



A PRO-INVESTOR LEGISLATIVE AGENDA FOR THE 110th CONGRESS

Preamble

For 87 years the North American Securities Administrators Association (NASAA) has worked on initiatives impacting state and federal legislation, rulemaking, and coordinated enforcement actions all with the common goal of protecting investors and maintaining investor confidence in our markets. NASAA is committed to continuing its venerable mission and to that end announces the following legislative agenda. The items in this agenda fall into five broad categories: 1) Preserving the authority of state regulators to protect investors, and evaluating the negative effects of preemption of certain state laws; 2) Strengthening the mechanisms currently in place that provide redress to investors for wrongdoing by industry participants; 3) Maintaining federal laws designed to insure corporate accountability and shareholder confidence; 4) Promoting sound and effective regulatory initiatives; and, 5) Improving the scope and breadth of investor education efforts.

I. Support a Strong and Effective Regulatory Structure for Capital Markets.

As noted in the preamble, state securities regulators have a proud tradition of protecting investors. In their continued effort to accomplish this mission, state regulators will continue to vigorously defend their authority to regulate at the state level and bring enforcement actions seeking appropriate remedies against those firms and individuals that violate securities laws in their jurisdictions. NASAA members will remain vigilant in fighting attempts, such as the Committee on Capital Markets Regulation's Interim Report, to neutralize state regulators who are aggressively protecting investors, the bedrock of our market confidence.

Many NASAA jurisdictions have excellent relationships with fellow regulators, which NASAA believes are vital to effective and efficient regulation. The current level of cooperation is reflected by NASAA's participation in a joint national initiative with the SEC and NASD to protect seniors from investment fraud and sales of unsuitable securities. These synergies serve as building blocks for other cooperative efforts. For instance, NASAA looks forward to working with the SEC as it continues to study the various regulatory schemes affecting both broker-dealers and investment advisers. NASAA also looks forward to strengthening its partnership with industry SROs especially in the area of public disclosure of information on the disciplinary history of industry participants.

The complementary state-federal-industry regulatory relationship has a proven record of serving investors well. In light of the proposed consolidation of the NASD and the NYSE Regulation, the need for strong state securities regulatory authority is heightened. With more than 100 million investors relying on our securities markets to meet their financial goals – and on regulators to keep those markets well-policed – we must ensure that this successful and cooperative regulatory relationship remains as strong as possible and NASAA would support legislative initiatives designed to facilitate and strengthen this cooperation.

2. Restore Fairness and Balance in the Securities Arbitration System.

Every year thousands of investors file complaints against their stockbrokers. If these disputes aren't settled, investors are left with only one avenue to pursue their claims – arbitration – and for all practical purposes only one arbitration forum. This system, which is administered by an affiliate of the NASD, should be examined to ensure it is fair and transparent to all.

State securities regulators believe Congress should review the manner in which arbitrations are conducted to determine if there is sufficient disclosure of potential conflicts by panel members; to determine if selection, qualification, and composition of the panels is fair to the parties; whether the arbitrators receive adequate training; if explanations of awards are sufficient; if the system is fast and economical for investors; and if the entire arbitration process should be optional, not mandatory, for investors.

3. Encourage Hedge Fund Transparency and Pension Protection.

NASAA supports efforts to regulate hedge funds in a manner that will provide greater transparency to investors while not overburdening the hedge fund industry. With over 8,000 funds in existence and assets in excess of \$1 trillion, the fact that this industry remains, for the most part, unregulated is worrisome for investors and the U.S. markets in general.

ERISA rules make hedge funds and their managers “trustees” if more than 25% of the fund's assets are pension assets. The Pension Protection Act of 2006 removed public pension funds from the 25% calculation. State securities regulators question the wisdom of this change and they believe this is an issue that should be closely monitored. State securities regulators want to ensure that public pension plan monies are not subject to undue risk through investment in unregulated pooled vehicles.

4. Preserve the Authority of State Securities Regulators.

The Gramm-Leach-Bliley Act (GLBA) affirmatively preserves the authority of the Securities and Exchange Commission and state securities regulators to investigate and bring enforcement actions with respect to fraud and deceit or unlawful conduct by any person when the activities are conducted in a functionally regulated subsidiary of a depository institution. Clearly, Congress understood weakening the authority of state regulators in this area would be harmful to investors.

