

NASAA Insight

The Voice of State & Provincial Securities Regulation



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NASAA Offers Roadmap for 113th Congress to Promote Investor Confidence

NASAA has developed an aggressive advocacy agenda calling for affirmative Congressional action to promote sustained investor confidence.

During a March 5, 2013, news conference at the National Press Club, NASAA President and Arkansas Securities Commissioner Heath Abshure and Steve Irwin, NASAA President-elect and Pennsylvania Banking and Securities Commissioner, outlined specific areas in which NASAA will seek Congressional action in the 113th Congress.

"To help Main Street investors and businesses recover from the recession and financial crisis, we encourage the 113th Congress to focus its oversight and legislative energies on legislation that better protects investors and promotes economic growth," Abshure said.

"Our agenda provides the new Congress with a roadmap to promote investor confidence by striking the most reasonable balance between promoting capital formation and protecting investors," he said.

Abshure and Irwin said NASAA actively will seek legislation in the 113th Congress to:

- authorize the SEC's Office of Compliance Inspections and Examinations to collect user fees from the investment advisers it examines;
- permit reasonable civil recovery for fraud associated with crowdfunding and other small offerings;
- strengthen investor protection provisions weakened by the JOBS Act to minimize the Act's enormous potential for abuse; and
- empower state regulators to curtail the use of mandatory pre-dispute arbitration clauses in contracts between state-registered investment advisers and their clients.



NASAA President Heath Abshure (left) of Arkansas and President-elect Steve Irwin of Pennsylvania meet the press at the National Press Club.

NASAA also is calling on Congress to investigate opaque market activities, including those of "dark pools," hedge funds and high-frequency traders.

"Taken together, our legislative priorities represent positive and progressive changes for the benefit of Main Street investors. They seek to level the playing field for investors by increasing industry and market accountability and transparency, balancing the capital formation needs of small business with strong investor protection, and providing a fair avenue for redress when things go wrong," Irwin said.

"NASAA is committed to working with the Obama Administration and Congress to ensure that our nation's system of financial services regulation promotes the investor confidence necessary to support a strong U.S. capital market," Abshure said.

Agenda Built on Foundation of Investor Protection

NASAA's legislative agenda is built on a foundation that seeks to:

- **Promote sustained investor confidence by ensuring market transparency, enhancing investor education, and imposing strong penalties;**
- **Ensure that policies intended to spur capital formation balance the need to maintain investor protection;**
- **Support strong and complete implementation of investor protections in the Dodd-Frank Act by the conclusion of the 113th Congress;**
- **Ensure that regulation is an inherently public function that should be performed by government regulators, not outsourced to an industry SRO; and**
- **Ensure that state authority is not preempted, and instead should be expanded.**

Details on pages 4-5 >>

President's Message: Heath Abshure



"If history repeats itself, and the unexpected always happens, how incapable must Man be of learning from experience." | George Bernard Shaw

Shortly after the 113th United States Congress convened on January 3, we began hearing talk of further liberalization of the securities laws in the form of JOBS Act 2.0, creation of a new exchange for penny stocks, and continued deterioration of the investor protection ideas contained in Dodd-Frank. Against this backdrop, the SEC continues to toil over general advertising in Regulation D offerings and rules for crowdfunding.

Many seek to change the federal securities laws, arguing that they want to make it easier and cheaper for companies to sell securities.

Saying that you want to make it easier or cheaper for companies to sell securities is just a politically acceptable way of saying that investors are going to get less information. We aren't learning from experience; that is, the experience of the pre-1933 securities market.

Consider President Franklin D. Roosevelt's statement upon signing the Securities Bill on May 27, 1933:

"It gives me much satisfaction to sign the Rayburn-Fletcher Securities Bill, and I know I express national feeling in congratulating Congress on its passage. For this measure at last translates some elementary standards of right and wrong into law. Events have made it abundantly clear that the merchandising of securities is really traffic in the economic and social welfare of our people. Such traffic demands the utmost good faith and fair dealing on the part of those engaged in it. If the country is to flourish, capital must be invested in enterprise. But those who seek to draw upon other people's money must be wholly candid regarding the facts on which the investor's judgment is asked."

