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NASAA Insight

The Voice of State & Provincial Securities Regulation

NASAA

NASAA President to Financial Crisis Investigators: Preemption, Deregulation Contributed to Collapse

NASAA President and Texas Securities Commissioner Denise Voigt Crawford went before the Financial Crisis Inquiry Commission on Jan. 14 to testify that a series of actions by Congress and the courts to preempt the regulatory authority of state securities regulators contributed to the ongoing financial crisis.

"As the regulators closest to investors, state securities regulators provide an indispensable layer of protection for Main Street investors," Crawford testified. "Our presence did not contribute to the crisis; rather, the fact that our regulatory and enforcement roles had been eroded was a significant factor in the severity of the financial meltdown."

NASAA President Denise Voigt Crawford testifies before the Financial Crisis Inquiry Commission on Jan. 14, 2010.

Crawford's testimony came during the first public hearings held by the 10-member bipartisan panel since it was established by Congress to examine the causes of the crisis.

Crawford urged the Commission to consider how the aggressive investor protection role of state securities regulators may be expanded through the restoration of regulatory authority that was preempted by the National Securities Markets Improvement Act of 1996 (NSMIA).

Calls for preemption of state regulatory authority or for more authority for self-regulatory organizations "defy common sense," Crawford said. "The evidence clearly demonstrates that the state-federal regulatory structure actually works for the investor," she said.

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Groups Urge Senate to Enact a Pro-Investor Fiduciary Duty

NASAA was one of seven organizations to express strong support for an investor protection provision in the Senate's draft regulatory reform bill that would require all those who offer investment advice to be held to the highest standard of care for their clients – the Investment Advisers Act fiduciary duty.

In a joint letter to Chairman Christopher Dodd (D-Conn.) and Ranking Member Richard Shelby (R-Ala.) of the Senate Banking Committee, the organizations urged the Senate to resist industry efforts to cripple critical consumer protections provided by the "Restoring American Financial Stability Act of 2009" (RAFSA).

Also signing the letter were the Consumer Federation of America, Fund Democracy, the Investment Adviser Association, Certified Financial Planner Board of Standards, Inc., the Financial Planning Association and the National Association of Personal Financial Advisors.

In particular, the organizations noted that Section 913 of RAFSA accomplishes the goal of providing benefits to investors by imposing a fiduciary duty on all providers of investment advice "in a straightforward and sensible fashion by eliminating the broker-dealer exclusion from the (Investment Advisers) Act." The broker-dealer exemption allows brokers to avoid registering as advisers if the advice they provide to clients is "solely incidental" to selling securities.

"For too long, brokers have been free to market themselves as trusted advisers and offer extensive advisory services without having to meet the fiduciary standard appropriate to that role," the organizations said. The draft bill "eliminates the legislative loophole that has allowed this dual standard to persist."

"Unfortunately, some in the industry who have for years actively marketed themselves to investors as trusted advisers are resisting regulation as advisers," they added.

Investors will only benefit from the fiduciary provision of the Senate draft bill "if Congress resists efforts to scale back and water down critical protections provided by the legislation, efforts that have been advanced through a campaign of misinformation and mischaracterization. We urge you to stand up for investors by standing up to those who would undermine these important investor protections," they concluded.

President's Message: **Denise Voigt Crawford**

As the preeminent organization of securities regulators, the North American Securities Administrators Association (NASAA) has served as a visible and proactive advocate for the regulatory reforms necessary to strengthen investor protection.

I have addressed Congress, the media, federal regulators and others involved in the policy-making process to urge them to resist intense pressure by financial services industry interests to weaken regulatory reform legislation.

While high times may have returned to Wall Street, hard times persist on Main Street. Investors remain outraged as they continue to suffer the consequences of the unbridled risk-taking and large-scale financial fraud that shook through financial markets last year. Congress must not squander this opportunity to provide meaningful investor protection reforms.

