first panel, "Dodd-Frank Implementation: The Future of Financial Reform," spotlighted the impact of reform on investors. Moderated by Pennsylvania Securities Commissioner Steven Irwin, the panel included Florida Securities Division Director Franklin Widmann, Ohio Securities Commissioner Andrea Seidt and Maryland Securities Commissioner Melanie Lubin.

The second panel, "Exotics in the Neighborhood," took a look at structured products and other exotic choices increasingly offered to retail investors. Peter Cassidy of the Massachusetts Securities Division moderated the panel, which featured Jim McTague, Washington editor for Barron's; Mark Carver, director of iShares Product Management for BlackRock; and Elisha Tuku, executive director of Morgan Stanley.

Also at the conference, NASAA awarded the organization's highest honor, the Blue Sky Cube, to retiring securities commissioners Ralph Lambiase of Connecticut and Denise Voigt Crawford of Texas in recognition of their many years of leadership and service to NASAA and investors throughout North America.



NASAA President and North Carolina Deputy Securities Administrator David Massey opens NASAA's 2011 Spring Public Policy Conference in Washington, D.C.



Conference Chair Mark Minor, chief of the New York Investor Protection Bureau, welcomes attendees to the 2011 NASAA Spring Policy Conference in Washington, D.C. on March 28.

SEC Commissioner Aguilar Commends NASAA for acting as “stalwart champion” of investors

Adapted from March 28 remarks to NASAA by SEC Commissioner Luis Aguilar.

Increased communication and cooperation between us have many benefits, but they ultimately lead to the same result — greater protection of investors and the promotion of a fair and orderly capital market that benefits participants and investors alike.

I was particularly interested in this year’s conference theme — “Will Washington Choose Investors?” There is no more important question that can be asked. To put the focus on investors is of critical importance right now as federal regulators translate the legislation into rules that will determine whether the investor protection goals of the Dodd-Frank Act are realized.

For the last several years, we have been engaged in an uphill fight to restore the securities regulation framework at global, federal and state levels to where it should be.

This attack comes on multiple fronts — from the negative consequences of underfunding the SEC to continuing efforts by the industry to claw back or delay implementation of new authority provided by the Dodd-Frank Act.

In this country, regulating the securities marketplace has long been a partnership between the SEC and the

state regulators. NASAA has been a forceful and reliable advocate for investors and the American public, and I have been privileged to work with you on many issues. We are in this together, and I commend all of you for the work you do as regulators.

NASAA and its members have been very active in speaking on behalf of investors — whether it has been to champion the fiduciary standard, a higher standard than that currently in place, for broker-dealers who render investment advice, or to work toward enhancing protection for investors in private placements.

I’ve also greatly appreciated NASAA’s support for the SEC to be appropriately resourced. Just two weeks ago, your President, David Massey, sent a letter to Congressional leaders urging them to provide the SEC with needed resources.

NASAA has been a stalwart champion of investors, and your contribution to this dialogue is essential.

I thank you — both SEC staff and NASAA members — for your efforts, and I express my gratitude for the tireless work to come. I also ask you to send me your thoughts on the ways the Commission and NASAA can work together to leverage our expertise and increase our protection of investors.

Join Us as We Celebrate the Next Century of Investor Protection



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Wichita, Kansas

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Courts Side with NASAA in Two Major Cases

Billitteri vs. Securities America

NASAA joined Massachusetts and Montana in opposing certain provisions of a prospective class action settlement that could undermine state regulatory action and limit remedies available to investors.

NASAA filed a brief in U.S. District Court Northern District of Texas Dallas Division in March urging the court to deny a request for a preliminary injunction to halt administrative proceedings brought by state regulators against Securities America Inc. and Securities America Financial Corporation and other defendants.

Following a hearing in federal court, the preliminary injunction was denied.

"Investors and state securities regulators have won a significant legal victory," NASAA President David Massey said following the ruling. "This case could have had a

"Investors and state securities regulators have won a significant legal victory."

David Massey
NASAA President
N.C. Deputy Securities Administrator

chilling effect on all state securities regulators seeking restitution on behalf of investors. The court's decision means that defendants cannot use the federal courts to evade investors or state securities regulators."

State securities regulators in Massachusetts and Montana initiated investigations into allegations of wrongdoing by Securities America and others involving the offer and sale of private placements.