President Roosevelt's statements ring equally true today.

Certain members of Congress and other interested parties continue to label the federal securities laws as "antiquated" and call for drastic changes. It appears that these individuals have learned nothing from the past. Neither technology nor the passage of time convinces me that the heart of securities regulation — truthful disclosure of material information — should change.

Technological advances allow for faster and cheaper dissemination of material information, but they do not change the market system's basic requirement that investors have truthful material information before they make an investment decision.

Executive Director's Message: Russ Iuculano



Washington is as gridlocked as ever and full of finger-pointing and score-settling in these days of the sequester.

Since much of our legislative agenda focuses on steps to bolster market confidence, it is natural to ask about the effects the automatic spending cuts could have on public confidence.

Peggy Noonan's recent Wall Street Journal column, "Government by Freakout" was spot on in discussing the cumulative effects of fiscal cliffs, ceilings and sequesters. She wrote: "They only add to the sense that Washington is dysfunctional and cannot possibly help us out of the mire."

Our agenda is intended to provide the new Congress with a road map out of the mire, at least as far as promoting investor confidence.

One of the foundations upon which the agenda is built is the "full implementation of the investor protection provisions in the Dodd-Frank Act." Unfortunately, recent developments on Capitol Hill are threatening to repeal the Act's reforms or impede implementation of some of its most important investor protections.

For example, Sen. David Vitter (R-LA) introduced a bill to repeal the Dodd-Frank Act. The bill (S. 20) has 19 co-sponsors, including Sen. Mike Crapo (R-ID), the ranking member of the Senate Banking Committee.

We look forward to the work ahead of us. In the 113th Congress, there are 84 new freshman House members and 14 new Senators. In the prior Congress, there were 13 new Senators and 93 new Representatives. With almost half of the House and a quarter of the Senate not present during the Dodd-Frank Act's passage, we have an excellent opportunity to educate these new members of Congress as to how their constituents benefit from Dodd-Frank's investor protections.

NASAA Spots Spike in Crowdfunding Sites

NASAA Task Force Monitoring Internet for Signs of Crowdfunding Fraudsters

Crowdfunding's presence on the Internet has risen sharply in recent months in anticipation of rules to allow small businesses and entrepreneurs to raise investments online.

Crowdfunding is an online money-raising strategy. Through the Jumpstart Our Business Startups (JOBS) Act, small businesses and entrepreneurs will be able to tap into the "crowd" in search of investments to finance their business ventures once regulations are approved to do so. The regulations are expected later this year.

"Investors soon can expect to be inundated with crowdfunding pitches, legitimate or otherwise," said Heath Abshure, NASAA President and Arkansas Securities Commissioner.

An analysis of Internet domain names by state and Canadian securities regulators found 9,001 domains with "crowdfunding" in their name as of December, 2012, up from less than 900 at the beginning of the year.

Of these websites, about 2,000 contained content, more than 3,700 had no content and more than 3,000 appeared to be "parked" and serving as placeholders to reserve a domain name for later use or sale. Of the domains with "crowdfunding" in their name, about 6,800 have appeared since April 2012 when the JOBS Act was signed into law.

"Many of these sites appear to have been formed by large credible organizations while others appear to be created by individuals that may be operating out of their basements," said Robert Moilanen, Minnesota Securities Director and chair of the NASAA's Internet Fraud Investigations Project Group. "The pure volume suggests that the wave is about to overtake the dam."

Anticipating an increase in online fraud stemming in part from passage of the JOBS Act, NASAA created a task force on Internet fraud investigations shortly after the enactment of the JOBS Act to monitor crowdfunding and other Internet offerings. The group is currently coordinating multi-jurisdictional efforts to scan various online offering platforms for fraud, and, where authorized, will coordinate investigations into online or crowdfunded capital formation fraud.

NASAA members also are being trained in the use of an innovative online data mining tool developed by the staff of the Enforcement Division of the New Brunswick Securities Commission to help identify potentially fraudulent websites. The task force also is working with NASAA's Investor Education Section to develop investor and industry awareness programs regarding crowdfunding.