NASAA supports the intelligent and comprehensive approach to regulatory reform offered by the Restoring American Financial Stability Act of 2009 Discussion Draft presented in November by Senate Banking Committee Chairman Christopher Dodd (D-Conn.) and the Wall Street Reform and Consumer Protection Act passed by the House of Representatives in December. These measures will go far toward ensuring that investors – particularly senior investors – receive the protection they deserve.

NASAA will continue to play an active, vocal role in the legislative process to ensure that the vital components of regulatory reform are not sacrificed due to industry pressure.

What's Inside

Executive Director's Message: **Russ Iuculano**

The NASAA Corporate Office remains committed to achieving President Crawford's oft-stated goal of making our regulatory framework better for Main Street investors.

Our focus is now on engaging the Senate Banking Committee as it develops its regulatory reform legislation to continue the progress made by the House of Representatives.

The Senate Banking Committee is under intense pressure by financial services industry interests who have launched a full-scale campaign in an effort to weaken the regulatory improvements necessary to strengthen investor protection.

NASAA joined with six other groups - representing state securities regulators, investors, and members of the investment adviser and financial planning professions - in sending a letter to the Senate Banking Committee to rebut misinformation on the Senate bill's fiduciary requirement for investment advice. (For more on NASAA's financial regulatory reform policy positions, please turn to page 4 of this edition of the *NASAA Insight*.)

As regulatory reform in the Senate slowly moves forward, the NASAA Corporate Office has pledged to increase the flow of information to the membership to ensure each member jurisdiction is apprised of new developments.

State securities regulators have a long history of serving as a forceful and unified voice on behalf of the investing public. NASAA members must all do their part to encourage their state representation in Congress to help us achieve our shared goal of securing passage of meaningful regulatory reform legislation.

Danger Lurks on Free Lunch **Menu**

NASAA, AARP Report Results of Program Monitoring Senior Investment Seminars

More than three-quarters of older Americans are concerned that financial scams will damage their retirement nest eggs or those of someone they know, AARP and NASAA recently announced.

In a survey released by AARP, *Protecting Older Investors: 2009 Free Lunch Seminar Report,* 78 percent of Americans age 55 and over surveyed indicated that they are very or somewhat concerned about financial scams affecting them or someone they know. Fraudsters commonly engage older individuals by soliciting them to attend free lunch or dinner seminars to learn more about investing in retirement.

Nearly 6 million Americans age 55 and older have attended a free lunch or dinner in the past three years. For attendees of these free seminars, the potential cost can be quite high. Of those who attended a seminar, more than three out of four (78 percent) expected that the free financial seminar would center on opportunities to learn more about financial issues. However, once at the seminar, half said the presenter asked for personal information, such as contact information or information about their finances. Nearly 40 percent reported that the presenter tried to sell them financial products either during or after the seminar.

In response to such solicitations, AARP and NASAA launched the Free Lunch Monitor program in 2008 to raise public awareness about the possible dangers of attending free lunch seminars. Program participants also are encouraged to complete a checklist after attending a seminar. After a year of collecting checklists, volunteers reported that many seminars focused on different types of annuities, with 39 percent encouraged to purchase one, and nearly half said that the speaker did not discuss the risks associated with the annuity. Attendees were consistently promised that products were "low risk" or that they would yield "high rates of return."

"Low risk, high reward is a red flag warning for possible investment fraud," said NASAA President and Texas Securities Commissioner Denise Voigt Crawford. "Defrauding our senior population is unconscionable and protecting senior investors is a top priority of state securities regulators."

NASAA Meets the Press

NASAA President Denise Voigt Crawford is joined by officials from the National Press Club following her participation in the Press Club's Newsmakers series, which allows leading figures in public affairs to meet the press in Washington, D.C. During the event, President Crawford urged Congress to stand firm in the face of intense industry lobbying to dilute and derail financial services regulatory reform. Coverage of the event appeared in The Washington Post, Dow Jones and the Associated Press, among others.

