

NASAA Insight

The Voice of State & Provincial Securities Regulation



Spring 2014

NASAA to SEC: Revise Reg A Proposal

The North American Securities Administrators Association (NASAA) called upon the Securities and Exchange Commission (SEC) to make substantial revisions to its Regulation A proposed rule to remove potential harms to issuers and investors.

In a March 24 comment letter filed with the SEC, NASAA urged the agency to withdraw the preemptive provisions from the Regulation A proposal and work with state securities regulators to pursue follow-up rulemakings that will promote the use of Regulation A as intended by Congress.

Title IV of the Jumpstart Our Business Startups (JOBS) Act of 2012 raised to \$50 million the amount of money that can be raised through these offerings. The law expressly upheld the authority of states to review these offerings before they are sold to the public unless the securities are sold on a national exchange or sold to "qualified purchasers." In its proposed rule implementing Title IV, however, the SEC attempts to circumvent a Congressional directive by defining the term "qualified purchaser" as a person offered a Regulation A security. This is not what the term "qualified purchaser" means.

"State securities regulators believe the SEC's proposed Regulation A rulemaking must be revised substantially to, among other things, craft rules for the implementation of Title IV of the JOBS Act that will

promote responsible capital formation, protect investors, and preserve the authority of the states to review and register these offerings. It is our strong belief that the Commission's attempt to preempt state review in the Proposal exceeds the Commission's statutory authority and fails to adequately consider all relevant costs and the potential harm to both issuers and investors," said Andrea Seidt, NASAA President and Ohio Securities Commissioner.

"By adopting a rule compliant with the plain meaning and intent of the statute, while working closely with state securities regulators, the Commission will promote increased use of Regulation A for capital formation and preserve significant investor protections," Seidt wrote in NASAA's letter.

Of greatest concern to NASAA is the Commission's attempt to circumvent a Congressional directive to maintain state registration for offerings that are sold to unsophisticated investors and those with modest means.

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For more information about NASAA's concerns about the SEC's Reg A proposal, please see NASAA's Reg A Issue Brief at www.nasaa.org.

States Approve Streamlined Review Program

In March, NASAA members overwhelmingly approved a new streamlined multi-state review protocol to ease regulatory compliance costs on small companies attempting to raise capital under a provision of the Jumpstart Our Business Startups (JOBS) Act.

"This approval is an important first step toward creating a state-level filing and review program that eases regulatory hurdles for filers without sacrificing important investor protections," said Andrea Seidt, NASAA President and Ohio Securities Commissioner. "We look forward to implementing this program so that Regulation A will be an attractive and efficient option both for small businesses that need capital and the investors asked to provide it."

Under the new program, Regulation A filings would be made in one place and distributed electronically to all states. Lead examiners would be appointed as the primary point of contact for a filer and each state will be given 10 business days for review. Lead examiners alone

will interact with issuers to resolve any deficiencies.

The new program was initiated in response to Title IV of the JOBS Act, which raised to \$50 million from \$5 million the amount of money that can be raised through offerings exempt from registration under Regulation A.

Congress directed the SEC to adopt a rule implementing this JOBS Act provision. The SEC's proposed rule, contrary to Congressional intent, seeks to transform most Regulation A offerings into covered securities, which by law are not subject to state review. By doing so, the rule would eliminate state authority to review Regulation A offerings before they are sold to the public.

"State securities regulators have two core missions: protecting investors and helping small businesses access the capital they need to start their companies and grow much-needed jobs for the economy," Seidt said. "We can't fulfill either if the Commission prohibits our review as it proposes to do."

President's Message: Andrea Seidt



We have devoted this issue of the *NASAA Insight* to one of the most significant challenges our members have ever faced — the potential preemption of their regulatory authority, not by elected members of Congress, but by a federal agency.

Typically, when a company seeks to raise capital by marketing securities to a broad audience, it must first register its offering with the SEC, a state (or states), or both to ensure that potential investors have adequate information to make informed investment decisions and to ensure that the enterprise seeking the capital is not operating in an unjust or unfair manner.

An offering may qualify for an exemption from registration if it limits the amount of funding sought and the types of investors to whom it is marketed.

One of these exemptions, Regulation A, has allowed unregistered public offerings of up to \$5 million of securities in a 12-month period. Title IV of the Jumpstart Our Business Startups (JOBS) Act of 2012 raised to \$50 million the amount of money that can be raised through these offerings.

