I. INTRODUCTION

A. BACKGROUND

The Task Force on the Future of Shared State and Federal Securities Regulation (the "Task Force") was convened by the North American Securities Administrators Association, Inc. ("NASAA") in October 1995 to recommend ways in which more efficient and effective combined state and federal regulation can be provided to the U.S. securities markets without sacrificing investor protection or eroding investor confidence in the marketplace. The Task Force was asked to consider appropriate divisions of authority between state and federal regulatory authorities in light of the increased globalization of the securities markets, the speed at which electronic media have enhanced information flow, the limited resources regulatory authorities have at their disposal to monitor drastically expanding securities markets, the partial delegation of regulatory oversight to various self-regulatory organizations ("SROs") and the need for modernization of regulatory systems and techniques.

The concept of the Task Force had its genesis at a strategic planning meeting sponsored by NASAA in September 1994. The purpose of the meeting was to debate changes which state regulatory authorities could implement to streamline the capital-raising process while maintaining investor confidence in the fairness of the markets. Subsequently, consideration was given to convening a second summit consisting of representatives of state and other regulatory bodies, industry, the bar and academia to further explore these issues.

In the summer of 1995, Congressman Jack Fields of Texas introduced a sweeping legislative proposal in the U.S. House of Representatives to modernize both federal and state securities regulation.[1] In response to the legislative proposals, and in lieu of a summit meeting,

1 The Capital Markets Deregulation and Liberalization Act of 1995, H.R. 2131, 104th Cong., 2d Sess. (1995).

NASAA decided to convene the Task Force, a fourteen-member panel of regulatory, industry, legal and academic experts.

The Task Force has spent many hours debating the rationale for and the costs and benefits of reallocating regulatory responsibility between federal and state securities authorities regarding investment advisers, investment adviser representatives, broker-dealers, securities agents, sales of securities by issuers and secondary trading of securities. The Task Force also has focused its attention on issues relating to enforcement actions by multiple regulatory and law enforcement authorities.

In October 1996, Congress passed the National Securities Markets Improvement Act of 1996 (the "1996 Act"),[2] providing for extensive redistribution of regulatory authority between federal and state securities regulators. Consequently, the regulatory landscape as it exists today looks very different than it did when the Task Force began its work in November 1995. Several issues that were under consideration by the Task Force have now been addressed by the 1996 Act, and thus are not discussed in this Report.

The Task Force debated whether this Report should focus on broad policy issues related to the dual federal-state regulatory structure, or whether the Report should propose more specific and narrow recommendations. After considerable discussion, it was the sense of the members of the Task Force to concentrate on specific recommendations that would build upon the policies set forth in the 1996 Act, rather than attempt to revisit or revise those issues resolved by Congress. This Report thus addresses areas of state and federal securities regulation not covered by the 1996 Act, and certain new issues raised by the passage of the legislation.

There existed a diversity of views amongst the members of the Task Force concerning many of the recommendations contained in this Report. Although all members of the Task

2 National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (1996).

Force agree with the general thrust of the Report, not every member necessarily concurs with each specific recommendation contained herein.

B. GUIDING PRINCIPLES

In the course of our discussions, the Task Force identified several guiding principles we believe are important to bear in mind in designing and implementing a securities regulatory system for the future. These guiding principles are:

1. State securities regulation should facilitate national and international securities offerings.
2. State securities regulation should consist of a system of uniform statutes, rules and guidelines, that, to the maximum extent practicable, are uniformly adopted and administered by all states.
3. Cooperation and coordination among the states and between the U.S. Securities and Exchange Commission, the self-regulatory organizations and the states are imperative to an effective regulatory system and should be institutionalized to the extent possible.
4. Consistent with the above objectives, state securities regulation should remain responsive to local interests, needs and concerns.
5. The sophisticated and highly developed U.S. capital markets are respected across the globe. It is vital that investors continue to perceive that the markets are fair and honest. Therefore, all decisions with regard to regulatory design should give careful consideration to impacts on investor protection and the global marketplace.
6. The users of the capital markets are very diverse, and include entrepreneurs seeking start-up capital, small savers needing advice on retirement planning,

large multinational corporations raising capital through U.S. and international securities offerings and trustees of enormous pension funds making thousands of investment decisions in the course of a year. Various components of the securities industry address these differing needs and it is important that regulatory systems be sufficiently multifaceted and flexible to permit effective and efficient regulation that maximizes the possibility that all capital market users will be well served.

7. The capital markets are subject to continuing and sometimes dramatic change. Such change has resulted, in part, from increasing globalization and rapidly evolving information technology. New electronic communication systems, in particular, have the potential to facilitate the work of every participant in the capital markets. These systems may enhance capital formation on the one hand and enable acceleration and better concealment of fraudulent schemes on the other. In addition, information posted on the Internet about securities offerings may call into question at least two components of traditional securities regulation in the United States: (1) the regulation of securities *offers*, as opposed to *sales*; and (2) regulatory jurisdiction based on geographic boundaries, whether state or national.

8. All regulation entails costs, some obvious and others hidden. Securities regulatory costs are necessary to achieve investor protection and enhanced confidence in the markets. However, designers of regulation should seek to reduce costs as much as possible through regulations and regulatory tools that are, to the extent possible, clear, simple, uniform and reasonable.

C. SUMMARY OF RECOMMENDATIONS

REGISTRATION OF INVESTMENT ADVISERS AND INVESTMENT ADVISER REPRESENTATIVES

1. The Securities and Exchange Commission and state securities regulatory authorities should monitor the implementation of the recently mandated division of authority to register investment advisers,[3] focusing on its impact on protection of retail investors.

2. The Securities and Exchange Commission should permit federal registration, in lieu of state registration, of an investment adviser that has obtained the consent of the state administrator in which its principal place of business is located.

3. State securities regulatory authorities should develop regulations with respect to investment advisory practices for those investment advisers that will be regulated solely by one or more states pursuant to the National Securities Markets Improvement Act of 1996.[4] These regulations should parallel federal standards, powers and procedures, where appropriate, in order to ensure continuity in regulation and ease the transition when moving from one regulatory regime to another.

4. The Securities and Exchange Commission and state securities regulatory authorities should coordinate regulatory systems to enhance investor protection, avoid inconsistent requirements, and assure that transference from one system to the other will not be unduly burdensome for investment

---

3 Under the 1996 Act, the jurisdiction of state securities regulatory authorities to register investment advisers is limited to those advisers with assets under management of less than $25,000,000 that are also not advisers to registered investment companies. The Securities and Exchange Commission (the "Commission") has jurisdiction to register investment advisers with assets under management of $25,000,000 or more, advisers to registered investment companies and other investment advisers where state registration would be an unfair or a burden on interstate commerce. 1996 Act, § 303, *supra* note 2.

advisers. Additionally, the Securities and Exchange Commission should be given the authority to impose sanctions or limitations based on actions taken by state securities regulatory authorities. State laws generally encompass the ability to impose sanctions or limitations for violations of federal securities laws.

4 The 1996 Act, *supra* note 2.

5. The Securities and Exchange Commission and state securities regulatory authorities should meet periodically to discuss areas in which additional regulation of investment advisers is needed and areas in which a reduction in regulation is appropriate.

6. States that do not presently provide for oversight of investment advisers locally should do so by adopting laws, regulations, policies and procedures and by requiring registration of firms.

7. States that do not require registration of investment adviser representatives should provide for registration of those investment adviser representatives that are not registered as securities agents.

8. State securities regulatory authorities should streamline procedures for registering investment advisers and investment adviser representatives. State securities regulatory authorities should develop a uniform set of standards and qualifications to be applied universally from jurisdiction to jurisdiction. State legislation may be required now to expedite the use of a centralized electronic registration system for the registration of investment advisers and investment adviser representatives.

9. In light of the prospective availability of disciplinary information on the Central Registration Depository, states should amend their registration procedures for investment adviser representatives so that the registration would permit an individual to continue to render investment advice upon a change in employment, pending approval of the transfer, so long as that individual is employed by a different registered investment adviser.

10. States also should amend their statutes and rules, if necessary, to provide for continuous registration of investment advisers and investment adviser representatives.

11. States should adopt a uniform exemption from registration for an investment adviser representative providing investment advice primarily to institutional investors.

12. State securities regulatory authorities should implement an integrated registration system for investment adviser representatives and securities agents seeking both registrations, and study the feasibility of developing a national license.

REGISTRATION OF BROKER DEALERS AND AGENTS

13. State securities regulatory authorities should continue to streamline and simplify the regulatory system for broker-dealers and securities agents in order to facilitate multiple state registrations and should hold discussions with the various self-regulatory organizations, as necessary, to assure that any changes are coordinated.

14. Securities regulatory authorities in those states where registration of branch offices is required should adopt definitions and registration provisions that are uniform with the requirements imposed by the National Association of Securities Dealers, Inc. so that registration of branch offices can be completed electronically through the Central Registration Depository and multiple filings can be eliminated and definitions are consistent.

15. The Securities and Exchange Commission should adopt appropriate amendments to Rules 17a-3[5] and 17a-4[6] to provide a single, appropriate standard for maintaining broker-dealer books and records. This standard should incorporate provisions necessary for effective state regulation.

16. All securities regulatory authorities should cooperate in and coordinate broker-dealer examination and oversight activities of securities industry participants and should share examination results. To the extent that state freedom of information statutes require disclosure of examination results, state legislatures should adopt specific exemptions authorizing the confidentiality of

---

5 17 C.F.R. § 240.17a-3 (1996).

6 17 C.F.R. § 240.17a-4 (1996).

information obtained in the course of a broker-dealer or investment adviser examination conducted by another regulatory agency.

17. In those states that require registration of issuer-dealers, state securities regulatory authorities should adopt uniform registration standards. Additionally, uniform standards for registration of issuer-agents should also be adopted in those jurisdictions where registration is required.

REGISTRATION OF AND TRADING IN SECURITIES

18. The Securities and Exchange Commission should take into consideration the Memoranda of Understanding entered into by the North American Securities Administrators Association and several stock exchanges when determining whether a stock market's listing standards are substantially similar to the listing standards of the New York Stock Exchange, the American Stock Exchange or the National Market System of the Nasdaq Stock Market for the purposes of designating securities as "covered" for purposes of federal preemption.

19. State securities regulatory authorities should continue to expand the coordinated review programs that are currently in place among states in a region. Such programs are operating in some states for small corporate equity offerings in coordinated equity review program for offerings in amounts under $5,000,000. Additionally, a national coordinated equity review program for offerings in amounts over $5,000,000 should be developed.

20. State legislatures should enact legislation permitting receipt of registration documents and other information by state securities regulatory authorities through systems created for the purpose of facilitating electronic receipt of documents and information.

EXEMPTIONS FROM SECURITIES REGISTRATION

21. Amendments should be made to federal exemptions from securities registration in order to facilitate capital formation by small issuers without sacrificing the integrity of the capital markets. The Securities and Exchange Commission is encouraged to utilize its exemptive authority to achieve this end.

22. State securities regulatory authorities should adopt a uniform Regulation D, Rule 505 private placement exemption and implement it in a uniform manner, and Rule 506 filing procedures should conform to the requirements of the National Securities Markets Improvement Act of 1996.[7]

23. The Securities and Exchange Commission should define "qualified purchaser" for the purpose of identifying a "covered security" under the National Securities Markets Improvement Act of 1996[8] to require higher financial standards than those of an accredited investor but less stringent than those of a qualified institutional buyer. The definition of "qualified purchaser" in the National Securities Markets Improvement Act of 1996[9] amendments to the Investment Company Act of 1940[10] would be appropriate.

24. The model exemption for securities listed in certain manuals containing financial and other information, which was adopted by the North American Securities Administrators Association on April 28, 1996,[11] should be implemented by statute, rule or order in all states.

25. In order to facilitate offerings in the international marketplace, state securities regulatory authorities should uniformly adopt exemptions to facilitate secondary trading of the securities of foreign issuers that meet minimum asset or market capitalization tests, or the securities that are traded on a

7 The 1996 Act, § 102, *supra* note 2.

8 The 1996 Act, § 102, *supra* note 2.

9 The 1996 Act, § 102, *supra* note 2.

10 15 U.S.C. §§ 80a-1 to 80a-52 (1994).

11 NASAA Model Amendments to the Uniform Securities Act of 1956, NASAA Reports (CCH) ¶ 4919 (Oct. 1981, Nov. 1986) [hereinafter the NASAA Model Amendments].

recognized foreign stock exchange. The Securities and Exchange Commission is encouraged to facilitate acceptance of international accounting standards.

26. The Securities and Exchange Commission should adopt rules providing guidance regarding reliance upon the exemption from registration under the Securities Act of 1933[12] for sales of certain instruments.

ENFORCEMENT ACTIONS BY MULTIPLE REGULATORY AND LAW ENFORCEMENT AGENCIES

27. The Securities and Exchange Commission and state securities regulatory authorities, together with the self-regulatory organizations and state and federal criminal authorities, should develop protocols for determining which agency should initiate enforcement action in situations of concurrent jurisdiction, thereby reducing the number of duplicative enforcement actions.

12 15 U.S.C. § 77c(3)(a) (1994).

INTERSTATE COMPACTS

28. State securities regulatory authorities should form one or more interstate compacts for the purpose of promoting uniformity in state regulation. Where necessary, state legislatures should enact enabling legislation to permit the formation of such interstate compacts. In addition, Congress should approve such interstate compacts.

II. TASK FORCE MEMBERS

The Task Force consists of the following members:

Dee Riddell Harris, (Task Force Chairman), Managing Director, Hill Thompson Capital Markets, Inc. Immediate Past Director of Securities, Arizona Corporation Commission; President, North American Securities Administrators Association, Inc. (1995-96).

Philip A. Feigin, Securities Commissioner, Colorado Securities Division; President, North American Securities Administrators Association, Inc. (1994-95).

Mark J. Griffin, Director, Division of Securities, Utah Department of Commerce; President, North American Securities Administrators Association, Inc. (1996-97).

Stephen L. Hammerman, Vice Chairman and General Counsel, Merrill Lynch & Co., Inc.; Chairman, Merrill Lynch, Pierce, Fenner & Smith, Incorporated; New York Regional Administrator, U.S. Securities and Exchange Commission (1979-81).

Theodore A. Levine, Executive Vice President, PaineWebber Incorporated; General Counsel, PaineWebber Group, Inc.; Associate Director, Division of Enforcement, U.S. Securities and Exchange Commission (1978-84).

Hugh H. Makens, Partner, Warner Norcross & Judd LLP; National Association of Securities Dealers, Inc. Legal Advisory Board (1990-94); President, North American Securities Administrators Association, Inc. (1976-77).

Anthony B. Petrelli, Senior Vice President, Neidiger, Tucker, Bruner, Inc.; Chairman, Regional Investment Bankers Association (1995-96).

The Honorable David S. Ruder, the William W. Gurley Memorial Professor of Law and Former Dean (1977-85), Northwestern University School of Law; Senior Counsel, Baker & McKenzie; Chairman, U.S. Securities and Exchange Commission (1987-89).

Joel Seligman, Dean and Samuel M. Fegtly Professor of Law, The University of Arizona College of Law.

Marianne K. Smythe, Partner, Wilmer, Cutler & Pickering; Director, Division of Investment Management, U.S. Securities and Exchange Commission (1990-93).

Richard F. Syron, Chairman and Chief Executive Officer, American Stock Exchange; President, Federal Reserve Bank of Boston (1989-94).

The Honorable Richard Thornburgh, Counsel to Kirkpatrick & Lockhart LLP; Attorney General of the United States (1988-91); Governor, Commonwealth of Pennsylvania (1978-86).

Mark D. Tomasko, Immediate past Executive Vice President and Executive Director, Investment Counsel Association of America, Inc.

The Honorable Steven M. H. Wallman, Commissioner, U.S. Securities and Exchange Commission.

Detailed biographies of the Task Force members appear in Appendix A.

III. TASK FORCE PROCEDURES

The Task Force held nine meetings to discuss the issues presented to it. The following individuals presented testimony before the Task Force: Robert P. Goss, Executive Director, Certified Financial Planner Board of Standards, Inc.; Barry P. Barbash, Director, Division of Investment Management, U.S. Securities and Exchange Commission; Robert Plaze, Assistant Director, Office of Disclosure and Investment Adviser Regulation, Division of Investment Management, U.S. Securities and Exchange Commission; Robert J. Glovsky, Director, Boston University's Program for Financial Planners; Matthew P. Fink, President, Investment Company Institute; Duane Whitt, formerly Chief Operating Officer of SRD, Inc.; Todd Robinson, Chairman and Chief Executive Officer, Linsco/Private Ledger Corporation; James Strickland, General Partner, Coronado Venture Funds; Charles Bennett, Director, Corporate Financing, NASD Regulation, Inc.; Stanley Keller, Esq., Palmer & Dodge; Boston, Massachusetts; Richard Gaudier, Vice President, Merrill Lynch, Pierce, Fenner and Smith, Inc.; Charles Gittleman, Esq., Shearman & Sterling, New York, New York and Denise Voigt Crawford, Commissioner, Texas State Securities Board, President-elect, North American Securities Administrators Association, Inc.

IV. ISSUES AND RECOMMENDATIONS -- REGISTRATION OF INVESTMENT ADVISERS AND INVESTMENT ADVISER REPRESENTATIVES[13]

The Task Force began its discussions regarding the division of authority over registration of investment advisers prior to enactment of the 1996 Act. At that time, there were approximately 22,500 investment advisers registered with the U.S. Securities and Exchange Commission (the "Commission").[14] The Commission staff indicated it did not have the resources to examine all investment advisers routinely. In October 1995, Commission Chairman Arthur Levitt reported that the Commission audits the majority of investment advisers on an average of only once every forty-four years.[15] This was confirmed previously by the findings of a study conducted in 1990 by the U.S. General Accounting Office (the "GAO Report")[16] in which the GAO concluded that Commission oversight of investment advisers did not provide investors with assurance that investment advisers operate in compliance with the provisions of the Investment Advisers Act of 1940 (the "Investment Advisers Act").[17]

---

13 For background information on the registration of investment advisers and investment adviser representatives, *see* Appendix B, page 89, *infra*. The Investment Advisers Act of 1940, the Uniform Securities Act of 1956, and the NASAA Model Amendments Relating to the Regulation of Investment Advisers refer to the registration of investment advisers and investment adviser representatives. In contrast, the Uniform Securities Act of 1985 and some state statutes provide for the licensing of investment advisers and investment adviser representatives. In this report, all references to the registration of investment advisers and investment adviser representatives are intended to encompass the licensing of investment advisers and investment adviser representatives as well.

14 S. 1815, The Securities Investment Promotion Act of 1996: Hearings on S. 1815 Before the Committee on Banking, Housing and Urban Affairs, United States Senate, 104th Cong., 2d Sess. (1996) [Testimony of Arthur Levitt, Chairman, U.S. Securities and Exchange Commission].

15 Address by Arthur Levitt, Chairman, U. S. Securities and Exchange Commission at the NASAA Fall Conference, Vancouver, British Columbia (Oct. 1995). The inspection cycle for large investment advisers is five to six years.

16 U.S. General Accounting Office, *Investment Advisers: Current Level of Oversight Puts Investors at Risk* (June, 1990).

17 15 U.S.C. §§ 80b-1 to 80b-21 (1994).