In its brief, NASAA said: "The state regulators have dedicated significant resources and expended great effort in the course of these investigations and now face the potential of having this Court halt those proceedings."

The plaintiff's request to enjoin the state regulators would have terminated the efforts of the Massachusetts and Montana regulators. It also would have sent a clear message to other state securities regulators that despite their clear statutory authority to take steps necessary to police illicit conduct in their states, they potentially face having that authority impaired by defendants who could run to federal courts to plead poverty, NASAA said in its brief.

In May, Securities America reached a settlement agreement with Massachusetts, agreeing to pay \$2.8 million to the affected Massachusetts investors and an additional \$2.2 million if the class action settlement does not move forward.

Mathers Family Trust, et al. v. Cagle

In May, a Colorado appellate court issued an opinion consistent with the views outlined in a NASAA amicus brief in a case involving choice of law and forum selection provisions.

NASAA had filed an amicus brief in June 2010 in the Mathers Family Trust, et al. v. Cagle, et al. case, with the Colorado Court of Appeals.

In this case, the plaintiffs were purchasers of investments sold by a Colorado energy company. After losing substantial sums of money on the oil and gas ventures, the investors sued in Colorado district court. The investors' claims were dismissed by the district court, based on the forum selection clauses in the parties' agreements, which called for litigation in Texas.

In its brief, NASAA argued that choice of law and forum selection provisions in the documents used by investors to purchase interests in the oil and gas ventures were void for the following reasons:

- they run counter to the plain language and legislative history of the Colorado Securities Act;
- other state courts uniformly recognize that choice of law provisions in securities agreements are void;
- waiver provisions are void per the Colorado Securities Commissioner; and
- the lower court's decision conflicts with the policies underlying state securities laws.

"Colorado victims must have the ability to bring successful civil actions in Colorado against those who exploit the public," NASAA's brief said.

On May 12, 2011, the Colorado court issued an opinion declining to enforce the forum selection clauses.

The Court reasoned that for the anti-waiver provision of the Colorado Securities Act to adequately protect investors' rights, when those rights may not be enforceable in a different jurisdiction, investors must be permitted to bring their claims in Colorado.

The Colorado Court of Appeals reversed the trial court's dismissal and remanded the case for further proceedings.

NASAA anticipates that the defendants will petition for certiorari in the Colorado Supreme Court.

Read the full text of NASAA's amicus briefs and find more legal news on the NASAA website at www.nasaa.org.



Dodd-Frank's Key Investor Protections

The following is adapted from the written testimony of NASAA President David Massey before the Senate Banking Committee's July 12, 2011 hearing on "Enhanced Investor Protections After the Financial Crisis."

The Wall Street reforms and investor protection provisions in the Dodd-Frank Act were born out of necessity. The financial crisis made it clear that the existing securities regulatory landscape required an overhaul. This comprehensive law was crafted to promote stronger investor protection and more effective oversight to help prevent another economic crisis and restore the confidence of Main Street investors.

Reducing Investor Risk in Rule 506 Offerings

Section 926 of the Dodd-Frank Act took a necessary first step toward reducing risks for investors in private offerings by requiring the SEC to issue rulemaking excluding securities law violators from utilizing the Regulation D, Rule 506 exemption from securities regulation. In 1996, the National Securities Markets Improvement Act dramatically curtailed the authority of state securities regulators to oversee these unregistered private offerings. Rule 506 offerings are also exempted from federal oversight and the SEC generally does not review them, so they receive virtually no regulatory pre-screening. These unregistered private offerings naturally have become a favorite vehicle for unscrupulous promoters, who use the Rule 506 exemption to fly under the radar. Under Dodd-Frank, promoters and brokers who have a criminal or disciplinary history will no longer be able to prey on investors by using this exemption from registration.

Strengthening the "Accredited Investor" Standard

Private offerings were originally intended only for institutional investors and sophisticated individuals who were presumed capable of assessing risks and making investment decisions without the benefit of regulatory review and registration. The "accredited investor" standard was adopted as a means of assessing which investors could presumably fend for themselves. The standard as adopted by the SEC in 1982 has remained unchanged.

Section 412 addressed this problem by adjusting the financial thresholds in the definition of an "accredited investor", and by removing the value of the investor's primary residence from the net worth calculation. Dodd-Frank also directs the SEC to regularly review the definition of "accredited investor."