Be Wise to Scams in Wake of Disasters

NASAA warned investors to beware of scammers taking advantage of opportunistic investment schemes in the aftermath of Hurricane Sandy and the Newtown tragedy in recent months.

"Potential investors should be very cautious if approached with unsolicited disaster-related investment offers," said Heath Abshure, NASAA President and Arkansas Securities Commissioner. "People also should be aware of the rush of solicitations that follow a highly publicized natural disaster or other crises. There will be fraudulent charity solicitations. People wanting to help with relief efforts should send contributions to only those charities with an established track record."

One scam resulting from the Newtown tragedy emerged in late December. A stranger to the family of Noah Pozner, a 6-year-old killed in the shooting, was soliciting donations in Noah's memory, claiming that they would send them to his parents and siblings.

NASAA Director of Communications Bob Webster told newspapers, "We know cons try to cash in on headlines, and any who would even think about stooping to capitalize on the tragedy in Newtown are the lowest of the low."

Abshure also warned that fake victims may attempt to use social media to dupe well-intentioned donors.

NASAA Member Reappointed to FSOC

North Carolina Deputy Securities Administrator David S. Massey has been reappointed to a two-year term representing state securities regulators on the Financial Stability Oversight Council (FSOC). The FSOC is responsible for coordinating financial regulators to identify systemic risks to the nation's financial stability. The Dodd-Frank Act authorizes a state securities regulator, state insurance commissioner, and a state banking supervisor to serve as non-voting members of the FSOC.

"The inclusion of a NASAA representative on the FSOC represents a hard-earned recognition by Congress of the value of state securities regulation," said NASAA President and Arkansas Securities Commissioner Heath Abshure. "As the regulator closest to investors, state securities regulators have a track record of identifying developing trends before they impact the larger financial system. I am glad that NASAA will continue to be well represented on the FSOC."

NASAA Legislative Agenda for the 113th Congress

Summary

To promote investor confidence and strike a balance between capital formation and investor protection, NASAA's advocacy agenda in 2013 calls for affirmative Congressional action in five specific areas summarized below. The complete agenda is available at www.nasaa.org.

Calling on Congress to investigate opaque market activities to promote greater transparency and systemic stability.

- High-frequency trading, or HFT, is of particular concern to state securities regulators. This market phenomenon involves the use of powerful computers to buy and sell enormous amounts of securities at incredibly high speeds. HFT appears to have potentially dangerous implications for ordinary Main Street investors – the very people who look to state securities regulators for protection.
- Advances in technology and other factors have made it increasingly possible for these sophisticated market participants to identify and exploit informational asymmetries in order to maximize profits, often at the expense of retail investors.
- In calling for congressional action, our goal is to enable Congress to level the playing field among market participants to ensure that access to information by sophisticated and speculative investors does not unfairly disadvantage or harm retail investors.

Seeking legislation to ensure all investors are protected when receiving investment advice by authorizing the SEC to assess “user fees” and calling on the SEC to impose a uniform fiduciary duty.

- Recognizing current political realities, NASAA believes that the most effective and efficient way for Congress to improve the oversight of federally registered investment advisers is to enact legislation authorizing the SEC's Office of Compliance Inspections and Examinations (OCIE) to collect user fees from the investment advisers it examines.
- The revenue generated from user fees, which would not come at any cost to taxpayers, should be used by OCIE to fund additional examinations of federally registered investment advisers. As a matter of efficiency and cost, the imposition of user fees makes more sense than establishing a new self-regulatory organization for investment advisers.
- It has been more than two years since the SEC staff found that while investment advisers are subject to a strict “fiduciary duty” standard, broker-dealers are subject to more lenient standards governing their conduct.
- It is time for the SEC to pursue the course recommended by its 913 Study to subject broker-dealers to the same fiduciary duty standard currently applied to investment advisers when those brokers offer personalized investment advice to retail investors and other customers.

Seeking legislation to strengthen private remedies for victims of fraudulent offerings that were conducted under the JOBS Act.