Prior to the effectiveness of the 1996 Act, state securities agencies had the authority to register and examine the books and records of all investment advisers operating in their states, including all federally registered investment advisers not excluded from the definition of "investment adviser" or exempted from registration by statute or rule. However, state securities agencies, like their federal peers, have limited resources and did not conduct routine examinations of all investment advisers registered by them. Thus, the concerns discussed in the GAO Report also extend to state regulation of investment advisers.

In the 1996 Act, Congress granted to the Commission exclusive authority to register (1) an investment adviser with assets under management of not less than $25,000,000 or such higher amount as the Commission may, by rule, deem appropriate; (2) an investment adviser with less than $25,000,000 in assets under management with its principal office or place of business in a state that does not register investment advisers;[18] and (3) an adviser to an investment company registered under the Investment Company Act of 1940 (the "Investment Company Act").[19] In the 1996 Act, Congress authorized states to register an investment adviser with assets under management of less than $25,000,000 that is not registered with the Commission. The Commission, however, may by rule or regulation upon its own motion, or by order upon application, permit federal registration of any investment adviser to which registration with the states would be unfair, a burden on interstate commerce, or otherwise inconsistent with the 1996 Act.[20] The division in regulatory authority between the Commission and the states will reduce the number of registrants subject to inspection by each regulator.

In the 1996 Act, Congress preserved the authority of states to register an investment adviser representative with a place of business in the state, even if the investment adviser employing the

---

18 The states of Colorado, Iowa, Ohio and Wyoming do not require registration of investment advisers.

19 15 U.S.C. §§ 80a-1 to 80a-52.

20 The 1996 Act, § 303, *supra* note 2. *See also* Rules Implementing Amendments to the Investment Advisers Act of 1940, Advisers Act Release No. 1633, 62 F.R. 28112, at II.D (May 22, 1997).

investment adviser representative has assets under management of $25,000,000 or more. Currently, thirty states and the District of Columbia provide for the licensing of investment adviser representatives.[21]

A. INVESTMENT ADVISERS

Recommendation 1: ***The Securities and Exchange Commission and state securities regulatory authorities should monitor the implementation of the recently mandated division of authority to register investment advisers, focusing on its impact on protection of retail investors.***

The 1996 Act is based on the premise that state securities regulatory authorities need not conduct routine examinations of large investment advisers that are routinely examined by the Commission and that tend to be large money managers servicing high net worth individuals or large institutions. These investment advisers are most likely to be conducting business on a national basis. State securities regulatory authorities are best suited to perform routine examinations of smaller investment advisers, particularly financial planners. The business of

---

21 ALA. CODE § 8-6-3 (1993 & Supp. 1996); ARIZ. REV. STAT. ANN. § 44-3151(A), (B) (Supp. 1996); ARK. CODE ANN. § 23-42-301(c) (Michie 1994 & Supp. 1995); CONN. GEN. STAT. § 36B-6 (1996); DEL. CODE ANN. tit 6, § 7313(a), (b) (1993); D.C. CODE ANN. § 2-2635 (1994); FLA. STAT. ch. 517.12 (1988 & Supp. 1997); GA. CODE ANN. § 10-5-3(a) (1994); HAW. REV. STAT. § 485-14 (1995 & Supp. 1996); IDAHO CODE § 30-1406 (1996); IND. CODE § 23-2-1-8(c) (1993); MD. CODE ANN., CORPS & ASS'NS § 11-401(b), 11-402(b) (1993 & Supp. 1996); MASS. GEN. LAWS ANN. ch. 110A, § 201(C) (WEST Supp. 1996); MISS. CODE ANN. § 75-71-303 (1991); MONT. CODE ANN. § 30-10-201(3) (1995); NEV. REV. STAT. § 90.330(1) (1995); N.M. STAT. ANN. § 58-13B-5 (Michie 1991 & Supp. 1996); N.C. GEN. STAT. § 78C-17 (1990); N.D. CENT. CODE § 10-04-10 (1995); OKLA. STAT. tit. 71, § 201(c)(1) (1995 & Supp. 1997); OR. REV. STAT. § 59.165(1), (2) (1995); 70 PA. CONS. STAT. § 1-301(c)(c.1) (1994); R.I. GEN. LAWS § 7-11-203 (1992); S.C. CODE ANN § 35-1-420 (Law. Co-op. Supp. 1995); S.D. CODIFIED LAWS § 47-31A-201(c) (Michie 1991); TEX. REV. CIV. STAT. ANN art. 581-12 (West Supp. 1997); UTAH CODE ANN. § 61-1-3(3) (1993); VT STAT. ANN. tit. 9 § 4213(f) (Supp. 1995); VA. CODE ANN. § 13.1-504(A) (Michie 1993); WASH. REV. CODE § 21.20.040 (1992). In 1997, the Illinois State Legislature adopted amendments to the Illinois Securities Law to require the registration of investment adviser representatives. See generally 1997 Ill. Legis. Serv. P.A. 90-70 (H.B. 1168) (West).

these firms is most likely local in nature and is carried out within one or a handful of jurisdictions representing regional, rather than national, enterprises.

The Commission and state securities regulatory authorities should monitor implementation of the division of registration authority focusing on its impact on the protection of retail investors. The federal regulatory system has a somewhat different focus than the state regulatory system in that the states register firms and many also register and qualify individuals, while the federal system registers only firms, though it does provide for detailed disclosure of all key individuals' backgrounds. Retail investors, especially small ones, may require additional regulatory protections. Future modifications to the regulatory structure may be appropriate.

Recommendation 2: ***The Securities and Exchange Commission should permit federal registration, in lieu of state registration, of an investment adviser that has obtained the consent of the state administrator in which its principal place of business is located.***

As stated earlier in this report, the Commission may by rule or regulation upon its own motion, or by order upon application, permit federal registration of any investment adviser to which registration with the states would be unfair, a burden on interstate commerce, or otherwise inconsistent with the 1996 Act.[22] An investment adviser's recordkeeping, capital and bond requirements are determined by the state in which its principal place of business is located.[23] Consequently, if a state securities regulatory authority consents to an investment adviser's request that it be registered with the Commission rather than the state, the Commission should permit federal registration of that investment adviser. This provides a more

22 The 1996 Act, § 303, *supra* note 2.

23 The 1996 Act, § 304, *supra* note 2.

effective method of transferring jurisdiction in cases which reflect a national, rather than a regional or local interest.

Recommendation 3: ***State securities regulatory authorities should develop regulations with respect to investment advisory practices for those investment advisers that will be regulated solely by one or more states pursuant to the National Securities Markets Improvement Act of 1996.***[24] ***These regulations should parallel federal standards, powers and procedures, where appropriate, in order to ensure continuity in regulation and ease the transition when moving from one regulatory regime to another.***

A comprehensive framework exists for the regulation of federally registered investment advisers, based on the Investment Advisers Act, Commission rules and "no-action" letters, and on federal court decisions. The applicability of the federal regulatory framework to the regulation of small investment advisers is uncertain due to the division in authority to register investment advisers. The regulatory framework in many states is much less detailed than that which exists for federally registered investment advisers, and as a result, many state regulators refer to the federal decisions and Commission rulings in regulating investment advisers registered in their states. State securities regulatory authorities should analyze the federal regulatory framework and determine which standards, powers and procedures should be incorporated into the state regulatory system in order to ensure continuity in regulation. The states should then develop uniform state regulations incorporating those standards, powers and procedures.

24 The 1996 Act, *supra* note 2.

Recommendation 4: ***The Securities and Exchange Commission and state securities regulatory authorities should coordinate regulatory systems to enhance investor protection, avoid inconsistent requirements, and assure that transference from one system to the other will not be unduly burdensome for investment advisers. Additionally, the Securities and Exchange Commission should be given the authority to impose sanctions or limitations based on actions taken by state securities regulatory authorities. State laws generally encompass the ability to impose sanctions or limitations for violations of federal securities laws.***

The division of jurisdiction will require some investment advisers to transfer from one regulatory system to the other. The burden experienced by an investment adviser moving between regulatory systems should be minimal. Additionally, an investment adviser transferring from the state to the federal regulatory system should not be able to avoid the effect of state regulatory action against it.

As parallel federal and state investment advisory regulatory systems develop and evolve, the Commission and state securities regulatory authorities should engage in continuous dialogue to create harmony between the systems. Harmonization of the federal and state regulatory systems will enhance investor protection, avoid inconsistent requirements and assure that transference from one system to the other will not be unduly burdensome for investment advisers.

Recommendation 5: ***The Securities and Exchange Commission and state securities regulatory authorities should meet periodically to discuss areas in which additional regulation of investment advisers is needed and areas in which a reduction in regulation is appropriate.***

As parallel federal and state regulatory systems develop and evolve, the Commission and state securities regulatory authorities should identify areas in which additional regulation is needed and areas in which a reduction in regulation is appropriate. The Commission and state securities regulatory authorities should meet periodically to discuss these issues for the purpose of developing and implementing a coordinated response.

Recommendation 6: ***States that do not presently provide for oversight of investment advisers locally should do so by adopting laws, regulations, policies and procedures and by requiring registration of firms.***

The division of registration authority embodied in the 1996 Act reflects the view that the proper role for the Commission is to register investment advisers with assets under management in an amount likely to enable them to create a national presence, and that the proper role for the states is to register investment advisers with only a regional or local presence.

An exception exists with respect to those investment advisers with their principal office and place of business located in a state that does not register investment advisers. These investment advisers will continue to be registered with the Commission. Thus, the amount of assets under management becomes irrelevant, for an investment adviser with its principal office in one of the states that currently does not register investment advisers.

This statutory scheme may create some confusion for investors who attempt to check on an investment adviser because it may not be obvious to the investor which regulatory authority to contact regarding an investment adviser. In the 1996 Act, Congress maintained the registration authority of states over investment advisers with assets under management of less than $25,000,000 without regard to the state in which an investment adviser has its principal place of business. Investment advisers with assets under management of less than $25,000,000 will, in general, continue to be register in each state where the investment adviser is doing business. However, an investment adviser located in a state that does not provide for the registration or licensing of investment advisers will be subject only to federal registration requirements until such time as that state may deem it appropriate to establish its own registration requirements.

The legislatures of those states that do not register investment adviser firms should provide for local oversight by adopting laws, regulations, policies and procedures and by requiring registration of those firms.

B. INVESTMENT ADVISER REPRESENTATIVES

Recommendation 7: ***States that do not require registration of investment adviser representatives should provide for registration of those investment adviser representatives that are not registered as securities agents.***

The role of investment adviser representatives in the investment decisions of retail investors in the United States continues to grow as individuals increasingly must rely upon their self-directed investments to achieve their financial goals and prepare for retirement. Many individuals, unsure as to the best instruments into which to direct their investments, are turning to securities professionals to assist them. The focus of state securities regulation is shifting from registration of securities to the practices of individuals selling products or providing investment advice to retail investors.

As part of the registration process, the registration form used by state and federal regulators requires comprehensive information about the applicant's background, including education and work experience. In addition, the states may investigate an individual's background and require minimum standards of competency.

A possible effect of the 1996 Act is that an investment adviser representative will attempt to avoid state regulation by limiting her place of business to a state that does not have registration requirements. As discussed with respect to investment advisers, this may result in inadequate regulation of individuals to whom the public is increasingly turning for investment advice. States that do not require registration of investment adviser representatives should provide for registration of those representatives that are not registered as securities agents. In order to be uniform, states should adopt the NASAA Model Amendments to the Uniform Securities Act of

1956 (the "Uniform Act"), without additions or changes.[25] However, since examinations are an important component of state registration, the registration provisions should not become effective until such time as an appropriate competency examination is available.

C. UNIFORMITY AND STREAMLINING

Recommendation 8: ***State securities regulatory authorities should streamline procedures for registering investment advisers and investment adviser representatives. State securities regulatory authorities should develop a uniform set of standards and qualifications to be applied universally from jurisdiction to jurisdiction. State legislation may be required now to expedite the use of a centralized electronic registration system for the registration of investment advisers and investment adviser representatives.***

In addition to adopting uniform standards for regulating investment advisers, the states should take action to streamline their procedures for registering investment advisers and investment adviser representatives. The Central Registration Depository (the "CRD")[26] is being redesigned by the National Association of Securities Dealers, Regulation, Inc. ("NASDR") and, in the future, will be able to process registration applications filed by investment advisers and investment adviser representatives. The NASDR is encouraged to make this system available

25 NASAA Model Amendments ¶ 4905, *supra* note 11.

26 The Central Registration Depository (the "CRD"), jointly developed by the North American Securities Administrators Association, Inc., and the National Association of Securities Dealers, Inc., (the "NASD"), is an on-line registration data bank and application processing facility used by the NASD to maintain the qualification, employment and disciplinary histories of employees of NASD member firms.

as soon as possible. At that point in time, states should require investment advisers and investment adviser representatives to file initial and renewal applications for registration through the redesigned CRD. States should no longer require that filings be made directly with state securities regulatory authorities and any requirements for the filing of forms and exhibits other than the uniform form or those designated within the uniform form should be eliminated. The registration should become effective concurrently in every state in which an application for registration has been filed.

An application for registration filed by an investment adviser or an investment adviser representative with no disciplinary history should be approved automatically upon filing, unless the applicant is potentially disqualified from registration. The CRD, as redesigned, will provide state securities regulatory authorities with the ability to review disciplinary events as they occur and to initiate any appropriate action in response. Consequently, a state will no longer have a reason to delay because of uncertainty regarding the applicant's disciplinary history.[27]

Some state securities laws provide that it is unlawful for an investment adviser representative to transact business in a state unless the investment adviser representative is employed by an investment adviser registered in the state. Under current state registration procedures, an investment adviser representative's registration is tied to employment with a specific investment adviser. Currently state regulators treat the registration of an investment adviser representative who is changing employment as lapsed and do not issue a new registration until they have completed their review of the disciplinary history.

---

27 The practice of conditioning the license of the representative to the license of the advisory firm developed because state regulators lack a mechanism for obtaining notice of disciplinary actions taken against an investment adviser representative at the time the disciplinary action occurred. In the absence of such a mechanism, state regulators take the opportunity to review disciplinary history at the time of a change in employment. State regulators presently treat the license of an investment adviser representative who is changing employment as "lapsed" and do not issue a new license until they have completed their review of the disciplinary history.

Recommendation 9: ***In light of the prospective availability of disciplinary information on the Central Registration Depository, states should amend their registration procedures for investment adviser representatives so that the registration would permit an individual to continue to render investment advice upon a change in employment, pending approval of the transfer, so long as that individual is employed by a different registered investment adviser.***[28]

28 Individuals licensed to engage in other occupations are not tied by that license to a particular employer. Occupations such as real estate or insurance, require an agent to be affiliated with a broker in order to transact business; however, the agent's license does not lapse upon a change in employment.

Recommendation 10: ***States also should amend their statutes and rules, if necessary, to provide for continuous registration of investment advisers and investment adviser representatives.***

A state may wish to continue to require investment advisers and investment adviser representatives to pay a yearly registration fee; however, the registration should not expire at the end of the year (*i.e*., if an investment adviser or investment adviser representative fails to pay an annual fee in a timely manner, a state should have to institute formal action to revoke the registration for nonpayment of the fee).[29] An exception to continuous registration should apply in the case of an investment adviser representative who leaves the industry for a period of time exceeding two years. In that instance, there may be a concern that the professional who has not been practicing the profession may not be aware of significant regulatory and industry developments. Such a concern presumably led the National Association of Securities Dealers, Inc. (the "NASD") to require a representative of a broker-dealer whose registration has lapsed for a period of two or more years to retake and pass a qualification examination.[30] In order to provide consistency between representatives of broker-dealers and investment adviser representatives, investment adviser representatives who leave the business for two years or more should be required to take and pass the qualification examinations.[31] However, if an investment adviser

29 One possible model for state legislation relating to continuous registration is that adopted by Colorado for the licensing of broker-dealers and securities agents. Under the Colorado Securities Act, if the broker-dealer or securities agent does not pay its annual licensing fee within thirty days after the securities commissioner sends a written notice that the fee was not paid when due, the amount of the annual registration fee shall be double the amount originally payable. If the annual registration fee is not paid within sixty days after the securities commissioner sends written notice, the securities commissioner may by order summarily suspend the registration. If the annual registration fee is not paid within thirty days after the effective date of the summary suspension, the securities commissioner may by order summarily revoke the registration on the grounds that the registration has been abandoned. *See* COLO. REV. STAT. § 11-51-404 (1990 & Supp. 1996).

30 National Association of Securities Dealers, Inc., Membership and Registration Rules, § 1000.1021.c, NASD Manual (CCH) ¶ 1785.

representative has been registered in a jurisdiction, that individual should not have to retake and pass the qualification examinations to become registered in another state.

Some state statutes or rules currently require applicants for registration as investment adviser representatives to take and pass minimum qualifying examinations. These requirements are not uniform among the states. One examination used by some states to test such qualification is the Series 7, General Securities Registered Representative Examination. However, this is one of the basic licensing examinations for broker-dealer sales representatives promulgated by the NASD and New York Stock Exchange ("NYSE") and includes a substantial amount of material that is not directly relevant to practice as an investment adviser representative. States should develop an appropriate uniform qualifying or competency examination that tests skills specifically relevant to the furnishing of investment advice, with appropriate provisions for waivers or exemptions Due to the diversity of the investment adviser industry, it may be determined that separate examinations should be developed addressing different segments of the industry. Currently, there is no competency examination developed by regulators specifically to test investment adviser representatives. NASAA is currently developing a new competency examination for use during calendar year 1998 for investment adviser representatives which states should adopt uniformly. Thereafter, states should no longer require investment adviser representatives who are not associated with a NASD member firm to take the Series 7 examination. Additionally, the grade necessary to pass the examination should be uniform in all states, so that licensing in all states is uniform, thus simplifying the process for licensure in multiple states. To the extent a state also has examination requirements for an applicant designated as a supervisor, those requirements should be uniform.

---

31 State regulators will have to guard against investment adviser representatives engaging in the practice of "parking" their registrations. Parking of a registration involves an investment adviser acting as the firm with which an investment adviser representative is registration when that investment adviser representative is not actively engaged in the business.

Waivers from the competency examination requirements should be available to investment adviser representatives under certain circumstances. For instance, waivers might be made available when an individual has earned an industry designation that is predicated on reasonable competency standards and recognized by a model NASAA Rule. State securities regulatory authorities also should create a uniform "grandfather clause" under which the competency examination may be waived. Further, the Industry Continuing Education Council should develop appropriate modules pertaining to advisory activities. Persons who are registered as broker-dealer agents and subject to Industry Continuing Education Council requirements should be exempt from such competency examination requirements for investment adviser representatives.

Recommendation 11: ***States should adopt a uniform exemption from registration for an investment adviser representative providing investment advice primarily to institutional investors.***

The provisions of the 1996 Act and the SEC's investment adviser rules under which a state is permitted to register an investment adviser representative do not provide for exemptions from state registration based on the activities in which the investment adviser is engaged. The Task Force believes an investment adviser representative providing investment advice primarily to institutional investors does not require the same level of state regulatory oversight as an investment adviser representative providing investment advice to retail investors. States should adopt a uniform *de minimis* exemption from registration for registered representatives of an asset money management firm which has primarily an institutional clientele.

In addition, an exception to the registration requirement should apply to investment adviser representatives who have institutional clients only and are employed by firms that manage a

minimum of $100,000,000 of assets on a discretionary basis. The Task Force believes that an investment adviser representative engaging in transactions with institutional clients on behalf of such a firm does not require the same level of state regulatory oversight as an investment adviser representative providing investment advice to retail investors.