Except in limited circumstances, the JOBS Act maintained the authority of states to review these offerings before they are sold to the public. Yet, in its proposed rule implementing Title IV, the SEC is attempting to circumvent Congress's clear intent.

The Commission wants to transform Regulation A offerings into covered securities, which by law are not subject to state review. It has done so by proposing to define a "qualified purchaser" as anyone who is offered a security issued under Regulation A. In essence, the Commission wants to erase the word "qualified" from the law. The practical effect of the agency's proposed definition on most Regulation A offerings would be exemption from state regulatory review.

This end-run to preemption contravenes what Congress set out to do in passing the JOBS Act and sets a dangerous precedent that endangers future investors.

In fact, the Commission's proposed approach is contrary to enacted law such that, should it be finalized, there is a significant likelihood that issuers and their counsel, concerned about the legality of the Commission's actions, would be reluctant to engage in Regulation A offerings.

The Commission cannot ignore a statute, and we are deeply concerned that the Commission would even consider such an approach.

Executive Director's Message: Russ Iuculano



As President Seidt said, NASAA members are facing a grave challenge to their authority.

It is times of great challenge that great players make great plays.

Baseball's legendary Casey Stengel once said "Finding good players is easy. Getting them to play as a team is another story."

Obviously, Casey never had a team like NASAA.

For more than one year, NASAA members as well as the Corporate Office staff have gone to great extremes to demonstrate the innovation and determination of state and provincial securities regulators in proving that efficient capital formation and investor protection can coexist.

I'd like to first thank Faith Anderson of Washington and her team on the Small Business/Limited Offerings Project Group for the tremendous amount of time and effort they volunteered to help develop NASAA's Coordinated Review Program.

Thanks also to former NASAA Deputy General Counsel Rick Fleming for all he did to support the project group as the review program took shape.

Next, thanks go to the NASAA members who answered the bell and voted to approve the Coordinated Review Program and signed a memorandum of understanding agreeing to participate in the program.

I would be remiss not to spotlight the Herculean efforts of NASAA's legal team — General Counsel Joey Brady, Deputy General Counsel Valerie Mirko and Counsel Chris Staley — as they worked closely with President Seidt in drafting NASAA's strong response to the SEC's Regulation A proposal.

Thanks also to Mike Canning and Anya Coverman of our Government Affairs team and Bob Webster in Communications for increasing awareness of the questionable legality of the SEC's state preemption of Regulation A offerings, and identifying potential champions in Congress to assist NASAA's advocacy on this issue.

NASAA Launches Initiative to Help CPAs Identify Investment Fraud

As tax season approached, NASAA launched its latest outreach toolkit, Taking Account of Fraud, to provide materials to help NASAA members conduct outreach to certified public accountants within their jurisdictions to raise awareness of the red flags of fraud during tax season, particularly affecting their senior clients.



The toolkit leverages outstanding work of NASAA members in Montana and Minnesota. This targeted and tested outreach program was developed by the Montana Securities Department, which has used it for the past two years. Minnesota adapted the program for use with CPAs in its jurisdiction.

The toolkit includes a PowerPoint presentation, news release, fact sheet, and introductory letter, as well as a "how-to" guide with contact information for state accountancy boards, Canadian provincial and territorial accounting institutes, and state accounting societies.

"Tax time offers an important opportunity to spot and stop investment fraud in its tracks, especially scams that target seniors," said NASAA President and Ohio Securities Commissioner Andrea Seidt.

Seidt said the program's resources are designed to help tax preparers identify red flags indicating that their elderly or vulnerable clients may be exposed to financial abuse or fraud.

The warning signs include:

- Lack of Documentation
- Unusual Gains or Losses
- Being Paid in Stock
- Distribution from a Qualified Plan that was not Rolled into Another Qualified Plan
- Missing Interest or Dividends When Previously Reported
- Exotic Investments
- Handwritten Tax Documents
- Large Number of Trades
- 1035 and 1031 Exchanges

"While everything on the list is legal, if fraud or theft is discovered, one or more of these red flags are almost always present," Seidt said. "I hope this program can be the start of a strong partnership to help keep our seniors and vulnerable investors safe from financial harm."