- Congressional action to extend private remedies to victims of securities fraud is particularly urgent in light of SEC Chairman Elisse Walter's announcement in January that the SEC intends to move forward with rulemakings to implement the JOBS Act, which will legalize equity "crowdfunding" and allow the advertising of private placements.
- The JOBS Act will greatly increase the number of small investments in small, private companies. As a result, a single instance of fraud easily could result in damages to a large number of people. Federal law makes it virtually impossible for small investors to seek redress through class actions in an efficient manner.
- To ensure that victims of securities fraud will have recourse, NASAA urges the 113th Congress to explore amending federal law to ensure that all investors, especially those investing small amounts, have a reasonable avenue to seek recovery.

Calling on Congress to strengthen protections weakened by the JOBS Act before enacting additional capital formation legislation that could further weaken investor protection.

- The removal of the ban on "general solicitation" in offerings conducted under Rule 506, as mandated in Title II of the JOBS Act, for example, dismantled an important investor protection.
- The elimination of that ban warrants a corresponding increase in dollar thresholds in the accredited investor definition, and Congress should mandate such a change. Congress should also:
 - Ensure that clear guidance is given to issuers about the reasonable steps necessary to verify that purchasers are accredited investors.
 - Require the filing of a Form D prior to the use of any general solicitation and place reasonable restrictions on advertising, including performance advertising for private funds.
- Providing access to capital for new and small businesses is a worthy goal. However, if the 113th Congress legislates in this area, it is imperative that it do so in a careful and deliberate fashion that balances the goals of capital formation with investor protection.

Seeking legislation to improve the fairness of the securities arbitration process.

- NASAA urges Congress to encourage the SEC to exercise its rulemaking authority under the Dodd-Frank Act to prohibit or impose conditions on the use of mandatory pre-dispute arbitration agreements if it determines it is in the interest of the public or investors.
- States are seeing the emergence of mandatory pre-dispute arbitration clauses in contracts between state-registered investment advisers and their clients, despite the fiduciary duty imposed upon investment advisers. NASAA will seek legislation in the 113th Congress empowering state regulators to curtail the use of such clauses and to take the steps necessary to provide investors with a choice for dispute resolution.

NASAA Enforcement Report

States Show Increased Actions Against Investment Advisers

NASAA reported a significant increase in enforcement actions against investment adviser firms last year and a sharp rise in prison time for securities law violators.

According to NASAA's annual enforcement survey, the number of enforcement actions involving investment adviser firms nearly doubled to 399 in 2011 and accounted for 15 percent of all enforcement actions handled by state securities regulators.

Overall, state securities regulators conducted 6,121 investigations in 2011, which led to 2,602 criminal, administrative and civil enforcement actions.

The report noted that financial abuse of seniors was identified in nearly 600 reported enforcement actions. Prison time resulting from state-initiated actions totaled 1,662 years, up 47 percent from the year before.

"The report demonstrates that investors continue to rely upon state securities regulators. Enforcement remains one of our most fundamental responsibilities, if for no other reason, because no other regulator is going to act to protect hometown investors," said Heath Abshure, NASAA President and Arkansas Securities Commissioner.

State securities regulators also took important investor protection actions by removing or barring unscrupulous brokers and investment advisers from the licensed community. In 2011, nearly 2,800 licenses were withdrawn due to state action, up 7.7 percent from the year before; and 774 licenses were denied, revoked, suspended or conditioned, up 20 percent from the previous year.

State-initiated enforcement actions resulted in more than \$2.2 billion in investor restitution orders in 2011.

Abshure noted that much of this restitution is attributable to repurchases of auction rate securities (ARS) stemming from state-led actions. State securities regulators also levied fines or penalties of \$126 million.

The majority of the investment fraud cases reported by state securities regulators featured unregistered individuals selling unregistered securities. More than 800 reported actions involved unregistered securities, and more than 800 actions involved unregistered firms or individuals.

For the second consecutive year, Regulation D Rule 506 private offerings and real estate investment schemes were the most reported products at the heart of state securities enforcement actions.

The report is based on the results of a survey of NASAA members during the spring of 2012. This year, 48 U.S. NASAA members responded to the survey, a response rate of 94 percent. The data, statistics and trends included in the report provide a general overview of state securities enforcement efforts.