Expanding State Oversight of Investment Advisers

Congress recognized the strong record of the states in this area when it enacted Section 410 of Dodd-Frank to expand state authority to include mid-sized investment

advisers with \$25 million to \$100 million in assets under management. Having the states assume responsibility for mid-sized advisers will allow the SEC to focus on larger advisers. Investors will benefit from this change because it will enable the SEC to focus on the largest investment advisers, while mid-sized and smaller advisers will be subject to the strong state system of oversight and regulation.

Extending the Fiduciary Duty

Section 913 of the Dodd-Frank Act called for the SEC to examine the obligations of brokers, dealers, and investment advisers. We support the recommendations of the SEC staff report to apply a fiduciary duty to broker-dealers who provide personalized investment advice about securities to retail customers and believe it will have a significant positive impact on investors. NASAA looks forward to assisting the Commission as it develops rules to apply a fiduciary standard of care and loyalty to all who provide investment advice to ensure that this standard is as strong as the existing fiduciary duty of the Advisers Act.

Giving Investors a Voice at the SEC

Section 911 requires the SEC to establish and maintain a committee of investors to advise the SEC on its regulatory priorities and practices and also designated that a state securities regulator continue to serve as a member. SEC Commissioner Luis Aguilar recently said that this committee is of "critical importance to ensuring that the SEC is focused on the needs and the practical realities facing investors." Unfortunately, budget uncertainty has forced the SEC to defer the creation of this Investor Advisory Committee.

Providing Choice of Forum for Investors

Mandatory arbitration provisions in brokerage contracts take away the ability of a harmed customer to "have their day in court" by forcing investors into an industry-run arbitration forum. Section 921 of Dodd-Frank provides the SEC with rulemaking authority to prohibit, or impose conditions or limitations on the use of mandatory predispute arbitration agreements, and Congress should urge the SEC to use this authority.

Safeguarding Senior Investors

Section 989A of Dodd-Frank recognizes the harm to seniors posed by unqualified advisers and establishes a mechanism for providing grants to states that have enacted rules or laws protecting seniors against misleading designations. The grants are designed to give states the flexibility to use funds for a wide variety of senior investor protection efforts. Unfortunately, these grants have been indefinitely delayed.

Read the full testimony at www.nasaa.org.

NASAA: Because Every Investor Deserves Protection

About Us

The North American Securities Administrators Association (NASAA) is a voluntary association of securities administrators in the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada and Mexico.

Organized in 1919, NASAA is the oldest international organization devoted to investor protection.

As the preeminent organization of securities regulators, NASAA is committed to protecting investors from fraud and abuse, educating investors, supporting capital formation and helping ensure the integrity and efficiency of financial markets.



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Sept. 10-13, 2011

The NASAA Insight is a quarterly publication of the North American Securities Administrators Association.

Switch Update

SEC Implements IA Switch Rules; Extends Deadline into 2012

The Securities and Exchange Commission in June formally adopted rules to implement the switch of mid-sized investment advisers from federal to state registration. The Commission also voted to extend the deadline for this regulatory switch into mid-2012.

The SEC had initially proposed a target date of October 19, 2011 to complete the switch to state oversight of IAs with assets under management of between \$25 million and \$100 million.

In an April letter to NASAA President David Massey, the SEC staff indicated that the necessary reprogramming of the Investment Adviser Registration Depository (IARD) system to facilitate the switch would not be completed until the end of this year.

The SEC also approved a similar delay for the "private fund adviser" registration deadlines. Section 403 of the Dodd-Frank Act repeals, as of July 21, 2011, the private adviser

exemption in section 203(b)(3) of the Investment Advisers Act, and provides a new exemption for advisers to venture capital funds and advisers to private funds with less than \$150 million in assets under management in the United States. Both of these exemptions required rulemaking by the Commission.

"State securities regulators continue to plan to handle the mechanics of the transition in accordance with the SEC's schedule," Massey said.

"For advisers, the extra time generally means those contemplating switching shouldn't have to worry about making their filings until next year," Massey said.

Investment advisers should check with their state securities regulator for guidance, Massey said.

For additional information about the switch, visit the IA Switch Resource Center on the NASAA website at www.nasaa.org.