Congress should undertake a review of recent activities by both the Office of Thrift Supervision (OTS) and the Office of the Comptroller of the Currency (OCC) for compliance with federal law. Specifically, these two agencies have in one instance promulgated rules and in another issued an opinion letter with sweeping preemption provisions, which have been upheld in several federal court decisions. Congress should consider adopting legislation that disapproves of such legislative-style activity by a few federal regulators and that expressly preserves the authority of state regulators to protect consumers from fraud and abuse in the banking and securities sectors.

5. Reinstate State Regulatory Authority of Regulation D 506 Offerings.

The scope of covered securities in Section 18(b) of the 1933 Act has expanded since the National Securities Markets Improvement Act of 1996 (NSMIA) was enacted, even though the definition has technically remained the same. More issuers are using Rule 506 and the listing standards on some of the exchanges are deteriorating, so more securities that fall within the definition of covered security are being offered to the public with little or no scrutiny.

Rule 506 of Regulation D offerings are provided the special status of private placements and are exempt from federal and state securities registration laws. As a result of this special status, there is no regulatory review of the 506 offerings at either the federal or state level. Thus, for example, NSMIA has preempted the states from prohibiting Regulation D offerings even where the promoters or broker-dealers have a criminal or disciplinary history. Some courts have even held that offerings made under the guise of Rule 506 are immune from scrutiny under state law, regardless of whether they actually comply with the requirements of the rule. All the while, state securities regulators have seen an increase in the number of Reg D Rule 506 offerings in their respective jurisdictions.

In light of the growing popularity of the offering and the expansive reading of the exemption given by certain courts, NASAA believes the time has come for Congress to reinstate state regulatory oversight of Regulation D offerings.

6. Update and Strengthen the Accredited Investor Definition.

Recently, the Securities and Exchange Commission proposed two rules that would require natural persons investing in hedge funds and other private funds that claim an exemption under 1940 Investment Company Act Section 3(c)(1) to have a minimum of \$2.5 million in certain types of investments at the time of their investment in the fund. Such investments would not include, among other items, the value of the individual's residence.

This test would be *in addition to the current requirement* that the investor must have either \$1 million in net worth or a certain level of income--\$200,000 individually or \$300,000 with a spouse. This standard was adopted in 1982, and NASAA has repeatedly encouraged the Commission to increase these levels to keep pace with inflation and a sustained growth in wealth and income. NASAA will be commenting on the proposed rulemaking, and believes the accredited investor standard should be revised in all its applications, rather than limited to investments in certain private funds.

Raising the individual investor standard to be an accredited investor would provide greater protection for investors and would aid state regulators in enforcement activities by ensuring that those individuals who are taking a greater risk are in fact accredited. In order to insure that those representing themselves as "accredited investors" do in fact meet the definition, NASAA suggests implementing, either by rule or by statute, a requirement that industry participants be required to independently verify a potential investor's representation that he or she meets the financial guidelines.

7. Maintain Strong Investor Protection Provisions of the Sarbanes-Oxley Act.

Investors were right to be outraged by the frauds of Enron, WorldCom and others and Congress was right to pass tough corporate accountability legislation in response. The industry-created scandals of recent years caused Main Street investors to lose billions of dollars and gave our nation's corporate reputation a black eye in the world community. Legislation passed in response to these corporate debacles was appropriate. In fact, the legislation has been successful as reflected by the continued rise in indexes that measure investor confidence in the markets. NASAA believes that weakening of Sarbanes-Oxley will drive investors from the market place and serve only to erode our capital markets.

NASAA opposes changes to the fundamental principles of the Sarbanes-Oxley Act, but recognizes that its regulatory requirements for small firms may require some modification.

8. Define Equity Indexed Annuities as Securities.

The sale of equity-indexed annuities (EIAs) has risen dramatically since 1995, when they first appeared on the market. Estimates are that \$25 billion of these products were sold in 2005. This increase in sales volume has been driven largely by the high commissions that sales agents earn on EIAs. As financial media commentators have said repeatedly — these products are not bought but sold. Problems have arisen, however, because EIAs are extremely complex and they have a number of onerous features, including long accumulation periods and high surrender charges. State securities regulators, as well as the SEC and the SROs, are receiving an increasing number of complaints about EIAs.