Enforcement Statistics At a Glance

Complaints Fielded
by State Securities Regulators
11,302

Investigations
6,121

Enforcement Actions
2,602

Investor Restitution Ordered
\$2.2 billion

Fines, Penalties,
Payments & Costs
\$290 million

Prison Time Sentenced
1,662, years

Licenses Withdrawn, Revoked,
Suspended or Conditioned
3,570

Actions Against
Investment Adviser Firms
399

Actions Against
Broker-Dealer Firms
359

Enforcement Actions
Involving Senior Victims
577

NASAA Supports FINRA Rule Proposal on Broker Compensation Disclosure

In a March 5, 2013 letter to the SEC, NASAA outlined its support of a FINRA rule proposal requiring disclosure of potential conflicts of interest related to recruitment compensation practices for registered representatives.

"It is unquestionable that conflicts of interest can arise between the benefits to a broker from enhanced compensation packages and the duties of a broker to her customers," wrote NASAA President Heath Abshure. "This is a dark corner of industry practices, and we will support FINRA efforts to bring transparency to this realm."

NASAA suggested that the rule proposal also should provide for specific, enhanced supervisory practices for firms to monitor and prevent possible account churning and excessive trading of accounts brought to a new firm during the first year(s) of the recruited brokers' employment transition.

"NASAA believes that effective disclosure of enhanced compensation will benefit consumers and we applaud FINRA's efforts to bring this practice into the light," Abshure wrote. "Notwithstanding, in doing so, NASAA does not condone the current practices regarding compensation practices within the industry."

SEC Leadership Change Prompts Questions on JOBS Act Rulemakings

The recent leadership changes at the Securities and Exchange Commission have raised a number of questions about the direction of JOBS Act rulemakings.

Following the resignation in December of SEC Chairman Mary Schapiro, President Obama designated SEC Commissioner Elisse Walter to lead the agency. Less than one month later, former U.S. Attorney Mary Jo White was nominated to serve as SEC chair.

Amid the changes at the top of the agency, as well as a significant turn over of division directors, there has been much speculation about progress of various JOBS Act rulemakings, particularly the proposed rule to lift the ban on general solicitation of private offerings.

At the SEC's Open Meeting on August 29 regarding General Solicitation in Rule 506, Walter expressed disappointment that actions suggested in public comments to mitigate risks to investors were not given meaningful discussion nor incorporated in the proposal.

This statement raises concerns consistent with those expressed by NASAA and investor advocates.

"We are looking very hard at how we move forward," Walter said in January during a meeting of the SEC's Investor Advisory Committee. "Once a statute is passed, we will carry it out. It is not our job to undo congressional determinations."

NASAA Amicus Brief Opposes Three-Year Limitation on Fighting Securities Fraud

NASAA and the Maryland Securities Commissioner recently filed an amicus brief in the Maryland Court of Appeals arguing that certain tenancy-in-common interests were investment contracts and, therefore, constituted securities under the Maryland Securities Act.

Additionally, the brief argued that private causes of action for fraud under the Maryland Securities Act are subject to the tolling provisions of Md. Cts. & Jud. Proc. §5-203 or the "Discovery Rule" recognized by Maryland common law.

The Circuit Court for Baltimore County found that the tenancy-in-common interests were more akin to an investment in real estate than a security.

NASAA and Maryland argued that the lower court erred by looking solely at the form of the investment interests rather than the "economic realities" of the transaction. The brief warned that this holding could potentially "make Maryland a safe haven for fraudulent activity."

NASAA and Maryland also argued that the court erred because it did not appropriately apply the statute of limitations provision in the Act in light of Maryland's generally applicable discovery rule.

The brief noted that the Plaintiff did not learn that the securities were fraudulent until contacted by the Securities Division after the statute of limitations period had run.

In arguing that the court should apply Md. Cts. & Jud. Proc. § 5-203 to the discovery rule when interpreting the period of time investors have to take legal action when defrauded, the brief warned that "[a]bsent the assurance that a right of action will be tolled pending discovery of fraud, the decision of prudent investors may be to avoid investing in even legitimate opportunities that necessarily promise a delayed return on the investment."

NASAA: Because Every Investor Deserves Protection

About Us

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

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

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



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