NASAA Offers Statement at Senate Arbitration Hearing

NASAA Board member and Minnesota Commerce Commissioner Mike Rothman, in a written statement, outlined for the Senate Judiciary Committee the importance of an upcoming decision by FINRA's National Adjudicatory Council (NAC).

The NAC is expected in May to determine whether a FINRA hearing panel erred in allowing Charles Schwab & Company to prevent its customers from participating in class-action lawsuits.

"A decision in favor of Schwab would pose an imminent threat to investors' ability to seek redress, particularly for small dollar claims," Rothman wrote. "In other words, the practical effect of the Hearing Panel's decision could be the elimination of the ability of investors to bring or participate in class actions, which is the only viable means for most small investors to recoup their losses."

Rothman's statement for NASAA was submitted for the record in a December 17, 2013, Senate Judiciary Committee hearing examining the Federal Arbitration Act and whether recent Supreme Court decisions will undermine the rights of consumers, investors and small businesses.

NASAA filed an amicus brief supporting FINRA's efforts to overturn its hearing panel's decision.

In its brief filed last year with the NAC, NASAA argued that the hearing panel erred by refusing to enforce FINRA rules prohibiting the use of class action waivers in customer agreements. In doing so, NASAA argued, the hearing panel placed investors in imminent harm by precluding their ability to seek redress for small dollar claims.

Restoring protections for Americans with limited means to invest is even more critical in light of changes enacted as part of the Jumpstart Our Business Startups Act (JOBS Act), which became law on April 5, 2012," Rothman wrote.

"The JOBS Act established a mechanism for small investors to engage in crowdfunding and loosened restrictions on advertising and solicitation of private securities," Rothman wrote. "NASAA anticipates that these provisions of the JOBS Act will lead to an increase in very small investments. If these investors are forced to waive their right to participate in class actions, they will be left with no economically viable remedy when they are defrauded, thereby undercutting the goal of the JOBS Act to spur investment in smaller offerings."

Seidt: “Working together, the Commission and the states have a tremendous opportunity to create a filing and review process that works well for issuers and investors.”

On March 24, 2014, NASAA submitted a comment letter to the Securities and Exchange Commission urging the agency to withdraw the preemptive provisions from its Regulation A proposal and work with state securities regulators to pursue follow-up rulemakings that will promote the use of Regulation A as intended by Congress. The following is the Executive Summary contained in the letter. The full text of NASAA’s letter, as well as additional perspective, is available on the Regulation A Resource Center on the NASAA website at www.nasaa.org.

In Title IV of the JOBS Act, Congress amended Section 3(b) of the Securities Act of 1933 by adding new Section 3(b)(2) to increase the annual offering limits for securities issued pursuant to this exemption from \$5 million to \$50 million.

Title IV also provided that Regulation A securities would be covered securities and exempt from state registration to the extent that the securities were sold on a national securities exchange or sold to “qualified purchasers.”

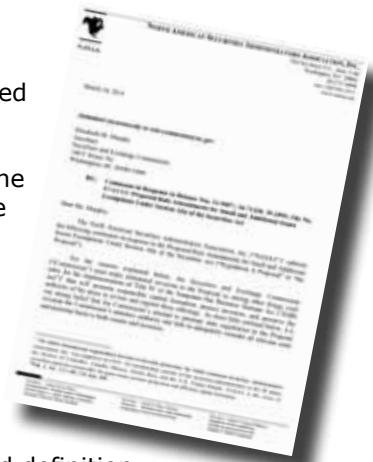
The Commission now proposes to implement Title IV by way of amendments to Regulation A that expand the preemptive reach of the exemption beyond the clear language and intent of Title IV of the JOBS Act and the

As a regulatory agency, the Commission lacks the authority to define “qualified purchaser” and preempt state registration in the manner contemplated in the Regulation A Proposal. The legislative history of the JOBS Act indicates Congress considered broad preemption of state authority over Section 3(b)(2) securities and soundly rejected it.

Furthermore, the Commission’s proposed definition of “qualified purchaser” is contrary to the plain meaning of Sections 18(b)(3) and 18(b)(4)(D) of the Securities Act, the legislative history of the provisions, and prior Commission pronouncements. The Commission’s proposed approach is contrary to enacted law such that, should it be finalized, there is a significant likelihood that issuers and their counsel, concerned about the legality of the Commission’s actions, would be reluctant to engage in Regulation A offerings.