NASAA Announces IARD System Fee Waiver

Ongoing Success of IARD System Allows Waivers to Continue through 2010

NASAA recently announced it will waive the initial set-up and annual system fees paid by investment adviser firms and investment representatives to maintain the Investment Adviser Registration Depository (IARD) system.

Denise Voigt Crawford, NASAA President and Texas Securities Commissioner, said, "The IARD system promotes effective and efficient investor protection through readily accessible disclosure of important information to the public while at the same time offering a consistent and streamlined registration process for investment advisers and their representatives. Given the current economic climate, we are pleased that the IARD system's continued success will allow us to maintain the system fee waivers put in place in 2005 for investment adviser firms and also to fully waive for a second year the system fees paid by investment adviser representatives."

NASAA's Board of Directors approved the system fee waiver and will continue to monitor the system's revenues to determine future fee adjustments.

Behind the **Crisis**

NASAA President and Texas Securities Commissioner Denise Voigt Crawford appeared before the Financial Crisis Inquiry Commission to focus on the ***role of state securities regulators*** *in the current financial crisis, and to provide the Commission with recommendations to enhance states' ability to* ***pursue financial fraud*** *and* ***prosecute the perpetrators*** *of those crimes. The following is an excerpt. Full testimony is available at the NASAA website: www.nasaa.org.*

By nature, we are the first line of defense for Main Street investors and for us, enforcement is a top priority. Through the years, states have been the undisputed leaders in criminal prosecutions of securities violators because we believe in serious jail time for securities-related crimes. We have successfully exposed and addressed the profound conflicts of interest among Wall Street stock analysts by requiring changed behavior. We led all regulators on late trading and market timing in mutual funds. We address on a daily basis abusive sales practices especially those targeting vulnerable senior investors.

State securities regulators continue to lead the effort to ensure that investors receive redemptions for their frozen auction rate securities that were marketed as safe and liquid investments, an effort that already has resulted in the largest return of funds to investors in history. In the last few years, state securities regulators have been at the forefront of investor protection. Our record demonstrates clearly that we have the will and ability to regulate.

Deregulation is no longer the presumptive policy prescription; indeed today, the sense is that the current crisis was deepened by excessive deregulation. Similarly, the naiveté behind the view that markets are always self-correcting now seems apparent. But clearly, reliance by the investing public on federal securities regulators, self-regulatory organizations (SROs) and "gatekeepers" in the years preceding the crisis (and in its very midst) to detect and prevent even the most egregious of frauds and deceit was equally naïve.

The most obvious developments over the past 15 years have been the rapid succession of market scandals. These seem disproportionate in both frequency and severity to prior periods in U.S. financial history. A consequence of these scandals has been that state regulators have become the dominant players in addressing many financial scandals.

The National Securities Markets Improvement Act of 1996 (NSMIA) significantly impacted the role of state regulators and enforcers in dealing with securities offerings and professionals. NSMIA preempted many state regulations and transferred significant enforcement responsibilities from the states to the federal government. NSMIA also prevented the states from taking preventative actions in areas that we now know to have been substantial contributing factors to the current crisis. One example is private placement offerings made under Regulation D Rule 506.

Private placements are exempt from federal registration and for all practical purposes exempt from federal oversight. While there may be federal requirements for private placements to come within the scope of Rule 506, in reality there is no federal regulatory enforcement. The SEC does not review Form D filings and rarely investigates Rule 506 offers.

NSMIA's preemption of state regulation of private placements, therefore, created a regulatory black hole - today no one regulates these offerings. The bottom line is that NSMIA hampers the states' ability to investigate known securities law violators when they become participants in subsequent offerings. We are constantly faced with playing catch up and often the result is that new investors are harmed before we can investigate and take enforcement action. Criminals have been given the upper hand and regulators are forced to triage investor harm in a cycle that plays out again and again.

As the regulators closest to investors, state securities regulators provide an indispensable layer of protection for Main Street investors.