Although EIAs may be legitimate investment vehicles for some people, NASAA is concerned that these products are unsuitable for many investors and that they are often associated with deceptive marketing tactics. Particularly troubling is the sale of EIAs to senior citizens, who are being aggressively targeted through investment seminars nationwide.

The status of EIAs as securities remains uncertain. The SEC first solicited public comment on the appropriate treatment of EIAs under federal securities law in 1997 but the agency has not yet issued guidance on the issue. The NASD has cautioned its members that EIAs may well constitute securities, depending upon the facts and circumstances in each case, and it requires member firms to follow special precautions when their associated persons sell EIAs, regardless of whether they are deemed to be securities. However, the NASD has expressly declined to address the legal status of EIAs.

NASAA believes that it is time to remove the legal uncertainty surrounding EIAs and that it is appropriate to classify these investment products as securities. This is conceptually sound under current law, at least in instances where EIAs are promoted and sold primarily as investments rather than insurance products. This is especially appropriate from the standpoint of investor protection, given the level of sales abuse associated with these products and the unique ability of securities regulators at both the state and federal level to address those abuses at the point of sale. The strong suitability standards found in the state and federal securities laws will help ensure that EIAs are sold only to investors for whom they are appropriate. The application of the securities laws to the sale of these products also will help ensure that investors receive complete, understandable, and accurate information regarding all material aspects of these products prior to purchase and that investors are afforded remedies if they are defrauded or harmed by other abusive sales practices.

9. Uphold State Role in Data Security Breach Protection.

As a result of both our enforcement and education efforts, state securities regulators have been made acutely aware of the investing public's concern with security of their personal data and protection from identity theft.

Heightened congressional interest in security breach legislation follows the enactment of laws in a number of states requiring institutions to notify affected consumers following a data security breach. Efforts by state legislatures have resulted in a heightened awareness by the general public of the deficiencies in the security of electronic information in general, and of numerous security breaches at some of the nation's largest firms in particular.

Currently, state securities examiners are conducting examinations of not only investment advisers but also broker-dealers to ensure the privacy of persons who give them personal information in the course of doing business or considering doing business. NASAA wants to ensure our authority is not inadvertently preempted in a data security breach law.

Any federal bill dealing with data security breaches should preserve state laws that address problems surrounding data security. A state role is vital to effective consumer protection, and we strongly support a continuation of the enforcement role of the state attorneys general in this area. In addition, should Congress decide to preempt certain state laws, high standards should be enacted in their place, including strong provisions for national security breach notification and when a consumer can impose a security freeze on access to his/her consumer credit report and credit score. Without such a strong federal substitute, consumers will be deprived of the protections that state laws currently provide.

10. Increase Sanctions for Crimes Against Senior Citizens.

Notwithstanding the multi-front offensive launched by state and federal securities regulators, senior citizens remain a target for unscrupulous scam artists. State securities regulators recently announced that 26 percent of all enforcement actions during 2004-2005 involved the financial exploitation of seniors.

Investment fraud targeting seniors is an ongoing concern, and NASAA believes that Congress should explore proposals to assist law enforcement and prosecutors to ensure that those who take advantage of our nation's elderly will be held accountable. Fraudulent investment sales to seniors will remain a problem of epidemic proportions as long as the benefits to the perpetrators outweigh the costs. Enhanced penalties for senior abuse – ranging from fines to jail terms – should help to raise those costs, deter law violations and punish appropriately those who exploit senior investors.

11. Advance and Increase Financial Education Efforts.

The securities regulators that form the NASAA membership are firmly committed to promoting and supporting financial literacy, and are firmly committed to delivering investor education. We believe we have an ongoing obligation to help our constituents develop the knowledge they need to make good personal financial decisions. We think that reaching our young citizens with financial education at a very early age can help them build a lifetime of good money management habits. And, the increased need to educate seniors about investment fraud cannot be overemphasized. It remains our fundamental belief that financial education is the first and best defense against financial fraud, abuse, and exploitation.

State securities agencies are leaders in grass-roots investor outreach and education and look for opportunities to join forces with other members of the financial education community.

NASAA urges Congress to fund programs to cultivate financial education partnerships amongst federal, state and nonprofit entities.



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