NASAA is concerned that the Commission would consider an approach inconsistent with Congressional intent and prior agency interpretations that is ultimately harmful to both issuers and investors.

The Commission points to a 2012 report issued by the Government Accountability Office that explored potential causes for the limited use of the Regulation A exemption in the Proposal’s cost benefit analysis and as a reason for preemption. The purpose of the GAO Report was to provide information about Regulation A offerings directly to Congress and should not be used as a



As a regulatory agency, the Commission lacks the authority to define “qualified purchaser” for purposes of securities issued under Regulation A...

National Securities Markets Improvement Act of 1996 (NSMIA).

Of greatest concern to NASAA is the Commission’s attempt to circumvent a Congressional directive to maintain state registration for offerings that are sold to unsophisticated investors and those with modest means.

NASAA is opposed to the Commission’s approach to define “qualified purchaser” for purposes of securities issued under Regulation A as all offerees in Tier 1 and Tier 2 offerings and all purchasers in Tier 2 offerings. The practical effect on most Regulation A offerings would be exemption from state regulatory review, a direct contravention of Congress’s intent when it passed the JOBS Act.

Continued next page

"While the Commission spent considerable time detailing the benefits it perceives in preempting state review, there is little, if any, consideration in the Proposal of the adverse costs that come with preemption, particularly the potential harm to investors."

foundation for preemption. Moreover, the GAO Report identified a number of other factors that limited or discouraged issuer use of the exemption, including a comparatively low \$5 million offering limitation, a slow and costly filing process associated with both state and Commission review, and the availability of other exemptions under the federal securities laws.

The Commission's Proposal to preempt state regulatory review is further flawed given the agency's failure to conduct a fair and adequate cost benefit analysis of the effect preemption would have on issuers and investors. While the Commission spent considerable time detailing the benefits it perceives in preempting state review, there is little, if any, consideration in the Proposal of the adverse costs that come with preemption, particularly the potential harm to investors.

Whenever the Commission engages in rulemaking, it is required to give due consideration to the potential effects on investor protection, separate and aside from the debate regarding effects on issuers.

The Proposal fails to examine any of the harm investors might incur in the absence of state review in the area of small and thinly traded company offerings. Data should be readily available to the Commission in light of investors' experience with preemption and microcap issuers in the Regulation D, Rule 506 context. While it is fairly well established that the Commission has not made Regulation D, Rule 506 review or enforcement one of its regulatory priorities, for the past three consecutive years, Regulation D, Rule 506 offerings have been the single most common investment product or scheme involved in state enforcement actions.

That was the case even before the Commission permitted general solicitation and general advertising in new Rule 506(c). While Regulation D does not entail the same qualification and review process as Regulation A, Regulation A offerings will likely target more vulnerable unsophisticated investors in both the primary and secondary markets.

The states have developed a new coordinated filing and review program created with active industry input. The states have embraced this opportunity for change and modernization, voting overwhelmingly in support of the NASAA Coordinated Review Program for Regulation A Offerings. NASAA will work with states over the next several weeks to implement the Program.

The Coordinated Review Program for Regulation A Offerings will provide greater efficiencies in the state review process, maintain important investor protections, and facilitate responsible capital formation.

In contrast, the Commission's Regulation A Proposal has not adequately considered the costs, benefits, and harms associated with its proposal.

Significantly, the Commission has not addressed the cost or harm to investors arising from preemption or the Commission's ability to carry out the agency's regulatory responsibility given its budgetary challenges. Furthermore, Form 1-A and corresponding Models A and B disclosure documents should all be updated and streamlined to further reduce small business issuer costs.







The Commission should remove the preemptive provisions from the Proposal and partner with state regulators and industry to update Form 1-A and related disclosure templates. A streamlined process with scaled disclosure and reporting, relying on NASAA's Coordinated Review Program, is the optimal path to making Regulation A a workable exemption. We stand firm in our belief that, working together, the Commission and the states have a tremendous opportunity to create a filing and review process that works well for issuers and investors.

"A streamlined process with scaled disclosure and reporting, relying on NASAA's Coordinated Review Program, is the optimal path to making Regulation A a workable exemption."