Also of note is that NSMIA, as originally conceived, stripped the SEC of two Commissioners and 20 percent of its budget. Therefore it does not take an extreme cynic to view NSMIA's preemption primarily as deregulation, rather than a systematic apportionment of appropriate responsibilities between federal and state regulators. This politically driven reality lessens the temptation to view this issue as part of the broader philosophical debate on federalism and the recurring question of appropriate state and federal roles for securities regulation.

Increasingly, state securities regulators have played a far more aggressive role in prosecuting systemic securities fraud. State securities regulators were ahead of the SEC in the investigation of securities analyst conflicts and "market timing" in mutual funds. The same can be said for the Enron investigation, where the Securities Bureau of the New York Attorney General used New York's unusually flexible securities law to investigate the role of the investment banks in the Enron fraud. Once again, state securities regulators were "out in front of" the SEC and the investigations by the New York Securities Bureau created pressure on the SEC to act, which they did by settling with the banks. Indeed, at the time of New York's investigation, it was unclear whether the SEC intended to pursue the banks at all, let alone aggressively.

More recently, state securities regulators have been the most aggressive enforcers in the auction rate securities cases, negotiating settlements with the major investment banks totaling well over $150 billion. The New York Securities Bureau reached the first settlements with the credit rating agencies. State securities regulators have also played a significant role in resolving similar cases.

Not only have the state securities regulators frequently been first, they have been tougher. A recent study of the restitution involved in mutual fund cases is particularly revealing. It compares restitution in cases involving both a state securities regulator and the SEC, with those involving the SEC alone. The study concluded that the cases with both "prosecutors" yielded considerably higher restitution ratios. It appears that, far from monitoring the securities markets and securities industry in order to detect and terminate abusive and illegal practices, the SEC was often prompted into action only after state regulators had unearthed them. The SEC took no public action with respect to the ARS matter until August 7, 2008, when its enforcement chief announced a preliminary settlement with Citigroup compatible with the agreements already reached with members of NASAA.

Our presence did not contribute to the crisis; rather, the fact that our regulatory and enforcement roles had been eroded was a significant factor in the severity of the financial meltdown.

State securities regulators respond to investors who typically call them first with complaints or request information about securities firms or individuals. They work on the front lines, investigating potentially fraudulent activity and alerting the public to problems. Because they are closest to the investing public, state securities regulators are often first to identify new investment scams and to bring enforcement actions to halt and remedy a wide variety of investment-related violations. The $61 billion returned to investors to resolve the demise of the ARS market is the most recent example of the states initiating a collaborative approach to a national problem.

The unique experiences of state securities regulators on the front lines of investor protection have provided the framework for my testimony. As the regulators closest to investors, state securities regulators provide an indispensable layer of protection for Main Street investors.

As the Commission continues to examine the causes of our current financial crisis and develop recommendations to prevent a reoccurrence, I respectfully suggest that the Commission consider how the role of state securities regulators may be expanded through the restoration of authority that was preempted over the past 14 years. NASAA's recommendations include: restoring state regulatory oversight of all Regulation D Rule 506 offerings; restoring certain provisions of the Glass-Steagall Act; increasing state regulation of investment advisers; establishing a Systemic Risk Council with state financial regulatory participation; deputizing state securities attorneys to leverage talent and resources in all jurisdictions and at the federal level; providing additional resources to uncover and prosecute securities fraud cases; conducting a thorough review of all civil and criminal remedies to ensure that they more effectively deter misconduct; and reexamining and removing the hurdles facing private plaintiffs in private actions.

Our presence did not contribute to the crisis; rather, the fact that our regulatory and enforcement roles had been eroded was a significant factor in the severity of the financial meltdown.

A **Long** and **Winding** Road

Congress Inches Toward Financial Services Regulatory Reform

The legislative battle over the restructuring of the financial regulatory system in the United States has taken several twists and turns as it wends its way through Congress.

In December 2009, the U.S. House of Representatives approved HR 4173, "The Wall Street Reform and Consumer Protection Act." The legislation provides meaningful investor protection reforms and acknowledges the important role of state securities regulators. Sen. Chris Dodd's effort to launch the Senate's version of regulatory reform was stalled in November amid strong industry opposition. A revised draft remains under development.