Recommendation 12: ***State securities regulatory authorities should implement an integrated registration system for investment adviser representatives and securities agents seeking both registrations, and study the feasibility of developing a national license.***

Many firms provide both investment advisory and brokerage services directly or through subsidiaries. Investment advisers that fall within the jurisdiction of state regulation and that engage in brokerage activities are required to register as both an investment adviser and a broker-dealer under the statutes of most states.[32] Employees of these firms are required to register as both investment adviser representatives and securities agents in those states that require registration. This process involves completion of two sets of paperwork, which call for similar information. In order to ease the licensing burden on these individuals, the Task Force recommends that states and the SROs implement an integrated registration system for investment adviser representatives and securities agents, wherein an individual seeking both registrations can attain them through completion of a single form, a single law and ethics examination and a single product knowledge examination. A uniform combined state law examination for adviser representatives and securities agents was recently developed and has been accepted by all states. A new examination should be developed containing questions to

32 Some states, however, exempt registered broker-dealers and sales agents from registration as investment advisers and investment adviser representatives, respectively. *See, e.g.*, ARIZ. REV. STAT. ANN. § 44-3152 (Supp. 1996), MASS. GEN. LAWS ANN. ch. 110A, § 401(m) (West Supp. 1996).

test the knowledge of investment adviser representatives that may also be licensed as securities agents, with appropriate waivers for SRO-registered representatives. In the alternative, the Series 7 should be expanded by the NASDR and the NYSE to include questions relating to the furnishing of investment advice. Applicants should continue to be able to take and pass existing examinations, where relevant. Additionally, if an individual has previously taken and passed an examination to qualify as an investment adviser representative or securities agent, that individual should not have to take any qualification examinations covering information previously tested.

V. ISSUES AND RECOMMENDATIONS -- REGISTRATION OF BROKER-DEALERS AND SECURITIES AGENTS

Section 15(a)(1) of the Securities Exchange Act of 1934 (the "1934 Act") provides for the registration of a dealer or broker engaging in securities transactions in interstate commerce.[33] In Section 15(b)(7), the Commission is permitted to establish standards of "operational capability" for brokers or dealers and standards of training, experience and competence for all natural persons associated with such broker or dealer.[34] Additionally, in Section 15(c)(3) the Commission is permitted to make rules with respect to the financial responsibility and related practices of brokers and dealers (*e.g.*, net capital rules, books and records requirements).[35]

In the 1938 Maloney Act Amendments to the 1934 Act, Congress provided the Commission with the authority to authorize national securities associations for the self-regulation of brokers and dealers under the oversight of the Commission.[36] The NASD was created pursuant to that authority. A subsidiary of the NASD, NASD Regulation, Inc., performs, among other things, the function of testing securities professionals. The NASDR prescribes two levels of qualification and registration: (1) registered representatives (sales personnel); and (2) principals (officers and other management personnel of the firm). Representatives of firms conducting interstate transactions must be affiliated with an NASD member. In order for the member to maintain a representative's registration, the representative must be active in the member's investment banking or securities business. In addition to the requirements under the 1934 Act, NASD members must comply with NASD Bylaws and Rules of Fair Practice.

33 15 U.S.C. § 78o(a)(1)(1994).

34 *Id*. at § (b)(7).

35 *Id*. at § (c)(3).

36 15 U.S.C. § 78o-3 (1994).

State securities laws also provide for the registration of broker-dealers and sales agents transacting business in the state.[37] A broker-dealer may not employ an agent unless the agent is registered, and the registration of the agent is not effective during any period when he is not associated with a registered broker-dealer or issuer.[38]

A. STREAMLINING AND SIMPLIFICATION

Recommendation 13: ***State securities regulatory authorities should continue to streamline and simplify the regulatory system for broker-dealers and securities agents in order to facilitate multiple state registrations and should hold discussions with the various self-regulatory organizations, as necessary, to assure that any changes are coordinated.***

The majority of broker-dealers currently operating in the United States conduct business in more than one state and are members of the NASD. Clients of broker-dealers and sales agents are often mobile, have dual or multiple residences and may want to effect transactions in their accounts when they are outside of their state of domicile.

Consistent with Task Force recommendations with respect to investment advisers and investment adviser representatives, the Task Force believes states should continue to streamline and simplify their procedures for registration of brokerage firms and sales agents to facilitate multiple registrations. Consequently, many of the Task Force's recommendations for changes in the licensing process for investment advisers and investment adviser

37 *See* UNIF. SEC. ACT § 201 (1956), upon which many states pattern their registration provisions.

38 *Id.*

representatives also apply to the registration of broker-dealers and sales agents. These recommendations include those relating to the application process, continuous registration, automatic registration of individuals and entities without disciplinary history, recognition that a registration belongs to the individual holding it and should not be tied to a specific employer,[39] and institution of uniform examination requirements.[40]

State licensing requirements and procedures in the area of broker-dealer and sales agent regulation are more advanced, uniform and efficient than in the investment adviser area to a significant degree. However, further streamlining can make the system even more efficient for both the regulated and the regulators.

39 A securities agent would be required to be employed by a registered broker-dealer in order to transact business. A securities agent should be permitted to continue to effect transactions upon a change in employment, pending approval of the transfer, so long as that individual is employed by a new broker-dealer.

40 *See* the discussion beginning on page 22 regarding streamlining registration procedures for investment advisers and investment adviser representatives.

B. UNIFORMITY AND COOPERATION

Recommendation 14: ***Securities regulatory authorities in those states where registration of branch offices is required should adopt definitions and registration provisions that are uniform with the requirements imposed by the National Association of Securities Dealers, Inc. so that registration of branch offices can be completed electronically through the Central Registration Depository and multiple filings can be eliminated and definitions are consistent.***

Some state securities statutes provide that it is unlawful for a broker-dealer to conduct business from a branch office within the state unless the branch office is registered with the state securities regulatory authority. Registration of branch offices provides a means of notifying state securities regulatory authorities of the identity of branch offices operating within the state. Securities regulatory authorities in those states where registration of a branch office is required should adopt definitions and registration provisions that are uniform with the requirements imposed by the NASD so that registration of branches can be completed electronically through the CRD and multiple filings can be eliminated and definitions are consistent.

A broker-dealer's failure to register a branch office in a state may provide an investor with the right to bring a private action against the broker-dealer to rescind transactions effected by personnel of the unregistered branch office or the state may compel rescission. This private right of action may be created or sanctions imposed even though the firm and all of the securities agents conducting business from the unregistered branch office are registered in the state.

An investor has discretion over which transactions are included in the action against the firm and may seek to rescind only unprofitable transactions. The Task Force recognizes that this rescission may be out of balance with the wrong for which redress is sought. States should reconsider whether a failure to register a branch office should result in a rescission action in view of the large sums which are involved and the fact that liability may be triggered by a clerical error or through innocent inadvertence.

Recommendation 15: ***The Securities and Exchange Commission should adopt appropriate amendments to Rules 17a-3 and 17a-4 to provide a single, appropriate standard for maintaining broker-dealer books and records. This standard should incorporate provisions necessary for effective state regulation*****.**

In addition to discussing the procedures for effecting the registration of brokerage firms and securities agents, the Task Force discussed state provisions under which brokerage firms are required to establish minimum levels of capital, to obtain a bond and to maintain certain records. In Section 103 of the 1996 Act,[41] these matters are addressed as well. Specifically, in Section 103, Congress limited the authority of the states to adopt laws, rules or regulations, to issue orders, or to take other administrative action establishing capital, custody, margin, financial responsibility, recordkeeping, bonding or financial or reporting requirements that differ from, or are in addition to, the federal requirements. In Section 103, the Commission is also required to consult with the states periodically concerning the adequacy of the federal requirements.

With respect to recordkeeping, the Task Force has been advised that current federal books and records requirements do not require broker-dealer firms to provide state regulatory

41 The 1996 Act, § 103, *supra* note 2.

authorities with the information those regulators deem necessary adequately to oversee broker-dealers and sales agents conducting business within their borders. The industry has urged that cost-effective, uniform requirements be adopted for the maintenance of books and records. The Commission has released for public comment a proposed books and records rule.[42] The proposed rule was drafted with input from the states and addresses state needs for information. The Task Force recommends that, upon completion of the comment period, the Commission should adopt amendments to Rules 17a-3[43] and 17a-4,[44] promulgated under the 1934 Act, to provide a single, appropriate standard for maintaining broker-dealer books and records. This standard should incorporate provisions necessary to effective state regulation and should be developed taking the costs of compliance to securities firms into consideration.

---

42 Books and Records Requirements for Brokers and Dealers under the Securities Exchange Act of 1934, Exchange Act Release No. 34-37850, Fed. Sec. L. Rep. (CCH) ¶ 85,853 (Oct. 22, 1996).

43 17 C.F.R. § 240.17a-3 (1996).

44 17 C.F.R. § 240.17a-4 (1996).

Recommendation 16: ***All securities regulatory authorities should cooperate in and coordinate broker-dealer examination and oversight activities of securities industry participants and should share examination results. To the extent that state freedom of information statutes require disclosure of examination results, state legislatures should adopt specific exemptions authorizing the confidentiality of information obtained in the course of a broker-dealer or investment adviser examination conducted by another regulatory agency.***

Brokerage firms and branch offices are subject to routine periodic financial, operational and sales practice examinations by the Commission, the American Stock Exchange (the "AMEX"), the Chicago Board Options Exchange (the "CBOE"), the NASDR, the NYSE and the states. The SROs should share examination results with state regulatory agencies, where appropriate. The absence of information sharing has increased the number of multiple examinations and investigations.

In the absence of shared examination information, the number of time consuming and costly inquiries from multiple regulators for firms and branch offices increases. Multiple examinations cause the Commission, SROs and states to devote significant personnel resources to examinations. On November 28, 1995, in recognition of the need to undertake their regulatory responsibilities in a more efficient and effective manner, the Commission, the AMEX, the CBOE, the NASDR, the NYSE and NASAA entered into a MOU concerning consultation and coordination of the regulatory examination of broker-dealers.[45]

45 Memorandum of Understanding: The Securities and Exchange Commission, American Stock Exchange, Chicago Board Options Exchange, National Association of Securities Dealers, New York Stock Exchange,

In the MOU the participants acknowledged that broker-dealers may be subject to oversight by more than one SRO and by each state in which they effect transactions in securities. One of the topics addressed in the MOU is coordination of examinations.

Specifically, in the MOU the participants provide that the SROs will share among themselves "information, including reports of examination, customer complaint information, and other non-public regulatory information as appropriate to foster a coordinated approach to regulatory oversight of broker-dealers subject to examination by more than one SRO." Additionally, the MOU requires SROs to inquire of each broker-dealer as to whether the broker-dealer requests coordination of its separate on-site routine examinations. If a coordinated examination is requested, a designated examining authority will conduct the financial operational examination at the same time as any sales practice examination. Furthermore, under the terms of the MOU, NASAA will encourage states to utilize examination resources to inspect firms and branch offices of firms that may not be examined by the Commission on a frequent basis.

The MOU is a significant initial step in streamlining and improving coordination of the examination process. However, it does not achieve the goal of reducing and minimizing duplicative examinations. The Task Force believes the Commission, SROs and state securities regulatory authorities should work together toward the goal of including the states as full participants in the coordinated examination process, and in the sharing of examination reports. Inclusion of all regulatory agencies within the coordinated examination process will decrease the number of examinations and reduce the regulatory burden on broker-dealers.

In order for a coordinated examination system in which the states participate to be successful, certain prerequisites will have to be satisfied. First, the participating regulatory authorities must have confidence in the ability of the other participants to perform examinations. To address this issue, the Task Force recommends that the Commission, SROs and states

---

and the North American Securities Administrators Association Concerning Consultation and Coordination of the Regulatory Examination of Broker-Dealers, NASAA Reports (CCH) ¶ 2352 (Nov. 28, 1995).

develop a protocol for completion of examinations and provide training in utilizing the protocol to those individuals who will be performing the examinations. The Commission, SROs and state securities regulatory authorities also should consider developing an accreditation program for individuals conducting examinations. Second, the participating regulatory agencies must be confident that regulatory agencies receiving information obtained in the course of an examination are able to maintain the confidentiality of that information. Consequently, the Task Force recommends that only states that can maintain the confidentiality of shared information participate in coordinated examinations. In order to ensure that all states are able to participate in coordinated examinations, the Task Force recommends that to the extent state freedom of information statutes require disclosure of examination results, state legislatures should adopt specific exemptions authorizing the confidentiality of information obtained in or arising from the course of a broker-dealer examination conducted by another regulatory agency.

Recommendation 17: ***In those states that require registration of issuer-dealers, state securities regulatory authorities should adopt uniform registration standards. Additionally, uniform standards for registration of issuer-agents also should be adopted in those jurisdictions where registration is required.***

The securities statutes in some states require an issuer that engages in transactions in its own securities to register as a dealer. Additionally, the officer, director or employee effecting the transactions may be required to register as an agent.

Nonprofit corporations organized and operated exclusively for religious, educational, benevolent, fraternal, or charitable purposes frequently issue securities that are offered and sold by officers, directors or employees of the organization. The individuals selling the securities do not receive commissions, directly or indirectly, for the sale of the securities. As part of the registration procedures, some states require these individuals to take and pass examinations to test their knowledge of securities law and products.

The standards and procedures for registration as an issuer-dealer or issuer-agent are not uniform among the states that require registration. The disparate requirements are burdensome, particularly for those organizations not created for the purpose of selling securities and, particularly when the individuals are engaging in transactions in securities of organizations with which they have an affiliation, rather than in the general sale of securities. State securities regulatory authorities in those states that require the registration of issuer-dealers should adopt uniform registration standards and procedures. Additionally, uniform standards for registration of issuer-agents should be adopted by state securities regulatory authorities in those jurisdictions where registration is required. In establishing the uniform examination requirement, the state securities regulatory authorities should consider the relevancy of the information tested in the

examination to the activities of the individual. In particular, state authorities should consider whether completion of the Series 7 Examination is necessary for issuer-agents, in light of the irrelevance of much of the information required by that examination to the limited activities of the agent and issuer and the historic absence of regulatory problems with such individuals.

VI. ISSUES AND RECOMMENDATIONS -- REGISTRATION OF AND TRADING IN SECURITIES[46]

Under the 1996 Act, no law, rule, regulation, order or other administrative action of any state or political subdivision thereof requiring or with respect to registration or qualification of securities or transactions may apply to a "covered security" or to a security that will be "covered" upon completion of a transaction, except as provided in the 1996 Act. Additionally, states may not regulate the offering document prepared on behalf of the issuer of a covered security, or any proxy statement, shareholder report or other disclosure document relating to a covered security or the issuer thereof that is required to be filed with the Commission or any national securities organization registered under section 15A of the 1934 Act, with the exception of laws, rules, regulations or orders or other administrative actions of the state of incorporation of the issuer, nor may states directly prohibit, limit, or impose conditions based on the merits of the offering or issuer.[47] States may continue to require the filing of documents filed with the Commission, and require the payment of fees and the filing of reports indicating sales in the state.[48]

A "covered security" under the 1996 Act includes a security listed or authorized for listing on the NYSE or the AMEX, or authorized to trade on the Nasdaq National Market System ("Nasdaq NMS") (or any successor to such entities); a security listed or authorized for listing on a national securities exchange (or tier or segment thereof) that has listing standards that the Commission determines by rule (on its own initiative or on the basis of a petition) are substantially similar to the listing standards applicable to securities listed on the NYSE, AMEX or authorized to trade on

46 For background information on securities registration, *see* Appendix B, page 89.

47 The 1996 Act, § 102, *supra* note 2.

48 The 1996 Act, § 102, *supra* note 2.

the Nasdaq NMS; or is a security of the same issuer that is equal in seniority or that is a senior security to one of the securities listed above.[49]

A. THE NASAA MOU

Recommendation 18: ***The Securities and Exchange Commission should take into consideration the Memoranda of Understanding entered into by the North American Securities Administrators Association and several stock exchanges when determining whether a stock market's listing standards are substantially similar to the listing standards of the New York Stock Exchange, the American Stock Exchange or the National Market System of the Nasdaq Stock Market for the purposes of designating securities as "covered" for purposes of federal preemption.***

The designation of securities listed on the NYSE, AMEX and Nasdaq NMS as "covered" securities is a codification in federal law of provisions of state law exempting from registration securities listed or approved for listing upon notice of issuance on the NYSE or the AMEX or traded or approved for trading on the Nasdaq NMS. Many state statutes also exempt from registration securities listed or approved for listing upon notice of issuance on other exchanges or on certain tiers of other exchanges. Many states extended the exchange listing exemption to other exchanges based on the agreement of those exchanges to enter into MOUs with NASAA in which minimum listing standards are set forth. These MOUs should be considered by the

49 The 1996 Act, § 102, *supra* note 2.

Commission when determining whether listing standards are similar for the purpose of designating securities listed on an exchange as covered. Additionally, the Commission should permit state securities regulatory authorities to participate in rulemakings that takes place pursuant to Section 18 of the Securities Act of 1933.

B. COORDINATION AND UNIFORMITY

Recommendation 19: ***State securities regulatory authorities should continue to expand the coordinated review programs that are currently in place among states in a region. Such programs are operating in some states for small corporate equity offerings in coordinated equity review program for offerings in amounts under $5,000,000. Additionally, a national coordinated equity review program for offerings in amounts over $5,000,000 should be developed.***

States have attempted to coordinate their review of offerings through adoption of uniform policies promulgated by NASAA such as policies relating to loans and material transactions, impoundment of proceeds, options and warrants, promoters' equity investments and promotional shares.[50] With respect to direct participation programs, NASAA has adopted

50 NASAA Statement of Policy Regarding Loans and Other Material Affiliated Transactions, NASAA Reports (CCH) ¶ 371 (Apr. 25 1993); NASAA Statement of Policy Regarding the Impoundment of Proceeds, NASAA Reports (CCH) ¶ 2151 (Apr. 25, 1993); NASAA Statement of Policy Regarding Options and Warrants, NASAA Reports (CCH) ¶ 2801 (Apr. 25, 1993); NASAA Statement of Policy Regarding Promoter's Equity Investment, NASAA Reports (CCH) ¶ 3101 (Apr. 25, 1993); NASAA Statement of Policy Regarding Promotional Shares, NASAA Reports (CCH) ¶ 3201 (Jan. 1, 1988).

uniform review guidelines for real estate, oil and gas, equipment leasing, mortgage pool and similar public direct investment programs.[51]

NASAA also has created the Small Company Offering Registration ("SCOR")[52] program for offerings exempt from federal registration under Rule 504 of Regulation D.[53] SCOR, through the use of the simplified Form U-7 disclosure document, provides a uniform disclosure format for small business issuers.