How NASAA's Coordinated Review Works

State regulators, through NASAA, undertook a year-long project to develop a Coordinated Review Program for Regulation A Offerings that will help streamline state registration of offerings under both Section 3(b)(1) and 3(b)(2). The result was a new coordinated filing and review program created with active industry input. The states have embraced this opportunity for change and modernization, voting overwhelmingly in support of the program on March 7, 2014.

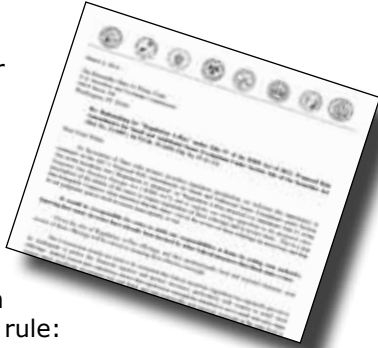
The streamlined multi-state review protocols for Regulation A offerings are designed to ease regulatory compliance costs on small companies seeking to raise capital. With this new program, Regulation A filings will be made in one place and distributed electronically to all states. Lead examiners will be appointed as the primary point of contact for a filer, and each state will be given 10 business days for review. The lead examiners alone will interact with the issuer to resolve any deficiencies.

NASAA Multi-State Coordinated Review Program					
Filing Process	Review Process				
					
Day 1	3 Business Days	10 Business Days	5 Business Days	3 Business Days	Day 21
<p>Issuers desiring coordinated review will e-mail an electronic copy to the program coordinator (State of Washington). The exhibits include Form 1-A & financial statements. The program coordinator will distribute the documents to the states selected by the issuer on the application form. Filing fees paid directly to each state.</p>	<p>Within three business days after receipt of the application, the program coordinator will select a lead disclosure examiner and lead merit examiner (assuming registration is sought in both types of jurisdictions).</p>	<p>Within an additional 10 business days, the lead examiners will draft and circulate a proposed comment letter to the other disclosure states and/or merit states.</p>	<p>Within an additional five business days, the participating jurisdictions may communicate any concerns or comments to the lead examiners.</p>	<p>Within an additional three business days, the lead examiners will make any necessary revisions and send the initial comment letter to the issuer.</p>	<p>If there are no deficiencies in the application, no comments will be necessary and the registration will be cleared by the lead examiners within 21 business days after it is filed.</p> <p>If there are deficiencies, the lead examiners will communicate with the applicant and the participating jurisdictions to resolve deficiencies. Whenever an issuer files a response to any deficiency, the lead examiners will reply within five business days.</p> <p>When a lead examiner determines that the application satisfies all substantive review standards, the examiner will clear the application and provide same-day notice to participating jurisdictions. The lead disclosure examiner and lead merit examiner may clear application at different times. Each participating jurisdiction agrees to clear the application upon clearance by the lead examiner.</p>

What Others Are Saying . . .

Secretaries of State

In a March 4, 2014 letter to the SEC, Secretaries of State from Illinois, Indiana, Massachusetts, Mississippi, Nevada, New Hampshire, North Carolina and Wyoming, called for the removal of preemptive language from the SEC's proposed Reg A rule:

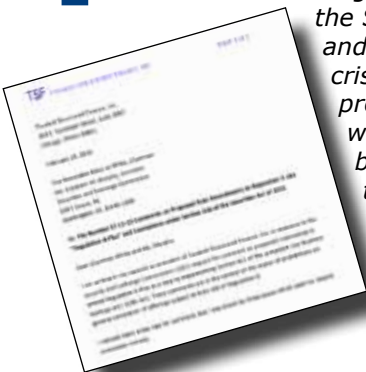


"It would be irresponsible for states to shirk our responsibilities at home by ceding state authority, knowing how many investors have already been harmed by other federal measures that block state review. . . . Given the size of Regulation A-Plus offerings, and their predominantly local and regional character, state review of these offerings will be critical to ensuring their effective oversight."