"The Wall Street Reform and Consumer Protection Act is an important step toward better protecting investors," said Denise Voigt Crawford, NASAA President and Texas Securities Commissioner. "NASAA commends the House for putting the interests of Main Street investors ahead of Wall Street. We also applaud Representatives Barney Frank (D-Mass.) and Steve Cohen (D-Tenn.) for their leadership in successfully sponsoring a floor amendment to strike the language that would have permitted FINRA to regulate investment advisory activities of its broker-dealer members."

> ***NASAA commends the House for putting the interests of Main Street investors ahead of Wall Street.***

The Cohen-Frank amendment stripped from the bill a provision that would have allowed the SEC to delegate expanded supervisory responsibility to FINRA, the broker-dealer membership organization. This expanded authority would have incorporated oversight of the investment advisory activities of FINRA's current member firms.

"This rulemaking authority potentially could have been used by FINRA to weaken the fiduciary duty requirements of its membership under the guise of a 'harmonized' fiduciary standard," Crawford said. "NASAA remains opposed to any effort to expand the jurisdiction and authority of private membership organizations into an area that is more appropriately the province of government. For decades the regulation of investment advisers has been the responsibility of state and federal governments, both of which are transparent and accountable to the investing public. Extending this broad responsibility to a private membership organization amounts to an 'outsourcing' of a critical government regulatory obligation."

As passed by the House, the Wall Street Reform and Consumer Protection Act contained several other provisions related to state securities regulatory authority, including:

Financial Services Oversight Council

A state securities administrator was added as a nonvoting member of the Council through the efforts of Chairman Frank and Reps. Paul Kanjorski (D-Penn.) and Dennis Moore (D-Kan.). Also, clarifying language was added that the nonvoting members will be included in all Council meetings, proceedings, discussions and deliberations. "The responsibility of identifying and managing systemic risk should not be assigned to a single agency, but instead should be the responsibility of a council comprised of state and federal regulators," Crawford said. "Because we are closest to the investing public, state securities regulators are often first to identify new investment frauds and to bring enforcement actions to halt and remedy a wide variety of market-wide investment-related violations."

Consumer Financial Protection Agency

Language was added to exclude state-registered investment advisers from the oversight of the CFPA. Also, a savings clause was added to clarify that all federal and state securities activity is excluded from the jurisdiction of the CFPA. "There was no rationale for differentiating the SEC's jurisdiction from that of state securities regulators," Crawford said. "State jurisdiction in this context is complementary but not overlapping and we are pleased that our concerns were addressed in the approved legislation."

Increased State Investment Adviser Authority

The threshold for state-registered investment advisers was raised to $100 million from $25 million assets under management. The sponsors of the bill also included a mandate that investment advisers are "regulated and examined or required to be regulated and examined" by a state for the threshold to be raised in that state. The manager's amendment also added language to permit an investment adviser with AUM between $25 million and $100 million, which registers with five or more states, to maintain its registration with the Commission. "The state system of investment adviser regulation has worked well with the $25 million threshold since it was mandated in 1996," Crawford said. "The states have developed an effective regulatory structure and enhanced technology to oversee investment advisers. Increasing the threshold to $100 million would reduce the SEC's examination burden and allow the agency to focus on larger firms and other market issues."

Enhanced Investor Protection for Seniors

Chairman Barney Frank's Manager's Amendment to H.R. 4173 included language that creates an Office of Financial Protection for Older Americans within the Consumer Financial Protection Agency. The function of this office is to facilitate the financial literacy of individuals age 62 and older to help protect them from unfair and deceptive practices and educate them on their financial choices. This office is directed to coordinate consumer protection efforts with other federal and state regulators. The Senior Investment Protection Act, which is based on adoption of NASAA's senior designation model rule, was incorporated into the bill passed by the House and has been included in the discussion draft of the Senate regulatory reform bill.