While many SCOR offerings are intrastate in nature, some are offered on an interstate basis. An issuer undertaking a SCOR offering is limited to raising $1,000,000 in a twelve month period. In order to ease the burden on issuers attempting to register a SCOR offering in more than one state, NASAA has sponsored the development of regional review programs.[54] Under the regional review programs, participating states convey all comments to a designated lead jurisdiction which then issues a comment letter. The issuer negotiates resolution of the comments with the examiner from the lead jurisdiction. The lead jurisdiction determines when the comments have been resolved and the offering registered for sale. The lead jurisdiction notifies the other states in the region where the offering has been filed that the offering has complied with the requirements for registration, and the offering is simultaneously registered in all of the jurisdictions that participated in the regional review. To help an issuer through a SCOR

---

51 NASAA Statement of Policy Regarding Real Estate Programs, NASAA Reports (CCH) ¶ 3601 (Oct. 24, 1991); NASAA Statement of Policy Regarding Oil and Gas Programs, NASAA Reports (CCH) ¶ 2621 (Oct. 24, 1991); NASAA Statement of Policy Regarding Equipment Programs, NASAA Reports (CCH) ¶ 1601 (Oct. 24, 1991); NASAA Mortgage Program Guidelines, NASAA Reports (CCH) ¶ 701 (Sept. 10, 1996).

52 Small Corporate Offering Registration Form, (Form U-7), NASAA Reports (CCH) ¶ 5057 (Apr. 29, 1989) (amended Apr. 28, 1996). *See also*, NASAA Statement of Policy Regarding Small Company Registrations, NASAA Reports (CCH) ¶ 411 (Apr. 28, 1996).

53 17 C.F.R. §230.504 (1996).

54 The Form U-7 may also be used as the disclosure document for offerings made pursuant to Regulation A of the Securities Act of 1933 (the "1933 Act"). *See* Additional Small Business Initiatives, Securities Act Release No. 6996, Exchange Act Release No. 32231, [1992-1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,134 (Apr. 29, 1993). Issuers of Regulation A offerings may request regional review by states in certain designated regions. *See* NASAA Small Company Offering Registration Issuer's Manual, NASAA Reports (CCH) ¶ 415 (Apr. 28, 1996).

offering, NASAA has developed the NASAA Small Company Offering Registration Issuer's Manual.[55] Currently regional review is available in the western states of Arizona, Utah, Colorado, Idaho, Oregon, Alaska and Washington;[56] the New England states of Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island and Vermont; and the Midwestern states of Illinois, Indiana, Kansas, Michigan, Missouri and Wisconsin.

In an extension of its regional review program, NASAA has developed a national coordinated review program for corporate equity offerings when they are too large to rely upon the ceiling of $5,000,000 available under Regulation A under the 1933 Act[57] and the issuer is too small to qualify for listing on an exchange. The coordinated equity review program is similar to the regional review program, in that it will utilize a "lead state review" based on a uniform set of policies. State securities regulatory authorities should continue and expand coordinated review programs for corporate equity offerings.

55 NASAA Small Company Offering Registration Issuer's Manual, NASAA Reports (CCH) ¶ 415 (Apr. 28, 1996).

56 California participates in the regional review of Regulation A offerings.

57 17 C.F.R. § 230.251 (1996).

Recommendation 20: ***State legislatures should enact legislation permitting receipt of registration documents and other information by state securities regulatory authorities through systems created for the purpose of facilitating electronic receipt of documents and information.***

Statutory authorization may be necessary in order for information filed with an intermediary such as the CRD to be deemed filed with the state. Many existing state statutory provisions specifically provide for the registration of broker-dealers and securities agents by filing documents with the CRD which are then transmitted electronically to the state securities regulatory authority. Additional statutory authorization may be necessary in order for states to accept documents and other information filed with the CRD for the purpose of registering investment advisers and investment adviser representatives.

Additionally, it is anticipated that securities registration statements filed with the Commission will be delivered electronically to the states for review under state securities registration provisions.[58] Electronic delivery will reduce costs to industry and ease compliance by, among other things, accelerating the registration process and making it more uniform.[59] It also should reduce expenses and resources devoted to registration by state regulatory authorities. Where necessary, state legislatures should enact legislation permitting receipt of registration documents and other information by state securities regulatory authorities through systems

---

58 In Section 510 of the 1996 Act, Congress directed the Commission to conduct a study of the impact of technological advances on the securities markets. In conducting its study, the Commission is directed to consider how the Commission has adapted its enforcement policies and practices in response to technological developments with regard to disclosure, prospectus delivery and other customer protection regulations, and the relationship of the Commission with state regulatory authorities and organizations to improve coordination and cooperation relating to technological developments, among other considerations. The 1996 Act, § 510, *supra* note 2.

59 Adoption by state regulatory authorities of the CRD as the depository for the filing of broker-dealer and sales agent registration forms resulted in a decrease in the number of non-uniform forms required to be filed with the states to complete the registration process.

created for the purpose of facilitating electronic receipt and distribution of documents and information.

VII. ISSUES AND RECOMMENDATIONS -- EXEMPTIONS FROM SECURITIES REGISTRATION

In the 1933 Act and rules promulgated thereunder, numerous exemptions from the registration requirements of Section 5[60] for designated securities and transactions are set forth.[61] State securities statutes include provisions parallel to many of the federal exemptions. The Task Force devoted many hours to the discussion of certain exemptions, including the federal exemption for intrastate offerings, state private placement exemptions and secondary trading exemptions. Additionally, the Task Force discussed the appropriate definition of "qualified purchaser" for reliance upon certain exemptions.

A. SMALL OFFERING EXEMPTIONS

Recommendation 21: ***Amendments should be made to federal exemptions from securities registration in order to facilitate capital formation by small issuers without sacrificing the integrity of the capital markets. The Securities and Exchange Commission is encouraged to utilize its exemptive authority to achieve this end.***

Under Section 3(b) of the 1933 Act,[62] the Commission is authorized to promulgate rules and regulations to exempt from registration any class of securities if it finds that registration of such securities is not necessary in the public interest and for the protection of investors by reason of

60 15 U.S.C. § 77e (1994).

61 *See, e.g.,* Section 3, 15 U.S.C. § 77c (1994); Section 4, 15 U.S.C. § 77d (1994); Rule 144A, 17 C.F.R. § 230.144A (1996); and Regulation D, 17 C.F.R. §§ 230.501 to 508 (1996), promulgated under the 1933 Act.

62 15 U.S.C. § 77c(b) (1994).

the small amount involved or the limited character of the public offering, but the aggregate amount at which the issue is offered to the public may not exceed $5,000,000.

In passing the 1996 Act, Congress added Section 28 to the 1933 Act.[63] Section 28 permits the Commission to exempt "any person, security, or transaction, or any class or classes or persons, securities or transactions, from any provision or provisions of this title."[64] The Task Force encourages the Commission to utilize this exemptive authority to provide an exemption from registration for offerings of up to $10,000,000 in order to facilitate capital formation for small businesses.

In the absence of Commission action under Section 28 of the 1933 Act, the Task Force recommends that Section 3(b) of the 1933 Act[65] be amended to raise the limit on the offering amount to $10,000,000. Additionally, the Task Force recommends that the Commission make a corresponding change to Rules 504 and 505 of Regulation D. The amendment to Rule 504 should include the requirement that any offering in an amount over $1,000,000 made in reliance upon the rule be registered in the states where the offering is made. The Task Force recommends that the Commission reinstate[66] the state registration requirement within Rule 504 is based on the fact that such securities present a much larger risk. The trading of unregistered and unrestricted securities of an issuer in amounts above $1,000,000 may facilitate penny stock[67] and similar abuses.

B. PRIVATE PLACEMENT EXEMPTIONS

---

63 15 U.S.C. § 77z-3 (1997).

64 *Id.*

65 15 U.S.C. 77c(b) (1994).

66 Prior to 1992, offerings made pursuant to Rule 504 of Regulation D were required to be registered with the states.

67 *See* 15 U.S.C. § 78c(51)(a) (1994).

Recommendation 22: ***State securities regulatory authorities should adopt a uniform Regulation D, Rule 505 private placement exemption and implement it in a uniform manner, and Rule 506 filing procedures should conform to the requirements of the National Securities Markets Improvement Act of 1996.***[68]

Section 4(2) of the 1933 Act is an exemption from the provisions of Section 5 of the 1933 Act for "transactions by an issuer not involving any public offering."[69] In Section 3(b) of the 1933 Act, the Commission is granted the authority to adopt special exemptions for issuers of securities not to exceed $5,000,000.[70] Rules 505 and 506 of Regulation D[71] set forth rules governing limited offers and sales of securities without registration under the 1933 Act and is intended to be "a basic element in a uniform system of federal-state limited offering exemptions. . . ."[72] Rule 505[73] of Regulation D ("Rule 505") was adopted pursuant to the Commission's authority under Section 3(b). Rule 506[74] of Regulation D ("Rule 506") was adopted as a safe harbor under the private offering exemption of Section 4(2).

The Uniform Limited Offering Exemption ("ULOE") was drafted to provide a state exemption compatible with Regulation D.[75] Many states have adopted Regulation D, patterned an

---

68 The 1996 Act, § 102, *supra* note 2.

69 15 U.S.C. § 77d(2) (1994).

70 15 U.S.C. § 77c(b) (1994).

71 17 C.F.R. §§ 230.501 to 508 (1996).

72 *Id*. at preliminary Note 2.

73 *Id.* at § 505.

74 *Id.* at § 506.

75 Uniform Limited Offering Exemption, NASAA Reports (CCH) ¶ 6201 (Apr. 21, 1983, amended Apr. 29, 1989).

exemption after Regulation D, or have adopted ULOE or a variation thereof.[76] Uniformity has not been achieved, however, as some states have included additional requirements as conditions to their exemptions or have issued their own interpretative opinions in the area.[77]

The 1996 Act provides that a security is a covered security with respect to a transaction that is exempt from registration pursuant to Commission rules or regulations issued under Section 4(2) of the 1933 Act.[78] Since offerings exempt under Rule 506 involve covered securities, states are no longer permitted to comment on or impose substantive conditions, requirements or limitations on the offerings. States, however, are not prohibited from requiring an issuer to file a SEC Form D as that form was in effect on September 1, 1996.

The arena of private placements is unnecessarily complicated by inconsistent state regulation of offerings. In the 1996 Act, Congress did not prohibit states from imposing

---

76 The following states have adopted Regulation D, patterned an exemption after Regulation D or have adopted ULOE or a variation thereof. Ala. Admin. Code r. 830-X-6.11 (1991); ALASKA ADMIN. CODE tit. 3, §§ 08.500 to 08.506 (1993); ARIZ. ADMIN. CODE R14-4-126 (West, WESTLAW current through June 30, 1996); CAL. CORP. CODE § 25102 (West 1977 & Supp. 1996); CONN. GEN. STAT. § 36b-21 (1996), CONN. AGENCIES REGS. §§ 36b-31-21b-9a to 9b (1994) (formerly §§ 36-500-490b-9a to 9b); GA. COMP. R. & REGS. r. 590-4-5.01 (1991); HAW. REV. STAT. § 485-6(15) (1995), Hawaii Administrative Rules § 16-38-22; Idaho Rules and Regulations, Department of Finance, Rule 270; IOWA ADMIN. CODE r. 191-50.16 (1996); KAN. ADMIN. REGS, r. 81-5-6 (1994); 808 KY. ADMIN. REGS. 10:210 (1996); LA. ADMIN. CODE tit. 64 §§ 703, 705, 707 (1987); MD. REGS. CODE tit. 2 §§ 02.04.09 to 02.04.13 (1996); MASS. REGS. CODE tit. 950 § 14.402 (1994); MICH. ADMIN. CODE r. 451.803.7 (1991); MINN. STAT. § 80A.15 (1992 & Supp. 1993); Mississippi Rules of the Secretary of State, Rule 703; MO. CODE REGS. ANN. tit. 15, § 330-54.210 (1993); MONT. ADMIN. R. 6.10.120 (1996); NEB. REV. STAT. § 8-1111(16) (1992); New Hampshire Administrative Rules, Atg-Se 703.01; New Mexico Rules of the Director of the Securities Division, Rule 86-6.01.I; N.C. ADMIN. CODE tit. 18, r.6.1205 (April 1995); N.D. ADMIN. CODE § 73-02-03-03 (1992); OHIO REV. CODE ANN. § 1707.03 (Anderson 1992 & Supp. 1995); OKLA. STAT. tit. 71, § 401 (1991); OR. ADMIN. R. 441-65-060 (West, WESTLAW through April 30, 1996); PA. STAT. ANN. tit. 70, § 1-203 (West 1994 & Supp. 1996); R.I. GEN. LAWS § 7-11-402 (1992); S.C. CODE ANN. § 35-1-320 (Law. Co-op. 1987 & Supp. 1995), 27 S.C. CODE ANN. REGS. 113-21 (1993); TENN. COMP. R. & REGS. tit. 0780 ch. 4-2.08 (1990); 7 TEX. ADMIN. CODE § 109.13 (West 1996); Vt. Stat. Ann. tit. 9, § 4204a (1993); 21 VAC 5-40-30; West Virginia Administrative Regulations, Commissioner of Securities. Rule 15.06; Wis. Stat. Ann. § 551.23 (West, WESTLAW through 1995 Act 469, published July. 10, 1996); and Regulations of the Wyoming Securities Division, ch. 6, § 2. Colorado has adopted a statutory exemption for an offer or sale of a security in compliance with an exemption from registration with the Commission under Sections 3(b) and 4(2) of the 1933 Act. COLO. REV. STAT. § 11-51-308 (Supp. 1996).

77 Hugh H. Makens, Willie R. Barnes & Jean E. Harris, *Blue Sky Practice, Part I: Doing It Right: Liability Arising from State Private Offerings Under ULOE and Limited Offering Exemptions* 323 (ALI-ABA Course of Study SB 65, Regulation D Offerings and Private Placements, Co-Sponsored by the Securities Law Committee of the Federal Bar Association) (Mar. 1997).

78 The 1996 Act, § 102, *supra* note 2.

limitations on securities sold in transactions relying upon an exemption from registration promulgated under Section 3(b) of the 1933 Act. Consequently, state registration and exemption requirements continue to apply to offerings exempt from federal registration requirements under Rule 505. A guiding principle of the Task Force is that disparate requirements that do not further significant investor protection should be eliminated. The states should strive to create uniformity in the requirements for private placements by adopting a uniform private placement exemption and implementing it in a uniform manner.

C. SALES OF SECURITIES TO CERTAIN QUALIFIED PURCHASERS

Under the 1996 Act, a security offered or sold to a "qualified purchaser" as defined by the Commission by rule is a "covered security." The Commission may define qualified purchaser differently with respect to different categories of securities.[79]

79 The 1996 Act, § 102(b)(3), *supra* note 2.

Recommendation 23: ***The Securities and Exchange Commission should define "qualified purchaser" for the purpose of identifying a "covered security" under the National Securities Markets Improvement Act of 1996 to require higher financial standards than those of an accredited investor but less stringent than those of a qualified institutional buyer. The definition of "qualified purchaser" in the National Securities Markets Improvement Act of 1996 amendments to the Investment Company Act of 1940 would be appropriate.***

State registration provisions are preempted with respect to a transaction involving an offer or sale of a security to a qualified purchaser. Consequently, a "qualified purchaser" will not be afforded the protections of state securities law.

The Task Force discussed the appropriate definition of a "qualified purchaser" for the purposes of state institutional investor definitions. In the course of its discussions, the Task Force considered two possible definitions contained in rules promulgated pursuant to the 1933 Act, the definition of "accredited investor" found in Regulation D,[80] and the definition of a qualified institutional buyer ("QIB"),[81] a concept created under federal Rule 144A, and concluded that the appropriate standard falls between these two definitions.

The Task Force determined that the definition of "accredited investor" found in Regulation D is too low in the absence of disclosure requirements or limitations on the offering amount.

80 17 C.F.R. § 230.501 (1996). The definition of an accredited investor appears in Appendix C, page 102.

81 17 C.F.R. § 230.144A (1996). The definition of a qualified institutional buyer appears in Appendix C, page 102.

Alternatively, the definition of a QIB is so high that it would exclude a substantial number of transactions.

In Section 209 of the 1996 Act, Congress defined a "qualified purchaser" for the purposes of the Investment Company Act as "(i) any natural person (including any person who holds a joint, community property, or other similar shared ownership interest in an issuer that is excepted under section 3(c)(7) with that person's qualified purchaser spouse) who owns not less than $5,000,000 in investments as defined by the Commission; (ii) any company that owns not less than $5,000,000 in investments and that is owned directly or indirectly by or for [two] or more natural persons who are related as siblings or spouses (including former spouses), or direct lineal descendants by birth or adoption, spouses of such persons, the estates of such persons, or foundations, charitable organizations, or trusts established by or for the benefit of such persons; (iii) any trust that is not covered by clause (ii) and that was not formed for the specific purpose of acquiring the securities offered, as to which the trustee or other person authorized to make decisions with respect to the trust, and each settlor or other person who has contributed assets to the trust, is a person described in clause (i), (ii), or (iv); any person, acting for its own account or the accounts of other qualified purchasers, who in the aggregate owns and invests on a discretionary basis, not less than $25,000,000 in investments."[82] The Task Force believes that this standard would be an appropriate standard for defining a "qualified purchaser" for the purposes of transactions under the 1933 Act.

82 The 1996 Act, § 209, *supra* note 2.

D. SECONDARY TRADING EXEMPTIONS

In Section 4(1) of the 1933 Act, an exemption from registration is provided for transactions other than by an issuer, underwriter or dealer.[83] In Section 4(3) most transactions by dealers are exempted[84] and in Section 4(4) certain transactions not solicited by a dealer are exempted.[85] These exemptions have been used to facilitate secondary trading.[86]

Recommendation 24: ***The model exemption for securities listed in certain manuals containing financial and other information, which was adopted by the North American Securities Administrators Association on April 28, 1996, should be implemented by statute, rule or order in all states.***

Most state securities laws include various exemptions for offers and sales of securities applicable to both initial offerings and secondary trading. These exemptions include certain exchange exemptions, and various non-issuer exemptions based on such factors as the number of sales or types of transactions.

---

83 15 U.S.C. § 77d(1) (1994). The definition of underwriter under Section 2(u) of the 1933 Act is very complicated, as the term "underwriter" can include persons other than those involved in an underwritten registered offering.

84 *Id*. at § (3).

85 *Id*. at § (4).

86 In the 1996 Act, covered securities include those securities that are part of a securities transaction exempt from registration with the Commission under Sections 4(1), 4(3) (provided that the issuer files periodic reports with the Commission pursuant to Sections 13 or 15(d) of the Securities Exchange Act of 1934 (the "1934 Act")) and 4(4), and therefore, such securities are not subject to state registration provisions. A large number of issuers file periodic reports under the 1934 Act. An issuer that does not file periodic reports pursuant to Section 13 or 15(d) of the 1934 Act may continue to rely on exemptions available under state securities statutes. Such issuers include many foreign issuers.

The 1996 Act created a class of "covered securities" which are preempted from state registration requirements.[87] Included within that classification are securities exempt from registration under Section 4(1) and 4(3) of the 1933 Act if the issuer files required reports with the Commission under Section 13 or 15(d) of the 1934 Act. Thus, most secondary market transactions are no longer subject to state registration requirements.

One of the state exemptions most commonly relied upon for effecting secondary trades is the "manual exemption" set forth in Section 402(b)(2) of the Uniform Act.[88] This exemption from registration is provided for secondary transactions in securities of issuers as to whom certain information is contained in a securities manual. The manual exemption was incorporated into the Uniform Act in an effort to afford investors the protection of some minimum disclosure with respect to issuers whose securities are traded in the over-the-counter market. The rationale for the exemption is that the manual provides investors with information that would probably otherwise not be readily available. This information may assist investors in making more informed investment decisions. Although most states have adopted a manual exemption, the requirements of the exemptions and the manuals that are recognized vary considerably, thus making compliance difficult for brokers and dealers involved in effecting these transactions.