Industry Practitioner Janet Tavakoli

In a February 24, 2014 letter, Janet M. Tavakoli of Chicago-based Tavakoli Structured Finance, Inc. wrote:

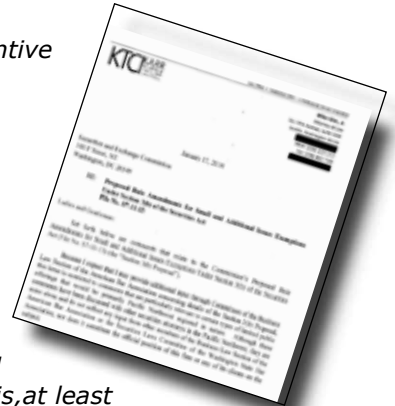
"Specifically, I would like to draw the SEC's attention to the proposed definition of 'qualified purchaser,' the proposed exemption from review by the states, and the perceived disregard for the intent of Congress. . . . Capital formation thrives in an investor-friendly atmosphere. These issues, which fly in the face of both market experience and reason, are the opposite of what is required to achieve the goal of strengthening the economy through capital formation that results in growth. . . . It is hard to fathom how the SEC took Congressional findings—and the SEC's experience before and after the 2008 financial crisis—and came up with these proposed rule amendments without realizing it risks being branded as a rogue regulator that requires reining in by Congress."



Securities Attorney Mike Liles

In a January 17, 2014 letter to the SEC, securities attorney Mike Liles of Karr Tuttle Campbell in Seattle, Washington, wrote:

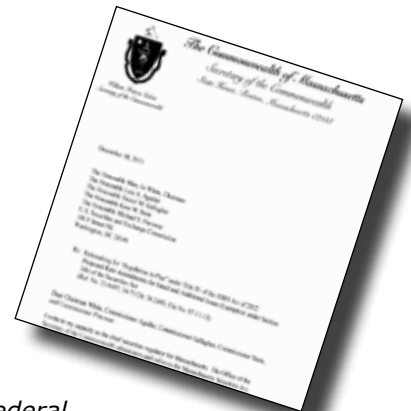
"The lack of any substantive concept akin to 'sophisticated investors, capable of protecting themselves' in the currently proposed definition of 'qualified purchaser' under Rule 256 of the Section 3(b) Proposal, which is designed for offerings to unsophisticated retail investors (individuals), is, at least from the perspective of this practitioner, unexpected and questionable. . . . In effect, the use of the definition of 'qualified purchaser' merely as a tool for effecting preemption of state regulation without providing any substantive element of investor protection, is jarring in this context and would not appear to be what Congress intended in enacting Section 401(b) of the JOBS Act.' The relevance of this aspect of the Section 3(b) Proposal is the possibility that, if adopted, it might not withstand legal challenge, and that possibility might discourage efforts by regional investment bankers from committing the significant resources required to properly service small business public offerings"



Secretary of the Commonwealth William Galvin

In a December 18, 2013 letter to the SEC, Massachusetts Secretary of the Commonwealth William Galvin wrote:

"The states have tackled preemption battles on many fronts, but never before have we found ourselves battling our federal counterpart. Shame on the S.E.C. for this anti-investor proposal. This is a step that puts small retail investors unacceptably at risk."



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.



North American Securities
Administrators Association
750 First Street NE
Suite 1140
Washington, D.C. 20002

Contact NASAA

Phone: 202-737-0900
Fax: 202-783-3571

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 www.nasaa.org

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NASAA'S Rick Fleming Named New Investor Advocate for SEC

The North American Securities Administrators Association congratulates NASAA Deputy General Counsel Rick A. Fleming on his appointment as the Securities and Exchange Commission's new Investor Advocate.

Fleming becomes the first person to lead the SEC's Office of the Investor Advocate, which was created by the Dodd-Frank Wall Street Reform and Consumer Protection Act. He was appointed to the position by SEC Chair Mary Jo White to whom he will report.

"This office will serve a critical role in ensuring that the SEC focuses on the needs of ordinary investors. For nearly two decades, Rick has fought directly on the front lines for investors at the state and national level. Through his work with the

Office of the Kansas Securities Commissioner and more recently at NASAA, Rick has demonstrated an unparalleled passion for investor advocacy and commitment to investor protection," said Andrea Seidt, NASAA President and Ohio Securities Commissioner.

"State securities regulators are very pleased with Rick's appointment. Main Street investors deserve a

true advocate with Rick's experience and strong voice to speak on their behalf, and we look forward to working with Rick in his new role to ensure that those voices are heard as the SEC advances its critical investor protection mission," Seidt said.

Prior to joining NASAA in 2011, Fleming was General Counsel for the Office of the Kansas Securities Commissioner.



Rick Fleming