Many of the provisions that NASAA advocated also were included in a discussion draft issued by Senate Banking Chairman Christopher Dodd (D-Conn.), outlining his vision for regulatory reform. They include: raising the state IA AUM threshold to $100 million from $25 million; adjusting the accredited investor standard for inflation; including a state securities administrator on the SEC's Investor Advisory Committee; removing the broker-dealer exclusion from the Investment Advisers Act; providing private rights of action to investors for aiding and abetting violations; restoring state authority over Regulation D Rule 506 offerings; including the Senior Investment Protection Act; and giving the SEC the authority to ban mandatory predispute arbitration in securities cases.

"The comprehensive proposals offered by Chairman Dodd would help usher in a new era of protection for millions of Main Street investors," Crawford said. "These proposals are a very positive step in the right direction toward restoring the accountability and responsibility that are required to strengthen investor protection and rebuild confidence in our nation's financial markets and their regulators."

As expected, the Senate proposals came under serious attack by industry lobbyists. In response to the resistance to the discussion draft by committee Republicans and some Democrats, Chairman Dodd began negotiations with committee members from both parties.

In December, NASAA urged members of members of Congress to resist intense pressure by financial services industry interests to weaken the regulatory improvements necessary to strengthen investor protection. "Powerful interests in the financial services industry have aligned to delay, derail and distort the regulatory changes to the status quo that are necessary to strengthen investor protection," Crawford said at a National Press Club Newsmakers event. "While high times may have returned to Wall Street, hard times persist on Main Street. Congress must not squander this opportunity to provide meaningful investor protection reforms."

Powerful interests in the financial services industry have aligned to delay, derail and distort the regulatory changes to the status quo that are necessary to strengthen investor protection.

As the new year began, President Obama sought to jumpstart the financial services regulatory reform debate by proposing two "common sense" reform initiatives that would have to be incorporated into the legislation moving on Capitol Hill. One proposal, backed by former Federal Reserve Chairman Paul Volcker, would prevent commercial banks and institutions that own banks from owning and investing in hedge funds and private equity firms, and limit the trading they do for their own accounts. A second proposal seeks to limit the size of any one financial firm in relation to the entire sector by updating the current 10 percent cap on the share of insured deposits. Under the White House plan, the limitation would take into account nondeposit funding.

Chairman Dodd said he would study the President's proposal "and will give it careful consideration as the committee moves forward on financial reform."

In the meantime, industry lobbyists continued to assault the reform proposals.

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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NASAA Awards

NASAA Honors Members for Outstanding Service to Investors

NASAA recently recognized several individuals within member jurisdictions for their outstanding service to investors.

During the 2010 Winter Enforcement Conference, Kevin Anselm of Oregon was presented with the NASAA Distinguished Service Award for her leadership on the negotiating team that led to a settlement with Prosper Marketplace Inc.

Several members also were presented with NASAA's Outstanding Team Service Award for their efforts on the Auction Rate Securities Task Force, which resulted in the largest return of funds to investors in history.

They include: Cheryl Farson, Arizona; Ronak Patel, Texas; and Peter Dean, New York.

In addition, special recognition was awarded to task force members: Pat Ahearn, Angela Angelakos, Peter Cole, Bill Donahue, Zesley Haislip, Judi Lahr, Jennifer Monopoli, Jim Nix, Jerry Rome, Nathan Soendker, and MaryBeth McWilliams.

During the 2009 NASAA Investor Education Training Seminar, Andrew Roth of California and Gena Wilimitis of New Mexico were presented with NASAA's Distinguished Service Award in Investor Education. Roth was recognized for his leadership on the NASAA IE Section Rapid Response team, while Wilimitis was honored for her service on the Affinity and Military Outreach Project group and for her efforts on behalf of investors in New Mexico, specifically frequently victimized populations including religious groups, women in transition and Native Americans.

Awards from NASAA's Investor Education Presentations Outreach program were presented to Illinois and West Virginia.