A consequence of a state imposing restrictions on the availability of the manual exemption is that the additional requirements may limit the ability of broker-dealers to trade securities of certain issuers in the secondary markets, and reduce the range of available investment choices for the citizens of some states. At a minimum, the additional restrictions create uncertainty about the availability of the exemption for a particular proposed transaction. Such uncertainty may create delays in executing transactions and tends to increase costs. The additional requirements are especially burdensome to trading in securities of foreign issuers because such

87 The 1996 Act, *supra* note 2 (amending Section 18 of the 1933 Act).

88 UNIF. SEC. ACT § 402(b)(2) (1956).

issuers may not be able to meet the conditions of the exemption and the relevant state statute may not provide an alternate exemption on which sellers can rely.

The Task Force concludes that the manual exemption can be an important and useful method of allowing secondary trading while ensuring that, at a minimum, certain financial information regarding a company is available so that it can be easily determined whether the exemption may be relied upon for trading a security in the secondary market. The Task Force believes, however, that the manual exemption must be uniform in order to be of optimum use to broker-dealers and investors. Consequently, the Task Force recommends that the model exemption for securities listed in certain manuals containing financial and other information which was adopted by the North American Securities Administrators Association on April 28, 1996[89] be implemented by statute or rule.

89 NASAA Model Amendments ¶ 4919, *supra* note 11.

Recommendation 25: ***In order to facilitate offerings in the international marketplace, state securities regulatory authorities should uniformly adopt exemptions to facilitate secondary trading of the securities of foreign issuers that meet minimum asset or market capitalization tests, or the securities that are traded on a recognized foreign stock exchange. The Securities and Exchange Commission is encouraged to facilitate the acceptance of international accounting standards.***

The securities of many foreign issuers would qualify for trading on the NYSE, AMEX or Nasdaq NMS, except for the inability of such companies to provide financial statements prepared in accordance with U.S. generally accepted accounting principles. The Commission may decide to allow foreign issuers to qualify for trading on U.S. securities markets using home country financial statements. A number of these companies are traded on major foreign exchanges in Europe and Asia, but are not currently traded in organized U.S. stock markets. Most state securities acts provide a secondary trading exemption for securities of issuers listed in certain financial manuals, but these exemptions are often too restrictive to permit trading in foreign issues. For example, since for many foreign issuers the periods for financial reporting do not coincide with the requirements for domestic issuers, those foreign issuers may not be able to update the information reported in the manuals in a timely manner so as to comply with the requirements of many state manual exemptions.

Given the increasing importance of investments in foreign securities to U.S. investors, states should facilitate secondary trading in securities of foreign issuers meeting prescribed minimum asset or market capitalization tests, or that are traded on a recognized foreign stock exchange, even if the issuer cannot meet the manual exemption requirements. In order to

accommodate the different financial reporting periods of foreign jurisdictions, the Task Force recommends that states uniformly adopt other exemptions that would be independent of the time constraints set forth in the manual exemption and parallel Commission requirements. Moreover, the Task Force recommends that states adopt the NASAA World Class Foreign Issuer Exemption[90] and that states adopt additional exemptions for securities traded on foreign exchanges that have entered into MOUs with NASAA, providing appropriate assurances as to listing standards.

E. EXEMPT NOTES, DRAFTS, BILLS OF EXCHANGE OR BANKER'S ACCEPTANCES

Recommendation 26: ***The Securities and Exchange Commission should adopt rules providing guidance regarding reliance upon the exemption from registration under the Securities Act of 1933 for sales of certain instruments.***

In the 1996 Act, Congress included within the definition of a "covered security"[91] those securities designated as exempt under Section 3(a) of the 1933 Act (with certain exceptions).[92] Under Section 3(a)(3), "any note, draft, bill of exchange or banker's acceptance which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited," is exempt.[93] The Commission in a 1961 release noted that "the legislative history of the 1933 Act

90 NASAA Statement of Policy on World Class Foreign Issuer Exemption, NASAA Reports (CCH) ¶ 3803 (Sept. 10, 1996).

91 State registration provisions are preempted with respect to covered securities.

92 The 1996 Act, § 102, *supra* note 2.

93 15 U.S.C. § 77c(a)(3) (1994).

makes clear that section 3(a)(3) applies only to prime quality negotiable commercial paper of a type not generally purchased by the general public, that is, paper issued to facilitate well recognized types of current operational business requirements and of a type eligible for discounting by Federal Reserve Banks."[94]

The securities laws of many states include an exemption equivalent to or expanding upon the exemption under Section 3(a)(3). Unlawful sales of notes occur frequently, and state securities regulatory authorities commonly bring actions against the issuers alleging that the notes did not meet the requirements for exempt securities under state statutes equivalent to Section 3(a)(3). The Commission should adopt rules providing guidance regarding reliance upon the exemption from registration set forth in Section 3(a)(3). The rules should set forth the conditions that must be satisfied in order to rely upon the exemption and incorporate state and federal administrative and judicial decisions relating to sales of securities in which the sellers improperly relied upon the exemption set forth in Section 3(a)(3).

---

94 Securities Act Release No. 33-4412, 1 Fed. Sec. L. Rep. (CCH) ¶ 2045 (Sept. 20, 1961). For a discussion of § 3(a)(3) of the Securities Act of 1933, *see* 3 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION pp. 1187-98 (1989 and Supp. 1996).

VIII. ISSUES AND RECOMMENDATIONS -- ENFORCEMENT ACTIONS BY MULTIPLE REGULATORY AND LAW ENFORCEMENT AGENCIES

The activities of an issuer, broker, dealer, agent, investment adviser or investment adviser representative may fall within the jurisdiction of several different regulatory authorities and law enforcement agencies including the Commission, state securities agencies, the SROs, and federal and state criminal prosecutorial authorities. Moreover, because the imposition of sanctions in one state gives rise to the possibility of revoking or suspending a registration in another state, even states in which the conduct did not occur have jurisdiction to review the conduct in order to determine whether or not to suspend or revoke the registration. Thus, the same conduct may result in multiple civil or criminal enforcement actions charging identical or substantially similar violations. Some of these multiple actions are justified when the conduct is such that the violator should not be permitted to be registered in any state, but in other situations, the burden on the defendant of multiple civil or criminal actions may be so great as to exceed the harm caused by the violation.

Recommendation 27: ***The Securities and Exchange Commission and state securities regulatory authorities, together with the self-regulatory organizations and state and federal criminal authorities, should develop protocols for determining which agency should initiate enforcement action in situations of concurrent jurisdiction, thereby reducing the number of duplicative enforcement actions.***

The Antitrust Division of the Department of Justice and the Federal Trade Commission (the "FTC") have encountered similar situations involving jurisdiction by both of these federal agencies to prosecute certain violations of federal antitrust statutes. These two agencies have entered into a liaison agreement which sets forth guidelines for determining when each agency will investigate and prosecute violations over which dual regulatory authority exists. Additionally, the FTC has implemented a program to facilitate the sharing of information with state antitrust enforcement authorities in merger investigations.[95] The Task Force urges the drafters of securities enforcement protocols to look to such antitrust protocols for guidance.

95 The information sharing program operates in connection with the National Association of Attorneys General Voluntary Pre-Merger Disclosure Compact (the "Compact"). Participants in the program are required to utilize the information for official law enforcement purposes. Additionally, the merging parties must consent to the sharing of information and must waive confidentiality protections provided under federal law. Trade Reg. Rep. (CCH) ¶¶ 13,211 to 13,213, 13,410 (1995).

IX. ISSUES AND RECOMMENDATIONS -- INTERSTATE COMPACTS[96]

The Task Force believes that a guiding principle of state and federal securities regulatory policy should be the facilitation of capital formation.[97] Capital formation will be facilitated through state efforts to harmonize regulation. One means by which harmonization can be facilitated is through formation of interstate compacts.

Recommendation 28: ***State securities regulatory authorities should form one or more interstate compacts for the purpose of promoting uniformity in state regulation. Where necessary, state legislatures should enact enabling legislation to permit the formation of an interstate compact. In addition, Congress should approve such interstate compacts.***

State requirements in some areas of securities regulation are very diverse. The diversity in regulation creates a compliance burden for the regulated person or entity.

Interstate compacts have been utilized in various commercial arenas for the purpose of creating uniformity in regulation by facilitating cooperation, furthering efficient practices, and exchanging data and views on mutual problems. Other state regulatory agencies such as those which regulate banking and insurance have utilized interstate compacts successfully to create a high degree of uniformity in regulation and to establish minimum levels of competence and capability of the regulators. An interstate compact would provide a means by which state

---

96 For background information on interstate compacts, *see* Appendix D, page 111.

97 In the 1996 Act, Congress requires the Commission to consider promotion of capital formation in connection with its rulemaking activities. The 1996 Act, § 106, *supra* note 2.

securities regulatory authorities could coordinate interpretations of policies they have adopted. State securities regulatory authorities should form one or more interstate compacts for the purpose of promoting uniformity in state regulation. Where necessary, state legislatures should enact enabling legislation to permit the formation of an interstate compact. Congress should approve such interstate compacts.

APPENDIX A

Biographies of Task Force Members

DEE RIDDELL HARRIS

Mr. Harris is a managing director of Hill Thompson Capital Markets, Inc., a New York investment banking firm with offices in Phoenix, Arizona. He served as director of the Securities Division of the Arizona Corporation Commission from November 1989 to February 1997. Prior to this, he was executive vice president and chief operating officer of Outlook Capital Management, Inc., a national real estate investment company based in Long Beach, California.

Mr. Harris is the immediate past president of the North American Securities Administrators Association ("NASAA"). He is a member of the Arizona Commerce and Economic Development Commission, immediate past chairman of the American Bar Association ("ABA") Subcommittee on Developments in State Securities Regulation, co-chairman of the Book Acquisition Subcommittee of the Publications Committee of the ABA Business Law Section, and a member of the ABA Committee on Federal Regulation of Securities.

A charter member of the planning committee for the Arizona Venture Capital Conference, he helped organize five successful venture capital conferences in Phoenix resulting in investments in excess of $60 million in showcased Arizona companies. Mr. Harris served on a committee to develop the Arizona Strategic Plan for Economic Development in 1992 and is a member of the Phoenix Committee on Foreign Relations. He is a director and former officer of the Enterprise Network, a member of the Arizona Business Leadership Association, and a former member of the NASD Ad-hoc Committee on Uniform Settlement and Transfer of Limited Partnership Interests. In addition, Mr. Harris is a former member of the CFTC - State Advisory Committee of the U.S. Commodity Futures Trading Commission, and served on the planning committee for the SEC Government-Business Forum on Small Business Capital Formation in 1992 and 1993.

From 1993 to 1996, he served on the planning committee for the annual Los Angeles Securities Regulation Seminar.

Mr. Harris played a major role in establishing the Arizona Stock Exchange, an electronic call auction market. In 1991, he was awarded the designation “Friend of Small Business” by Arizona Small Business United. He was awarded the NASAA Blue Sky Cube, its highest honor, in 1996, and a NASAA Distinguished Service Award in 1997. Mr. Harris has testified six times before Congress regarding pending federal securities legislation. He was heavily involved in negotiations relating to the National Securities Markets Improvement Act of 1996 and the Limited Partnership Rollup Reform Act of 1993.

Mr. Harris received his Bachelor of Science in Business Administration degree in economics from the University of Tulsa in 1962 and a Juris Doctorate from the University of Wisconsin in 1972.

PHILIP A. FEIGIN

Mr. Feigin has been the Securities Commissioner for the Colorado Securities Division since March of 1988. Previously, he served as the Assistant Securities Commissioner in Colorado from 1982 to 1988, and before that, was the Chief Attorney of the Enforcement Division of the Office of the Wisconsin Commissioner of Securities from 1979 to 1982. He began his legal career in Madison, Wisconsin in private practice from 1977 to 1979.

Mr. Feigin has been very active in the activities of the North American Securities Administrators Association ("NASAA") since 1980, and has held many positions in the organization. In October 1994, he began his one year term as NASAA President. He also serves as a member of the State Regulation of Securities Committee of the Business Law Section of the American Bar Association and as a member of the Board of Trustees of the Investor Protection Trust. He is a former member of the CFTC - State Advisory Committee of the U.S. Commodity Futures Trading Commission. Mr. Feigin was also one of the drafters of the Model State Commodity Code.

Over the years, Mr. Feigin has testified on behalf of NASAA before numerous Congressional and state legislative committees on a variety of subjects, including the Racketeer Influenced and Corrupt Organizations Act, commodities issues, securities activities of banks, and other securities-related matters.

He received a Bachelor of Arts degree in American History from the University of Wisconsin - Madison in 1971, and a Juris Doctorate from Pepperdine University School of Law in 1977.

MARK J. GRIFFIN

Mr. Griffin is the Director of the Division of Securities within the Utah Department of Commerce. Mr. Griffin's career in securities regulation spans twelve years, during which he has been an investigator, Director of Licensing, Director of Enforcement, prosecutor and administrator of two state securities agencies in Utah, and previously, Nevada. He has held the titles of Assistant Utah Attorney General and Nevada Deputy Secretary of State.

Mr. Griffin is a member of the Board of Trustees of the Investor Protection Trust Fund, dedicated to the protection of investors through nationwide media educational programs. He is also a member of the Board of Directors of the Wayne Brown Institute, a non-profit organization engaged in mentoring and facilitating capital formation for emerging high technology companies in several western states. He is the president of the North American Securities Administrators Association.

Mr. Griffin has testified six times before the United States Congress and has conducted two White House briefings concerning investors' rights and civil litigation under federal securities laws. He recently served on Utah Governor Leavitt's Task Force on Capital Formation and has been a guest lecturer on topics of capital formation, investment fraud avoidance and securities regulation.

Mr. Griffin holds a Juris Doctorate from Brigham Young University and is a member of the Utah State Bar.

STEPHEN L. HAMMERMAN

Mr. Hammerman is Vice Chairman of the Board of Merrill Lynch & Co., Inc. He served as New York Regional Administrator for the United States Securities and Exchange Commission from 1979-1981. From 1964 to 1968, Mr. Hammerman served as an Assistant United States Attorney in the Criminal Division for the Southern District of New York.

In 1985, Mr. Hammerman was appointed by President Reagan to the Board of Directors of the Securities Investors Protection Corporation. He also served as the 1988 Chairman of the Board of Governors of the National Association of Securities Dealers. From June 1995 to June 1997 he served on the Board of Directors of the New York Stock Exchange. Mr. Hammerman currently serves on the boards of the Long Island Jewish Medical Center, the National Center for Disability Services, Nassau County Crimestoppers, and the Police Athletic League.

He graduated from the University of Pennsylvania's Wharton School in 1959 and received his law degree in 1962 from New York University.

THEODORE A. LEVINE

Mr. Levine is general counsel for PaineWebber Group, Inc. and executive vice president of PaineWebber Incorporated.

Mr. Levine began his career in 1969 as a trial lawyer with the United States Securities and Exchange Commission ("SEC"). He remained at the SEC for fourteen years, rising to the position of associate director in the Division of Enforcement. In February 1984, he joined the Washington, D.C.-based law firm of Wilmer, Cutler and Pickering, where he was a partner for nine and one-half years.

Mr. Levine was admitted to the practice of law in the Commonwealth of Virginia in September 1969, admitted to practice in the District of Columbia in May 1970, admitted to practice before the Supreme Court in 1980, and admitted to practice in the State of New York in August 1993.

He is a member of the American Bar Association Committee on Federal Regulation of Securities, and its Advisory Committee to the Committee on Federal Regulations of Securities. He is also a member of the Executive and Planning Committees of the Ray Garrett Corporate and Securities Law Institute; the New York State Bar Association; the Securities Industry Association -- Compliance and Legal Division; the NASD Regulation, Inc. Board of Directors and its National Business Conduct Committee; the Board of Advisors of the George Washington University Law School Alumni Association; the Securities Regulation Institute Advisory Board and the Practicing Law Institute Securities Institute Advisory Committee.

Mr. Levine received a Bachelor of Arts degree from Rutgers University in 1966, and his Juris Doctorate from George Washington University National Law Center in 1969.

HUGH H. MAKENS

Mr. Makens has been a partner with the firm of Warner Norcross & Judd, LLP, based in Grand Rapids, Michigan since 1978. Prior to joining the firm, he served as the Director of the Michigan Corporation & Securities Bureau (1972-78) and as a trial attorney with the United States Securities & Exchange Commission ("SEC") (1966-72). He served in the U.S. Army Corps of Engineers with a rank of Captain, and later as Captain, Judge Advocate General Corps of the Army Reserve.

He has held teaching appointments with Oakland University; the Wayne County Sheriff's and Policy Academy; and at the Thomas M. Cooley Law School.

A member of the American Bar Association ("ABA"), the Michigan Bar Association, the Illinois Bar Association, the Chicago Bar Association and the Grand Rapids Bar Association, Mr. Makens also is a past treasurer, past secretary and past vice president of the Detroit Chapter of the Federal Bar Association. He is a past president of the North American Securities Administrators Association (1976-77). Mr. Makens is a member of the Advisory Committee of the Michigan Corporation & Securities Bureau. His ABA committee memberships include the past chairmanship of the State Regulation of Securities Committee (1983-86); the chairmanship of the Meetings Committee of the Section of Business Law; the Federal Regulation of Securities Committee and its sub-committees on Market Regulation; the Committee on Economics of Law Practice of the Law Practice Management Section. He previously served on the Legal Advisory Board of the National Association of Securities Dealers (1990-94), President of the Central Securities Administrator's Council (1975-76), member of a federal advisory committee of the SEC (1973-76), the CFTC Advisory Committee on State Jurisdiction and Responsibilities Under the Commodity Exchange Act (1977-78), the Midwest Association of Securities Administrators

Franchise Law Committee (past chairman) and Real Estate Limited Partnership Committee (past vice chairman).

State committee appointments have included the Attorney General's Advisory Committee on Rules to Implement the Michigan Consumer Protection Act (1977-78), the Attorney General's Municipal Finance Advisory Committee (1977-78) and the Michigan Governor's Advisory Commission on Administrative Law (1977-82).

Mr. Makens has lectured across the country at universities, service clubs and national professional organizations on topics involving state and federal securities laws, corporation law, real estate law and franchise law, Regulation "D" offerings and other private placements, and broker-dealer and investment adviser regulation. His writings appeared in numerous publications such as *The Michigan CPA*, *The UCLA Law Review*, *Wayne Law Review*, *University of Baltimore Law Review*, *The Business Lawyer*, the *ALI-ABA Course Materials Journal* and various Practicing Law Institute publications.

Mr. Makens is recognized in the publication "Best Lawyers in America" by Naifeh & Smith.

Mr. Makens obtained his Bachelor of Science in Business Administration Degree, *cum laude*, from the Michigan Technological University in 1961 and his Juris Doctorate from Northwestern University School of Law in 1964.

ANTHONY B. PETRELLI

Mr. Petrelli is a Director and immediate past Chairman of the Regional Investment Bankers Association. He is senior vice president, manager of Corporate Finance - Investment Banking Department and member of the Management Committee at Neidiger, Tucker, Bruner, Inc. Prior to this, Mr. Petrelli served as senior vice president and director of Wall Street West, Inc. (1984-87), executive vice president, director and manager of Corporate Finance Department of Hanifen, Imhoff, Inc. (1978-84), and assistant vice president and manager of corporate underwritings and syndication of Bosworth, Sullivan & Co., Inc. (1972-87).

Mr. Petrelli serves currently as Advisory Director for Rocky Mountain Internet, a publicly traded Internet access provider (1996 to present); ImagMatrix Corporation, a publicly traded document imaging software company (1996 to present); Vari-L. Company, a publicly traded component manufacturer for the wireless communication industry (1994 to present); and for Carilyle Golf, Inc. (1994 to present). Mr. Petrelli has also held positions on the board of Homefree Village Resorts, Inc., a real estate development and management company, (1983-present), The Rockies Fund, Inc., a publicly traded venture capital firm, (1983-84), and Harris & Paulson, Inc., a publicly traded firm providing integrated computer systems to major law firms throughout the United States (1982-84). He has also served as an advisory director at United Petrosearch, Inc., a publicly traded oil and gas exploration and production company (1980-82). He served on the Board of Directors of the Association for Corporate Growth, Denver Chapter.

Additionally, Mr. Petrelli has served as a member of the National Fixed Income Committee of the NASD (1990-1996); a member of the District Surveillance Committee, District 3, NASD (1990-1993), an arbitrator for the NASD (1982 to present); Chairman of the District Business Conduct Committee, District 3, NASD (1990-1991); and as a member of the Advisory Committee of the Colorado State Securities Division (1990- 1993).

At the University of Colorado, Mr. Petrelli received a Bachelor of Science in Business Finance in 1974 and a Masters of Business Administration in 1979.

DAVID S. RUDER

Mr. Ruder is the William W. Gurley Memorial Professor of Law at Northwestern University School of Law and senior counsel in the Chicago office of Baker & McKenzie. He has been a member of the faculty at Northwestern University School of Law since 1961. As the School's Dean (1977 to 1985), he planned the construction of the school's Arthur Rubloff Building, and helped to persuade the American Bar Association and the American Bar Foundation to adopt the building as their headquarters.

From 1987 to 1989, Mr. Ruder served as Chairman of the United States Securities and Exchange Commission ("SEC"). While at the SEC, he actively participated in a number of important matters, including improvement of the securities market following the October 1987 market crash; SEC activities in international securities regulation; and various enforcement matters, disclosure initiatives, and penny stock market reform. While serving as the SEC Chairman, Mr. Ruder testified before Congress thirty-five times and delivered more than one hundred speeches.

From 1990 to 1993, he served as a member of the Board of Governors of the National Association of Securities Dealers, Inc. ("NASD"). He was Chairman of the NASD's Legal Advisory Board from 1993 to 1996 and is Chairman of its Arbitration Policy Task Force. From 1994 to 1997 he was Chairman of the Advisory Board of the California Securities Regulation Institute. Mr. Ruder is a member of the Board of Trustees of the Financial Accounting Foundation. He serves on the planning committee for Northwestern's Corporate Counsel Institute and the Ray Garrett Jr. Corporate and Securities Law Institute. He is a member of the American Law Institute, and is admitted to practice law in Illinois and Wisconsin. He is President of Northwestern's Corporate Counsel Center, which sponsors legal research and provides continuing professional education programs for corporate counsel.

Mr. Ruder received a bachelor's degree, *cum laude*, in 1951 from Williams College, where he was a member of Phi Beta Kappa and Gargoyle, the senior honorary society. He received his law degree with honors in 1957 from the University of Wisconsin, where he was a member of the Order of the Coif, editor-in-chief of the *Wisconsin Law Review* and the recipient of the Salmon W. Dalberg Prize as the outstanding graduating student.

JOEL SELIGMAN

Mr. Seligman has been the Dean and Samuel M. Fegtly Professor of Law at the University of Arizona College of Law since 1995. Before to this appointment, he served as Professor of Law at the University of Michigan Law School (1987-95); Visiting Professor of Law at the University of Michigan Law School (1986-87); Professor of Law at the George Washington University Law School (1983-86), and taught at the Northeastern University Law School (1977-83).

Mr. Seligman also worked with the Corporate Accountability Research Group (1974-77) and served as a consultant with the Federal Trade Commission (1979-82), with the Department of Transportation (1983), and with the Office of Technology Assessment (1988-89).

Mr. Seligman is an *ex officio* member of the Arizona State Bar Board of Governors, and is an inactive member of the State Bar of California. He is a former member of the Advisory Committee to the American Law Institute Corporate Governance Project (1980-92) and the Legal Advisory Board of the National Association of Securities Dealers, Inc. (1994-96).

Books he has authored include *Corporations: Cases and Materials*; *The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance*; *The High Citadel: The Influence of Harvard Law School* and *The SEC and The Future of Finance*. He is also co-author of *Securities Regulation* (a multi-volume treatise), *Fundamentals of Securities Regulation* and *Constitutionalizing the Corporation: The Case for the Federal Chartering of Giant Corporations*.

Mr. Seligman has been widely published in the *Business Lawyer*, *Harvard Law Review*, *George Washington Law Review*, and *The Michigan Law Review*, on topics including the SEC, capital markets, federal securities law and regulation, corporate law, shareholder litigation, international securities markets, corporate governance, shareholder voting rights, municipal securities disclosure, and mandatory corporate disclosure.

He received a Bachelor of Arts degree, *magna cum laude*, from the University of California at Los Angeles, where he was elected to *Phi Beta Kappa*, in 1971 and earned his Juris Doctorate, *cum laude*, from Harvard Law School in 1974.

MARIANNE K. SMYTHE

Ms. Smythe has been a partner with the Washington, D.C.-based law firm of Wilmer, Cutler and Pickering since 1993. She previously served as the Director of the Division of Investment Management of the United States Securities and Exchange Commission ("SEC") (1990-93). Prior to assuming the Directorship, Ms. Smythe served the SEC as Executive Assistant to the Chairman (1990), Associate Director of the Division of Investment Management (1988-90) and Attorney Fellow in the Division of Investment Management (1987-88).

Prior to these appointments, Ms. Smythe was Professor of Law at the University of North Carolina at Chapel Hill School of Law (1985-89) and Associate Professor (1981-85). She also served as that institution's Assistant Provost (1984-87). She has held the posts of Deputy Director, Division of Enforcement of the Commodity Futures Trading Commission (1980-81); Associate General Counsel, Pesticides, the United States Environmental Protection Agency (1980); and Assistant Director of the Division of Market Regulation of the SEC (1979-80).

Ms. Smythe also served as a United States Peace Corps volunteer, teaching secondary school biology in Nigeria (1964-66). She was a co-director of the Continuing Legal Education Southeastern Conference on Corporate and Securities Law at the University of North Carolina at Chapel Hill (1982-87); council member of the American Bar Association's Section of Administrative Law and Regulatory Practice (1989-92) and a member of the Board of Visitors, J. Reuben Clark School of Law, Brigham Young University.

Ms. Smythe's articles have appeared in publications including the *North Carolina Law Review*, *Columbia Law Review*, and *Administrative Law Journal*. Her topics spanned areas of environmental law, criminal law, self-regulation of the securities industry, and reparations

programs of the CFTC. She was also an editor of *"Special Study of the Options Markets"* while on the staff of the SEC (1978).

In 1963, Ms. Smythe received her Bachelor of Science Degree in Biology from Bucknell University, where she was elected to Phi Sigma, the national biology honorary society. From 1967 to 1971, Ms. Smythe was a candidate for a Doctor of Philosophy degree in British History at the University of North Carolina. In 1974, she earned her Juris Doctorate from the University of North Carolina at Chapel Hill School of Law, where she was elected to the Order of the Coif and was articles editor of the *North Carolina Law Review*.

RICHARD F. SYRON

Mr. Syron became the Sixteenth Chairman and Chief Executive Officer of the American Stock Exchange on April 1, 1994. One of the nation's top banking executives, with more than 20 years of government and financial experience, Mr. Syron had been president of the Federal Reserve Bank of Boston since January 1989. He also worked at the Federal Reserve Bank of Boston on two previous occasions, and in between served with the Federal Reserve Board as assistant to chairman Paul Volcker, and with the U.S. Treasury Department in Washington, D.C.

A prominent figure in the Boston business community, Mr. Syron was integrally involved in resolving the banking crisis in New England in the early 1990s, and was one of the first business leaders to recognize the credit squeeze that gripped New England businesses during the past several years.

Mr. Syron received a Ph.D. in economics from Tufts University in 1971, after earning an M.A. in the same field there two years earlier. In 1966 Mr. Syron graduated *magna cum laude* from Boston College with a Bachelor of Science degree in economics. He also holds honorary degrees from Boston College and Bentley College.

RICHARD THORNBURGH

Mr. Thornburgh is counsel to the Pittsburgh-based law firm of Kirkpatrick & Lockhart LLP in its Washington, D.C. office.

Elected Governor of Pennsylvania in 1978 and re-elected in 1982, he is the only Republican governor to serve two successive terms. In a 1986 Newsweek poll, he was named by fellow governors as one of the nation's most effective big-state governors. During his tenure as Governor, Mr. Thornburgh balanced state budgets for eight consecutive years, reduced personal and business tax rates, and cut the state's record-high indebtedness, leaving a surplus of $350 million. Under his leadership, Pennsylvania's unemployment rate, then among the ten highest in the nation, fell to rank among the ten lowest. While Mr. Thornburgh was in office, the State System of Higher Education was created and state funding for higher education and student loans reached record-high levels. Following the Three Mile Island nuclear accident in 1979, he was described by observers as "one of the few authentic heroes of that episode as a calm voice against panic."

Subsequent to his Governorship, he was unanimously confirmed by the United States Senate to the post of Attorney General of the United States, serving under Presidents Reagan and Bush (1988-91). He mounted an unprecedented attack on white-collar crime as the Department of Justice obtained a record number of convictions of savings and loan and securities officials, defense contractors and corrupt public officials. Mr. Thornburgh established strong ties with law enforcement agencies around the world to combat drug trafficking, money laundering, terrorism and international white collar crime. As Attorney General he also played a leading role in the enactment of the Americans with Disabilities Act, the most important civil rights legislation since the 1960s, and took vigorous action against racial, religious and ethnic "hate crimes." He renewed efforts to enforce the nation's anti-trust and environmental laws as

well. All told, Mr. Thornburgh served in the Justice Department under five Presidents, beginning as a United States Attorney in Pittsburgh (1969-75) and Assistant Attorney General in charge of the Criminal Division (1975-77).

Mr. Thornburgh twice personally argued and won cases before the United States Supreme Court, validating government drug testing policies and advancing the rights of victims of violent crimes. He is one of only seventeen persons to be named as honorary Special Agent of the Federal Bureau of Investigation.

Mr. Thornburgh served in the United Nations (1992-93), as the highest-ranking American in the organization, and was in charge of personnel, budget and finance matters. His report to the Secretary-General on reform, restructuring and streamlining efforts, designed to make the United Nations peacekeeping, humanitarian and development programs more efficient and cost-effective, was widely-praised. Mr. Thornburgh also served as Director of the Institute of Politics at Harvard University's John F. Kennedy School of Government (1987-88).

He is a member of the National Academy of Public Administration, the American Bar Foundation, the American Judicature Society and the Council on Foreign Relations. In 1992, he was honored by the American Legion with its highest award, the Distinguished Service Medal. In December 1993, he was an invited observer to Russia's legislative elections and, in June 1994, he directed a study for the International Republican Institute on the rule of law in Hong Kong. As an elected Delegate to Pennsylvania's historic Constitutional Congress (1967-68), Mr. Thornburgh spearheaded efforts at judicial and local government reform.

Mr. Thornburgh received an engineering degree from Yale University and his law degree from the University of Pittsburgh, where he served as an editor of the Law Review. He has been awarded honorary degrees by thirty other colleges and universities.

MARK D. TOMASKO

Mr. Tomasko is the immediate past Executive Vice President and Executive Director of the Investment Counsel Association of America, Inc. ("ICAA"), a national professional association of investment advisers. Prior to joining the ICAA, he served in the positions of Vice President, General Counsel and Secretary for Esselte Business Systems, Inc., a $1.4 billion NYSE office supplies manufacturer. He also held the title of Group Counsel of The Singer Company, where he was responsible for the legal affairs of five divisions. Mr. Tomasko started his career with the New York law firm of Chadbourne, Parke, Whiteside and Wolff.

Mr. Tomasko is a member of the Association of the Bar of the City of New York and of the American Bar Association.

Mr. Tomasko received a Bachelor of Arts degree in economics from Yale University in 1970 and his Juris Doctorate from the University of Pennsylvania Law School in 1973.

STEVEN M. H. WALLMAN

Mr. Wallman was nominated to the U.S. Securities and Exchange Commission by President Clinton and was confirmed by the Senate in June 1994. Prior to serving on the Commission, Mr. Wallman was in private practice with the Washington law office of Covington & Burling. He joined the firm in 1978 as an associate, becoming a partner in 1986. While at Covington & Burling, Mr. Wallman specialized in general corporate, securities, contract and business law. He also worked for the Boston Consulting Group in 1978.

Mr. Wallman is a member of the American Law Institute and of the American Bar Association.

Mr. Wallman received his bachelor's degree from Massachusetts Institute of Technology ("M.I.T.") in 1975, his Master's degree from the Sloan School of Management at M.I.T. in 1976 and his Juris Doctorate from the Columbia University School of Law in 1978.

APPENDIX B

Background Information Regarding State and Federal Securities Laws

A. REGISTRATION OF INVESTMENT ADVISERS AND INVESTMENT ADVISER REPRESENTATIVES

Prior to enactment of the 1996 Act,[98] the Investment Advisers Act provided that it was unlawful for an investment adviser to use the mails or any means or instrumentality of interstate commerce that is related to any advisory business if the investment adviser was not registered with the Commission under the Investment Advisers Act.[99] Most states have similar registration requirements for investment advisers,[100] except for Colorado, Iowa, Ohio and Wyoming[101] which do not require registration of advisers. The Commission has recently promulgated rules with a significantly different definition.

The Investment Advisers Act defines an investment adviser as "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as a part of a regular business, issues or promulgates analyses or reports concerning securities."[102] The scope of the definition encompasses a broad range of entities, including sole-proprietorships, that provide diverse

98 The 1996 Act, §§ 301 to 308, *supra* note 2. The investment adviser provisions of the 1996 Act are designated within the 1996 Act as the Investment Advisers Supervision Coordination Act. For a discussion of these provisions, *see* page 14. These provisions will be effective in April 1997.

99 15 U.S.C. § 80b-3(a) (1994).

100 Some states license rather than register investment advisers. In this report only the term "registered" is used.

101 Although Colorado, Iowa and Wyoming do not currently regulate investment advisers, each state's legislature has considered bills to do so. Due mainly to industry opposition, these states have been unable to adopt regulations covering investment advisers. Ohio, too, has introduced legislation to regulate investment advisers in the past. However, as a result of opposition of various persons covered by the proposed regulations, Ohio has not reintroduced legislation recently.

102 15 U.S.C. § 80b-2(a)(11) (1994).

services under differing fee structures. The Investment Advisers Act separately defines "person associated with an investment adviser"[103] and does not require registration of those individuals.

The Uniform Act,[104] upon which most states' securities acts are based, defines the term "investment adviser" in Section 401(f). The definition set forth under the Uniform Act is similar to that provided in the Investment Advisers Act.[105] In 1986, the North American Securities Administrators Association, Inc. ("NASAA") recommended significant amendments to Section 401(f) ("NASAA Model Amendments").[106] The NASAA Model Amendments specifically include financial planners within the definition of "investment adviser"[107] and add a definition of "investment adviser representative."[108]

The Commission has reported an enormous growth over the past fifteen years in the number of investment advisers registered with the Commission, from approximately 5,000 in 1981[109] to 12,700 in 1988[110] to 21,500 as of September, 1995.[111] Although it cannot be said for certain, the significant increase in the industry is generally attributed to the rapid growth of the

---

103 15 U.S.C. § 80b-2(a)(17) (1994).

104 UNIF. SEC. ACT (1956).

105 The official comment to the Uniform Act indicates that Section 401(f) was "taken almost verbatim" from the definition in the Investment Advisers Act. UNIF. SEC. ACT § 401(f), National Conference of Commissioners on Uniform State Laws comment (1956).

106 NASAA periodically adopts amendments and model rules to the Uniform Act. *See generally* NASAA Model Amendments to the Uniform Securities Act of 1956, NASAA Reports (CCH) ¶ 4907 (Oct. 1996).

107 *Id. See* Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as an Integral Component of Other Financially Related Services, Investment Advisers Release No. 770, 46 F.R. 41,771 (Aug. 13, 1981). The commentary to the Uniform Securities Act of 1956 indicates that the "holding out" language was patterned after SEC Rel. No. IA-770. NASAA Model Amendments to the Uniform Securities Act of 1956, NASAA Reports (CCH) ¶ 4881 (May 1991).

108 NASAA Model Amendments to the Uniform Securities Act of 1956, NASAA Reports (CCH) ¶ 4881 (May 1991).

109 1981 SEC ANN. REP. (1981).

110 1988 SEC ANN. REP. (1988).

111 1995 SEC ANN. REP. (1995).

number of entities that provide financial planning services in addition to providing investment advisory services.

There are three major categories of investment advisers based upon the principal type of services they provide to their clients. These three categories include: (1) large money managers; (2) smaller, mostly local, financial planners; and (3) entities and professionals (*e.g.*, broker-dealers and certified public accountants) that provide investment advisory services in conjunction with other financially-related services. Within each of these larger categories are subcategories, as explained below.

1. *Money Managers*.

The first category, large money managers, includes those investment advisers that provide investment advice to large institutions, investment companies and high net worth individuals. In many cases, money managers do not maintain custody of client assets. Money managers are further distinguished by whether they provide discretionary or non-discretionary money management services. A discretionary money manager has the authority to invest, on a day-to-day basis, the client's assets in conformance with mutually agreed upon investment objectives. A money manager may have discretionary authority over the assets of some clients and have non-discretionary authority over the assets of other clients. Additionally, a money manager may have custody of a client's portfolio.

2. *Financial Planners.*

In contrast to money managers, financial planners generally do not have discretionary authority over clients' assets. Traditionally, financial planners do not manage a client's assets; rather they assist clients in establishing an overall financial plan. Persons who may be financial planners include a wide variety of individuals in various occupations, such as accountants, attorneys, insurance agents, and registered representatives of broker-dealers. With few exceptions, there is neither a federal nor a state regulatory definition of a financial planner. Therefore, any person who so chooses may designate himself or herself as a "financial planner" or a "financial consultant" or use some other related title. It is important to note, however, that all investment advisers are not financial planners and, conversely, for regulatory purposes, all financial planners are not investment advisers.

In 1987, the Commission issued Release No. IA-1092 relating to the applicability of the Investment Advisers Act to financial planners and other persons who provide investment advice as a component of other financial services.[112] Release No. 1092 provides guidance as to the types of business activities that will bring an entity within the scope of the definition of "investment adviser."

3. *Dually-Regulated Entities and Professionals*.

The third category of investment advisers is best described as including those entities and individuals that provide investment advisory services to complement other financially-related services that such entities and individuals provide. These entities and individuals are subject to

112 Applicability of Investment Adviser Laws to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services, Investment Advisers Release No. 1092, 52 F.R. 38400 (Oct. 8, 1987).

regulatory oversight beyond that imposed on investment advisers in connection with their primary businesses.

For example, broker-dealers generally provide services based upon the actual purchasing and selling of securities. In order to provide its clients with a full range of services, a broker-dealer also may provide investment advisory services. As a result of these dual roles, the brokerage firm is regulated by both the Commission and most state securities regulators as both a broker-dealer and an investment adviser. Some states, however, exempt a registered broker-dealer from registering as an investment adviser,[113] and the Investment Advisers Act exempts from the definition of investment adviser any broker-dealer or agent who provides advice "solely incidental" to its business as a broker-dealer and who receives no special compensation for such services.[114]

Professionals such as accountants and attorneys may offer investment advice to their clients in conjunction with other services they provide. These professionals are licensed by the state to practice their profession and are subject to regulatory oversight by the licensing authority. The Investment Advisers Act and the NASAA Model Amendments, generally exclude from the definition of investment adviser any lawyer, accountant, engineer, or teacher, who provides investment advice "solely incidental" to the practice of the profession.[115]

113 *See supra* note 32.

114 15 U.S.C. § 80b-2(a)(11) (1994).

115 *Id.*; UNIF. SEC. ACT § 401 (1956).

4. *Exclusions and Exceptions from the Definition of "Investment Adviser."*

The state and federal definitions of investment adviser include extensive exclusions and exceptions. In addition to the exclusions and exceptions discussed above, the Investment Advisers Act and the Uniform Act generally exclude from the definition of investment adviser any bank, savings institution or trust company; any publisher of a bona fide newspaper or business or financial publication of general or regular circulation that renders only impersonal advice; and other persons as so designated by either rule or order of the regulator.[116]

5. *Investment Adviser Representatives.*

The NASAA Model Amendments exclude from the definition of an investment adviser a person registered at the state level as an investment adviser representative.[117] Additionally, the Investment Advisers Act generally excludes persons whose advice is limited to securities that are the direct obligations of the United States or securities of corporations in which the United States has a direct or indirect interest.[118] There is no comparable exclusion at the state level.

As noted above, the Investment Advisers Act does not include a definition of the term "investment adviser representative," but instead provides a definition of a "person associated with an investment adviser."[119] A "person associated with an investment adviser" is defined as "any partner, officer or director of such investment adviser (or any person performing similar functions), or any person directly or indirectly controlling or controlled by such investment adviser, including any employee of such investment adviser, except . . . persons associated with an

---

116 15 U.S.C. § 80b-2(a)(11) and NASAA Model Amendments § 401(f), *supra* note 10.

117 NASAA Model Amendments, § 401(f), *supra* note 10.

118 15 U.S.C. § 80b-2(a)(11) (1994).

119 15 U.S.C. § 80b-2(a)(17) (1994).

investment adviser whose functions are clerical or ministerial shall not be included in the meaning of such term."[120] The Commission does not separately register investment adviser representatives, though key individuals are required to provide extensive disclosure to the Commission. Also, there is no self-regulatory organization for investment advisers or investment adviser representatives.

The term "investment adviser representative" appears in the statutes of thirty-three states regulating the activity of investment advisers. The NASAA Model Amendments define "investment adviser representatives" as the individuals employed by or associated with an investment adviser (including partners, officers, directors or persons occupying a similar status or performing similar functions), except clerical or ministerial personnel, who (1) make recommendations or otherwise render advice regarding securities, (2) manage accounts or portfolios of clients, (3) determine which recommendation or advice regarding securities should be given, (4) solicit, offer, or negotiate for the sale of or sell investment advisory services, or (5) supervise employees who perform any of the foregoing.[121]

120 *Id.*

121 NASAA Model Amendments § 401(g), *supra* note 10.

B. REGISTRATION OF SECURITIES

Section 5 of the 1933 Act provides that it is unlawful to use the mails and interstate commerce to offer, sell or offer to buy securities, deliver securities or transmit a prospectus unless a registration statement is effective with the Commission with respect to such security.[122] Registration statements filed with the Commission are governed by the informational requirements of Section 7[123] and Section 10[124] as well as the anti-fraud provisions in Sections 11 and 17.[125] Except for certain rules regarding securities of blank check companies and limited partnership rollup transactions, registration statements filed under the 1933 Act are subject to a "full disclosure" standard. The Commission has interpreted this standard through adoption of rules and regulations, including disclosure guides for specified industries. The federal regulatory system generally does not include substantive review criteria similar to that included in some state securities registration statutes such as requirements for the escrow of “cheap stock” held by promoters, repayment of loans made to promoters or escrow of offering proceeds.[126]

While the 1933 Act includes a number of exemptions from registration, an issuer making a public offering of securities in the U.S. generally must file a registration statement with the Commission pursuant to Section 5 of the 1933 Act. This includes issuers of securities listed on national securities exchanges, foreign private issuers and even foreign governmental issuers. In addition to receiving registration statements filed under Section 5 of the 1933 Act, the Commission is responsible for administering federal laws applicable to proxy statements, tender

---

122 15 U.S.C. § 77e (1994)

123 15 U.S.C. § 77g (1994).

124 15 U.S.C. § 77j (1994).

125 15 U.S.C. § 77q (1994).

126 The 1933 Act does include provisions relating to the escrow of proceeds raised in an offering by a blank check company. 17 C.F.R. § 230.419 (1996).

offers and the disclosure system for public companies and receiving filings mandated by those laws.

State securities statutes also provide for the registration of securities offered or sold in both issuer and non-issuer transactions.[127] The Uniform Act and other state securities statutes establish numerous exemptions from registration by designating as exempt certain securities and certain transactions.[128] These exemptions mirror many of those provided by Section 3 (Exempt Securities)[129] and Section 4 (Exempt Transactions)[130] of the 1933 Act.

In the 1996 Act, Congress preempted state registration provisions with regard to "covered securities."[131] Covered securities include a security listed or approved for listing on notice of issuance on the NYSE or the AMEX or listed on the Nasdaq NMS as well as a security issued by an investment company that is registered under the Investment Company Act or that has filed a registration statement under the 1933 Act.[132] A person seeking to offer or sell a security that is not a covered security must comply with both state and federal registration requirements (unless there is an exemption available at one or both levels of government).

The Uniform Act sets forth three methods of securities registration: (1) registration by notification,[133] (2) registration by coordination[134] and (3) registration by qualification.[135] All state

127 *See, e.g.*, Section 301 of the Uniform Act upon which many state securities registration statutes are based. Section 301 provides that it is unlawful for any person to offer or sell any security in a state unless it is registered under the Uniform Act or the security or transaction is exempt under the Uniform Act. Unif. Sec. Act § 301 (1956).

128 UNIF. SEC. ACT § 402 (1956); ARIZ. REV. STAT. ANN. §§ 44-1843, 44-1844 (1994).

129 15 U.S.C § 77c (1994).

130 *Id*. at § 77d.

131 The 1996 Act, § 102, *supra* note 2. For a discussion of the 1996 Act provisions relating to covered securities, *see* page 35.

132 The 1996 Act, § 102, *supra* note 2.

133 UNIF. SEC. ACT § 302 (1956).

134 *Id.* at § 303.

securities statutes requiring the registration of securities provide for registration by qualification and many provide for registration by coordination Few state laws contain a registration by notification provision. New York[136] and the District of Columbia do not require registration of securities but do require registration of broker-dealers and agents.

Registration by notification is available for securities of issuers (other than those involved in extractive industries) that meet certain financial performance criteria.[137] A registration by notification becomes effective in a state in the afternoon of the second full business day after filing of the registration statement.[138]

Registration by coordination is available for securities of an issuer which also has filed a registration statement with the Commission but which has not yet become effective.[139] A registration by coordination automatically becomes effective in a state at the moment the federally filed registration statement becomes effective.[140]

Registration by qualification is available for the securities of any issuer.[141] A registration by qualification becomes effective when ordered by the state securities administrator.[142]

Registration of securities under the Uniform Act involves compliance with certain informational filing requirements,[143] payment of fees,[144] filing of consents to service of process[145]

---

135 *Id*. at § 304.

136 Although New York does not register securities, issuers of securities may be required to make filings with the Department of Law disclosing specified information. *See generally* N.Y. GEN. BUS. § 359e (McKinney 1995).

137 UNIF. SEC. ACT § 302(a) (1956).

138 *Id*. at § 302(c).

139 *Id.* at § 303(a).

140 *Id*. at § 303(c).

141 *Id.* at § 304(a).

142 *Id.* at § 304(c).

143 *Id*. at §§ 302 to 305.

144 *Id.* at § 305.

and potential application of substantive review criteria set forth in Section 306.[146] Additionally, registrations by coordination and qualification are subject to the provisions in Section 305 relating to escrow of proceeds and of promotional securities.[147]

With respect to registration by notification and qualification, the Uniform Act specifies the information that must be contained in the registration statement. With respect to registration by coordination, the Uniform Act requires states to accept the form of registration statement filed with the Commission.[148]

The substantive review criteria authorizes denial of a registration statement if it contains materially misleading information or omits to state material information,[149] the issuer or any affiliate has violated the securities laws,[150] the security was subject to a regulatory or court proceeding[151] or the offering would tend to work a fraud on investors.[152] Section 306 of the Uniform Act authorizes denial of registration where the offering would be made with unreasonable amounts of promoters' profits or participation.[153] Some states may deny an offering on the basis that it is not fair, just and equitable to investors.[154]

---

145 *Id*. at § 414(g).

146 *Id*. at § 306.

147 *Id*. at § 305.

148 *Id*. at § 302(b).

149 *Id* . at § 306.

150 *Id.*

151 *Id.*

152 *Id.*

153 *Id*.

154 *See, e.g.,* TEX. CIV. CODE ANN. tit. 581 §10 (West Supp. 1997).

Generally, state securities statutes do not contain provisions for the review of proxy statements or reports filed by public companies. Instead, most states concentrate their resources on the review of offerings of non-exchange listed securities.

The Commission has authority under Section 3(b) of the 1933 Act to exempt certain public offerings from registration under Section 5. Pursuant to this authority, the Commission adopted Rule 504 under Regulation D which allows issuers to sell up to $1,000,000 of unrestricted securities using general solicitation.[155] Use of written disclosure is discretionary with the issuer and the exemption may be used by persons subject to the disqualification provisions in Regulation A.[156]

The Commission also adopted Regulation A under Section 3(b) to exempt certain public offerings which allow issuers to offer up to $5,000,000 of unrestricted securities. Also, the 1996 Act granted the Commission broad exemptive powers to exempt any person, security, or transaction, from any provisions of the 1933 Act.[157] While there is a requirement for the filing of an offering circular with the Commission and the exemption is not available to persons subject to its disqualification provisions, there is no audit requirement for financial statements.[158] Because there is no federal registration statement being filed for an offering under either Rule 504 of Regulation D or Regulation A, these offerings must be filed at the state level under the registration by qualification provision in most states. These offerings may be subject to the substantive review provisions of state securities laws. However, some states have modified their substantive review provisions to facilitate registration of these offerings.[159]

---

155 17 C.F.R. § 230.504 (1996).

156 17 C.F.R. § 230.251 to 230.263 (1996).

157 15 U.S.C. § 77dd (1997).

158 *Id.*

159 *See* ARIZ. ADMIN. CODE R14-4-134 (West, WESTLAW current through June 30, 1996); WASH. ADMIN. CODE §§ 460-17A-010 to 460-17A-070 (1995).

APPENDIX C

Definitions

A. ACCREDITED INVESTOR

"Accredited investor" as that term is defined in Rule 501 of Regulation D promulgated pursuant to authority granted under the Securities Act of 1933 (the "Act") (17 C.F.R. § 230.501):

> . . . shall mean any person who comes within any of the following categories, or who the issuer reasonably believes comes within any of the following categories, at the time of the sale of securities to that person:
>
> (1) Any bank as defined in section 3(a)(2) of the Act, or any savings and loan association or other institution as defined in section 3(a)(5)(A) of the Act whether acting in its individual or fiduciary capacity; any broker or dealer registered pursuant to section 15 of the Securities Exchange Act of 1934; any insurance company as defined in section 2(13) of the Act; any investment company registered under the Investment Company Act of 1940 or a business development company as defined in section 2(a)(48) of that Act; any Small Business Investment Company licensed by the U.S. Small Business Administration under section 301(c) or (d) of the Small Business Investment Act of 1958; any plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, if such plan has total assets in excess of $5,000,000; any employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974 if the investment decision is made by a plan fiduciary, as defined in section 3(21) of such act, which is either a bank, savings and loan association, insurance company, or registered investment adviser, or if the employee benefit plan has total assets in excess of

$5,000,000 or, if a self-directed plan, with investment decisions made solely by persons that are accredited investors;

(2) Any private business development company as defined in section 202(a)(22) of the Investment Advisers Act of 1940;

(3) Any organization described in section 501(c)(3) of the Internal Revenue Code, corporation, Massachusetts or similar business trust, or partnership, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of $5,000,000;

(4) Any director, executive officer, or general partner of the issuer of the securities being offered or sold, or any director, executive officer, or general partner of a general partner of that issuer;

(5) Any natural person whose individual net worth, or joint net worth with that person's spouse at the time of his purchase exceeds $1,000,000;

(6) Any natural person who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year;

(7) Any trust, with assets in excess of $5,000,000, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person as described in 230.506(b)(2)(ii); and

(8) Any entity in which all of the equity owners are accredited investors.

B. QUALIFIED INSTITUTIONAL BUYER

Rule 144A promulgated under the Act (17 C.F.R. § 230.144A) defines a "qualified institutional buyer" as:

(1) For the purposes of this section, “qualified institutional buyer” shall mean:

(i) Any of the following entities, acting for its own account or the accounts of other qualified institutional buyers, that in the aggregate owns and invests on a discretionary basis at least $100 million in securities of issuers that are not affiliated with the entity:

(A) Any “insurance company” as defined in section 2(13) of the Act;

NOTE: A purchase by an insurance company for one or more of its separate accounts, as defined by section 2(a)(37) of the Investment Company Act of 1940 (the “Investment Company Act”), which are neither registered under section 8 of the Investment Company Act nor required to be so registered, shall be deemed to be a purchase for the account of such insurance company.

(B) Any “investment company” registered under the Investment Company Act or any “business development company” as defined in section 2(a)(48) of that Act;

(C) Any “Small Business Investment Company” licensed by the U.S. Small Business Administration under section 301(c) or (d) of the Small Business Investment Act of 1958;

(D) Any “plan” established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees;

(E) Any “employee benefit plan” within the meaning of Title I of the Employee Retirement Income Security Act of 1974;

(F) Any trust fund whose trustee is a bank or trust company and whose participants are exclusively plans of the types identified in paragraph

(a)(1)(i)(D) or (E) of this section, except trust funds that include as participants individual retirement accounts or H.R. 10 plans;

(G) Any “business development company” as defined in section 202(a)(22) of the Investment Advisers Act of 1940;

(H) Any organization described in section 501(c)(3) of the Internal Revenue Code, corporation (other than a bank as defined in section 3(a)(2) of the Act or a savings and loan association or other institution referenced in section 3(a)(5)(A) of the Act or a foreign bank or savings and loan association or equivalent institution), partnership, or Massachusetts or similar business trust; and

(I) Any “investment adviser” registered under the Investment Advisers Act.

(ii) Any “dealer” registered pursuant to section 15 of the [Securities] Exchange Act, acting for its own account or the accounts of other qualified institutional buyers, that in the aggregate owns and invests on a discretionary basis at least $10 million of securities of issuers that are not affiliated with the dealer, *Provided That* securities constituting the whole or a part of an unsold allotment to or subscription by a dealer as a participant in a public offering shall not be deemed to be owned by such dealer;

(iii) Any “dealer” registered pursuant to section 15 of the Exchange Act acting in a riskless principal transaction on behalf of a qualified institutional buyer;

NOTE: A registered dealer may act as agent, on a non-discretionary basis, in a transaction with a qualified institutional buyer without itself having to be a qualified institutional buyer.

(iv) Any investment company registered under the Investment Company Act, acting for its own account or for the accounts of other qualified institutional

buyers, that is part of a family of investment companies which own in the aggregate at least $100 million in securities of issuers, other than issuers that are affiliated with the investment company or are part of such family of investment companies. "Family of investment companies" means any two or more investment companies registered under the Investment Company Act, except for a unit investment trust whose assets consist solely of shares of one or more registered investment companies, that have the same investment adviser (or, in the case of unit investment trusts, the same depositor), *Provided That*, for the purposes of this section:

(A) Each series of a series company (as defined in Rule 18f-2 under the Investment Company Act [17 C.F.R. 270.18f-2]) shall be deemed to be a separate investment company; and

(B) Investment companies shall be deemed to have the same adviser (or depositor) if their advisers (or depositors) are majority-owned subsidiaries of the same parent, or if one investment company's adviser (or depositor) is a majority-owned subsidiary of the other investment company's adviser (or depositor);

(v) Any entity, all of the equity owners of which are qualified institutional buyers, acting for its own account or the accounts of other qualified institutional buyers; and

(vi) Any "bank" as defined in section 3(a)(2) of the Act, any savings and loan association or other institution as referenced in section 3(a)(5)(A) of the Act, or any foreign bank or savings and loan association or equivalent institution, acting for its own account or the accounts of other qualified institutional buyers, that in the aggregate owns and invests on a discretionary basis at

least $100 million in securities of issuers that are not affiliated with it and that has an audited net worth of at least $25 million as demonstrated in its latest annual financial statements, as of a date not more than 16 months preceding the date of sale under the Rule in the case of a U.S. bank or savings and loan association, and not more than 18 months preceding such date of sale for a foreign bank or savings and loan association or equivalent institution.

(2) In determining the aggregate amount of securities owned and invested on a discretionary basis by an entity, the following instruments and interests shall be excluded: bank deposit notes and certificates of deposit; loan participations; repurchase agreements; securities owned but subject to a repurchase agreement; and currency, interest rate and commodity swaps.

(3) The aggregate value of securities owned and invested on a discretionary basis by an entity shall be the cost of such securities, except where the entity reports its securities holdings in its financial statements on the basis of their market value, and no current information with respect to the cost of those securities has been published. In the latter event, the securities may be valued at market for purposes of this section.

(4) In determining the aggregate amount of securities owned by an entity and invested on a discretionary basis, securities owned by subsidiaries of the entity that are consolidated with the entity in its financial statements prepared in accordance with generally accepted accounting principles may be included if the investments of such subsidiaries are managed under the direction of the entity, except that, unless the entity is a reporting company under section 13 or 15(d) of the Exchange Act, securities owned by such subsidiaries may not be

included if the entity itself is a majority-owned subsidiary that would be included in the consolidated financial statements of another enterprise.

(5) For purposes of this section, ”riskless principal transaction” means a transaction in which a dealer buys a security from any person and makes a simultaneous offsetting sale of such security to a qualified institutional buyer, including another dealer acting as riskless principal for a qualified institutional buyer.

(6) For purposes of this section, “effective conversion premium” means the amount, expressed as a percentage of the security’s conversion value, by which the price at issuance of a convertible security exceeds its conversion value.

(7) For purposes of this section, “effective exercise premium” means the amount, expressed as a percentage of the warrant’s exercise value, by which the sum of the price at issuance and the exercise price of a warrant exceeds its exercise value.

APPENDIX D

Interstate Compacts

INTERSTATE COMPACTS

An overriding issue in any discussion of state securities regulation is the absence of uniformity among the states in many of their laws, regulations and policies. A related matter is that state securities regulatory authorities sometimes provide differing interpretations of uniform statutes, model rules and NASAA guidelines.[160] The Task Force received oral and written testimony from Task Force Staff and the NASAA Task Force on Interstate Compacts (the "NASAA Interstate Compact Task Force") on various means by which federal law, as an alternative to preempting state law, can encourage state securities regulators to interpret and enforce state securities laws, regulations, practices and procedures. Among the options discussed were adoption of federal legislation (i) tying federal funds to state adoption of a federal policy, or (ii) offering states the alternative of adopting a given federal policy of being preempted from regulating a particular area. Also discussed was Congressional authorization of interstate compacts entered into between two or more states.

The U.S. Supreme Court has held that Congress may not "commandee[r] the legislative processes of the States by directly compelling them to enact and enforce a federal regulatory program."[161] Congress may, however, provide incentives to states to act in a certain manner.

One incentive Congress has employed to encourage state cooperation in implementation of federal policies is to use its spending power to attach conditions to state receipt of federal funds. Under its spending power, Congress may condition a grant of federal funds on state adoption of a federal regulatory policy, so long as the conditions bear a reasonable relationship to the

160 NASAA has promulgated guidelines setting forth criteria an issuer must satisfy prior to the registration of an offering. These guidelines relate to offerings of equity and debt securities as well as direct participation programs. Many states have adopted all or some of these guidelines by rule or policy. The guidelines may be found in the CCH NASAA Reports, the C-Text Publications or they may be obtained from NASAA.

purpose of the federal spending.[162] In *South Dakota v. Dole* the federal government tied receipt of highway funds to raising the state drinking age to twenty-one.[163] The U.S. Supreme Court upheld the federal government's actions because, under this regime of fiscal encouragement, a state may decide whether or not it will comply with the federal policy in question. If the state's citizens view the policy as contrary to local interests, they may decline the federal grant.

The Task Force dismissed the option of recommending that Congress, at this time, employ its spending power as a method of promoting uniformity among the states because, while the federal government may support the concept of state uniformity in regulation, it appears that no federal grants exist nor is it likely that any will be created in the near term that have a relationship to this policy. However, at some point in the future, uniformly tied to federal grants may be an option that would be worth Congressional consideration. It seems likely that a considerable degree of uniformity could be achieved in response to a relatively small federal expenditure. Moreover, the federal expenditures would indirectly further other national policies by supporting greater state efforts in areas such as anti-fraud enforcement and sales practice regulation.

Congress also may rely upon the Commerce Clause to encourage states to regulate in a uniform fashion. Congress, under the Commerce Clause, is empowered to enact legislation offering the states the choice of regulating an activity according to federal standards or of being preempted from regulating that activity.[164] The U.S. Supreme Court has upheld conditional preemption under the rationale that state residents may prefer that their government devote its attention to matters other than the federal policy in question, and may choose to have the federal

---

161 *Hodel v. Virginia Surface Mining & Reclamation Assn., Inc*., 452 U.S. 264, 288 (1981). *See also FERC v. Mississippi*, 456 U.S. 742, 764 (1982) ("this Court never has sanctioned explicitly a federal command to the States to promulgate and enforce laws and regulations").

162 *South Dakota v. Dole*, 483 U.S. 203, 206-208 (1987).

163 *Id.*

164 *Hodel v. Virginia Surface Mining & Reclamation Assn., Inc.,* 452 U.S. 264, 288 (1981).

government, rather than the state government, bear the costs of enforcing the federal program.[165] Such a proposal may be appropriate in some areas of federal and state securities regulation.[166]

While Congress may encourage states to regulate in a "certain fashion," it may not coerce states into regulating in a "specific fashion."[167] The Commerce Clause permits Congress to regulate interstate commerce directly; it does not authorize Congress to regulate state governments' regulation of interstate commerce.[168]

The Task Force directed most of its attention in this area to a discussion on interstate compacts. Interstate compacts have been utilized in various commercial arenas for the purpose of facilitating cooperation, furthering efficient practices, preserving the right of local self-government, and exchanging data and views on mutual problems. Participation in an interstate compact enables regulatory personnel from different states to meet and exchange views on shared problems, and to make personal contacts with personnel from other states and industry.

The NASAA Interstate Compact Task Force cited four examples of existing interstate compacts upon which a state securities interstate compact might be modeled. These compacts include the Multistate Tax Compact,[169] the National Association of Insurance Commissioners (the "NAIC"),[170] the Conference of State Bank Supervisors (the "CSBS"),[171] and the Interstate Oil and Gas Compact.[172]

---

165 *See FERC v. Mississippi*, 456 U.S. at 764 ("if a state simply stops regulating in the field, it need not even entertain the proposals").

166 Such a provision is present in portions of the 1996 Act. The broker-dealer books and records provision, for example, requires that states, in effect, enforce Commission rules or be preempted from regulating books and records at all. The 1996 Act, *supra* note 2, §103.

167 *New York v. U.S.,* 505 U.S. 144, 175 (1992). In *New York* the U.S. Supreme Court struck down a provision of the Low-Level Radioactive Waste Policy Amendments of 1985 that would have required that states either enter into interstate compacts governing the storage of low-level radioactive waste or take title to the low-level radioactive waste.

168 *Id.*

169 *U.S. Steel v. Multistate Tax Comm'n*, 434 U.S. 452 (1978).

The Multistate Tax Compact was formed to facilitate proper determination of state and local tax liability of multistate taxpayers; promote uniformity and compatibility in state tax systems; facilitate taxpayer convenience and compliance in the filing of tax returns; and avoid duplicative taxation. Formed in 1967 among seven states, the compact grew to twenty-one members by 1972. The commission formed under this compact (consisting of tax administrators from each of the member states) adopts uniform administrative regulations in the event two or more states have uniform statutory provisions relating to a specified tax. The regulations are advisory only in that each member state has the power to reject, modify or adopt the regulations. The regulations have no force in a member state until adopted by the state pursuant to its own laws. Any member state is permitted to withdraw from the compact by enacting a repealing statute. Prior approval from Congress was not sought, but the U.S. Supreme Court has held the compact to be constitutional.[173]

The NAIC requires as a condition of membership that state insurance regulators meet certain standards. This process is known as accreditation. In order for a member state to be accredited, the state must adopt and abide by regulations created by the compact. The benefit of accreditation is that registrants in an accredited state are granted reciprocity in other jurisdictions, and thus can avoid qualifying under the standards set forth in multiple state statutes. Members that fail to comply with accreditation standards must voluntarily withdraw from membership or be expelled. Regulations are proposed by an executive committee comprised of state insurance regulators; however, other organizations such as the National

---

170 The National Association of Insurance Commissioners, *Financial Regulation Standards and Accreditation Program* (1995).

171 The Conference of State Bank Supervisors, *Accreditation Program*, (1995). The Conference of State Bank Supervisors, *Interstate Banking and Branching Supervision Protocol and Statutory Options for Interstate Banking and Branching and Regulation of Foreign Banks* (1995).

172 Interstate Oil and Gas Compact, 49 Stat. 939 (1935).

173 *Multistate Tax Comm'n,* 434 U.S. at 457, 459.

Conference of State Legislatures, National Governors' Association, and National Conference of Insurance Legislators actively participate in the comment phase of the rulemaking process.

In contrast to the NAIC, the CSBS is a network of voluntary, regional compacts. State bank administrators serve as the executive members, but membership is open to individual state banks and trade organizations such as the Independent Bankers Association of Texas. Model rules are designed for use by the member states, but adoption of the rules is not required for continued membership. Practice within this organization is twofold. First, in the context of interstate banking, a state bank regulator becomes certified by the CSBS upon meeting certain criteria. Subsequently, bank examinations made by that state are accepted as valid by other CSBS member states. Secondly, CSBS member states can enter into agreements with the Federal Deposit Insurance Corporation (the "FDIC") providing that the state and the FDIC will perform examinations on an alternating basis. This reduces the burden on and expense to state regulators of the requirement that state banks be examined annually. Thus, an examination by a CSBS member is accepted in lieu of an examination by the FDIC in all states that are members and by the FDIC.

The Interstate Oil and Gas Compact was designed to respond to rampant abuse and waste in the production of oil and gas during the Depression. Membership is voluntary, yet the initial membership of six states has grown to the present number of twenty-nine members and seven associate members. The compact is governed by an executive committee. The governor of each member state selects a representative from the petroleum-related regulatory agencies located in the state to serve as a voting member of the executive committee. Two individuals, selected by the executive committee member, serve on substantive committees. Together, the executive and substantive committees comprise the commission. While continued membership remains voluntary, the governing articles of this compact require that members adopt legislation to implement the goals and directives of the compact. Industry representatives are active in the

formulation and development of ideas and rule proposals, but they are not able to participate in the formal adoption process.

An interstate compact or multistate agreement does not require Congressional consent unless formation of the combination would tend to increase the political power in the states, which may encroach upon or interfere with the supremacy of the federal government.[174] An interstate compact that receives Congressional approval, however, has the same authority as federal law. Thus, interstate compact members may choose to seek Congressional approval so that the policies adopted by the compact are binding on member states.[175]

Congressional consent can be explicit or implied. Congress may pass legislation indicating the limits and permissible functions of a compact or it may pass legislation relating to the subject matter covered by a compact from which consent to a compact can be implied.[176]

Congress' action in passing legislation indicating the scope of an interstate compact among state securities regulators would involve a delegation of authority to a commission or executive committee that would be authorized to draft model regulations and guidelines which would be binding on participating states. Under the principle of separation of powers, Congress cannot delegate its legislative powers to another branch of the federal government.[177] Congress, however, may seek the assistance of its coordinate branches of government in the execution of its powers, so long as it "shall lay down by legislative act an intelligible principle to which the person or body authorized to [exercise the delegated authority] is directed to conform, such legislative action is not forbidden delegation of legislative power."[178] The "intelligible principle"

---

174 *Virginia v. Tennessee*, 148 U.S. 503 (1893).

175 *See Cuyler v. Adams*, 449 U.S. 433, 438 (1981) (effect of multistate compacts for which Congress has consented have the effect of federal law).

176 *The Interstate Grain Marketing Compact - Should Washington Be A Partner?*, 15 Gonz. L. Rev. 797, 805 (1980).

177 *Field v. Clark*, 143 U.S. 649 (1892).

requires Congress to delineate clearly the general policy to be applied, the public agency which is to apply the general policy and the boundaries of the delegated authority.[179] Presumably, an analogy can be made between the authority created by Congressional approval of an interstate compact and the action of Congress in seeking assistance from another branch of government.

Since an interstate compact to which Congress has given its consent becomes a federal law, and because an interstate compact entered into for the purpose of promoting uniformity in state securities regulation would bind its members to pass legislation and adopt rules and policies in accordance with directives released by the controlling body of the compact, a state's participation in the interstate compact must be a voluntary act.

A state may not be able to participate in a compact absent a delegation from the state legislature to its securities regulator permitting the regulator to delegate rulemaking authority to the interstate compact commission.

The laws permitting delegation of regulatory authority vary among the states. Non-uniform standards on the permissible scope of delegation from a state legislature to an administrative agency or commission have developed out of state court decisions.[180] Additionally, many states have adopted the provisions of the Uniform Act permitting cooperation with other states to achieve uniformity in the form and content of registration statements and reports.[181] A few states

---

178 *Mistretta v. U.S.,* 488 U.S. 361, 366 (1989) *citing*, *J.W. Hampton & Co. v. United States*, 276 U.S. 394, 409 (1928). *See also Touby v. U.S.,* 500 U.S. 160, 165 (1990) (upholding the "intelligible principle" standard for delegation).

179 *Mistretta* at 372, *citing American Power & Light Co. v. SEC*, 329 U.S. 90, 105 (1946).

180 Some courts express rigid maxims against any delegation of an essentially legislative function. *See, e.g., Stephens v. Stewart,* 165 S.E.2d 572, 576 (Ga. App. 1968); *compare State v. Cutright*, 266 N.W.2d 771 (Neb. 1975). Other courts, however, have adopted the broader federal standard, at least in cases not involving personal rights and liberties. *See Boreali v. Axelrod*, 71 N.Y.2d 1, 11 (1987) (allowing board to issue licenses if the applicant is of "good moral character as determined by the board").

181 UNIF. SEC. ACT § 412 (1956). *See also* ALA. CODE § 8-6-23 (1993 and Supp. 1996); ALASKA STAT. § 45.55.950 (Michie 1996); ARK. CODE ANN. § 23-42-204 (Michie 1994 & Supp. 1995); COLO. REV. STAT. § 11-51-704 (Supp. 1996); CONN. GEN. STAT. § 36b-31 (1996); DEL. CODE ANN. tit. 6, § 7315 (1993); D.C. CODE ANN. § 2-2616 (1994); GA. CODE ANN. § 10-5-10 (1994); HAW. REV. STAT. § 485-16 (1995); KAN. STAT. ANN. § 17-1270 (1995); KY REV. STAT. ANN. § 292.500 (Banks-Baldwin 1987); MD CODE ANN., Corp. & Ass'ns § 11-203 (1993); MASS. GEN. LAWS ANN. ch. 110A, § 412 (West 1990); MICH. COMP. LAWS ANN. § 451-812 (West 1989); MINN. STAT. §

have adopted statutes patterned after a NASAA model amendment to the Uniform Securities Act, which states that "[t]o encourage uniform interpretation and administration of [state securities statutes], the administrator may cooperate with the securities agencies or administrators of one or more states, [or] . . . national or international organization of securities officials or agencies."[182] The NASAA model amendment provides that such cooperation expressly includes "formulating, in accordance with [the administrative procedure act] of this state, rules or proposed rules on matters such as statements of policy, guidelines, and interpretive opinions and releases."[183] One state, in addition to adopting two statutory provisions permitting cooperation with other state securities regulatory authorities to achieve uniformity,[184] has adopted a provision permitting the state securities regulatory authority to negotiate formal or informal agreements with other states with the intention of reducing the regulatory burden and expense of registering public securities offerings in multiple states in order to enhance and enlarge capital markets in the state.[185] To date such provisions have not been challenged as an unlawful delegation. Nevertheless, the delegating state presumably retains its sovereign authority to decline to adopt any proposed model rule.

It appears that even with respect to an interstate compact to which Congress has given its consent, a state's participation must be a voluntary act. Congress' power to require that a state

---

80A.25 (1992); MISS. CODE ANN. § 75-71-109 (1991); MONT. CODE ANN. § 30-10-107 (1995); NEV. REV. STAT. §8-1120 (1991); N.H. REV. STAT, ANN. § 421-B:28 (1991 & Supp. 1996); N.C. GEN. STAT. § 78A-49 (1994); N.D. CENT. CODE § 10-04-03 (1995); Ohio REV. CODE ANN. § 1701.20 (Anderson 1992); Okla. Stat. tit. 71, § 410 (1991); P.R. LAWS ANN., tit. 10, §892 (1978 & Supp. 1992); S.C. CODE ANN. § 35-1-160 (Law Co-op. 1987 & Supp. 1995); TENN. CODE ANN. § 48-2-116 (1995); UTAH CODE ANN. § 61-1-24 (1993); W.V. CODE § 32-4-412 (1996); WIS. STAT. § 551.63 (1994); WYO. STAT. ANN. § 17-4-124 (Michie 1989).

182 NASAA Model Amendments to the Uniform Securities Act of 1956, NASAA Reports (CCH) ¶ 4937 (May 1996). *See also* Rules and Regulations of the Idaho Department of Finance, Rule 410; 815 ILL. COMP. STAT. 5/11 (West Supp. 1995); IOWA CODE § 520.630A (1995); ME. REV. STAT, ANN. tit. 32, § 10702 (West 1988 & Supp. 1996); MO. REV. STAT. § 409.420 (Supp. 1995); NEV. REV. STAT. § 90.740 (1995); N.M. STAT. ANN § 58-13B-47 (Michie 1991); R.I. GEN. LAWS § 7-11-704 (1992); S.D. CODIFIED LAWS § 47-31A-420 (Michie 1991); WASH. REV. CODE § 21.30.180 (1992).

183 *Id.*

184 ARIZ. REV. STAT. ANN. § 44-1815 (1994); *Id.* § 44-3115 (Supp. 1996).

185 *Id.* § 44-2056 (Supp. 1996).

become a member of the compact is limited to offering states the choice of participating in the compact or being preempted from regulating in the areas covered by the compact.

APPENDIX E

Acknowledgments

ACKNOWLEDGEMENTS

The Task Force received correspondence from the following persons: Jean E. Hanson, Fried, Frank, Harris, Shriver & Jacobson, New York, New York; Art Haake, Lutheran Church Extension Fund; James L. Powell, Board of Church Extension of Disciples of Christ; David W. Johnson, National Covenant Properties; James C. Brown, Alliance Development Fund; and David T. Pace, Christian Church Extension Foundation, collectively as the Securities Task Force of the Denominational Investment & Loan Administrators. The Task Force is appreciative of the input received from these commenters.

The following individuals, although not members of the Task Force, regularly attended and participated in Task Force meetings: Lewis Brothers, Senior Vice President, PaineWebber, Inc.; Michael Emen, Senior Vice President and Counsel-Securities, American Stock Exchange; Orestes J. Mihaly, First Vice President and Assistant General Counsel, Merrill Lynch & Co., Inc.; Michael Missal, Kirkpatrick & Lockhart LLP; Dee Anne Sjogren, Peper, Martin, Jensen, Marchel and Hetlage, formerly of Kirkpatrick & Lockhart LLP.

The Task Force would also like to thank the many individuals who provided us with discussion materials and assisted in the drafting of this report. The Task Force would like to thank specifically Stephen L. Diamond, former Securities Administrator, Maine Department of Professional & Financial Regulation, Bureau of Banking; Robert M. Lam, Chairman, Pennsylvania Securities Commission; Donald J. Reis, Deputy Secretary of State, Nevada Office of the Secretary of State, Securities Division; Denise Voigt Crawford, Securities Commissioner, Texas State Securities Board; Robert N. McDonald, Maryland Office of the Attorney General, Division of Securities; Richard M. Weinroth, former General Counsel, Arizona Corporation Commission, Securities Division; G. Philip Rutledge, Deputy Chief Counsel & Director, Division of Corporation Finance, Pennsylvania Securities Commission; Veda M. Shamsid-Deen, Director

of Securities, District of Columbia Securities Division; Kristine Kluck, Staff Attorney, Nebraska Department of Banking & Finance, Bureau of Securities; Karol Pollock, former Staff Attorney, New Mexico, Regulation & Licensing Department, Securities Division; Matthew J. Neubert, Assistant Director for Trading & Markets, Arizona Corporation Commission, Securities Division; K. Robert Bertram, former staff attorney with the Pennsylvania Securities Commission; Neal E. Sullivan, Executive Director, North American Securities Administrators Association; Karen M. O'Brien, General Counsel, North American Securities Administrators Association; Jeffrey O. Himstreet, Associate Counsel, North American Securities Administrators Association; Daniel Kahl, Associate Counsel, North American Securities Administrators Association; and Lynn D. Naefach, Special Counsel to the Task Force. The Task Force would also like to thank all members of state securities regulatory agencies, the Commission, the National Association of Securities Dealers, Inc. and other self regulatory organizations, not specifically named herein, who provided information to assist the Task Force in its examination of the issues.