Testimony of Denise Voigt Crawford

Commissioner, Texas Securities Board and

President

North American Securities Administrators Association, Inc.

Before the

United States Financial Crisis Inquiry Commission

January 14, 2010

Chairman Angelides, Vice-Chairman Thomas, and members of the Commission,

I'm Denny Crawford, Texas Securities Commissioner and President of the North American Securities Administrators Association, Inc. (NASAA).[1] I am honored to be here today to focus on the role of state securities regulators in the current financial crisis, and to provide you with recommendations to enhance our ability to pursue financial fraud and prosecute the perpetrators of those crimes.

State Securities Regulatory Overview

State securities administrators are responsible for enforcing state securities laws, licensing firms and investment professionals, registering certain securities offerings, examining broker-dealers and investment advisers, pursuing cases of suspected investment fraud, and providing investor education programs and materials to the citizens of our states. Ten of my colleagues are appointed by state Secretaries of State; five fall under the jurisdiction of their states' Attorneys General; some are appointed by their Governors and Cabinet officials; and others, like me, work for independent commissions. I have worked for the Texas Securities Board for 28 years and been appointed Commissioner by both Republican and Democratic Administrations. By nature, we are the first line of defense for Main Street investors and for us, enforcement is a top priority.

Through the years, states have been the undisputed leaders in criminal prosecutions of securities violators because we believe in serious jail time for securities-related crimes. We have successfully exposed and addressed the profound conflicts of interest among Wall Street stock analysts by requiring changed behavior. We led all regulators on late

[1] The oldest international organization devoted to investor protection, the North American Securities Administrators Association, Inc., was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, the U.S. Virgin Islands, Canada, Mexico and Puerto Rico. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

trading and market timing in mutual funds. We address on a daily basis abusive sales practices especially those targeting vulnerable senior investors.

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

Regulatory Accomplishments vs. Regulatory Failures

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

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

The National Securities Markets Improvement Act of 1996 (NSMIA) significantly impacted the role of state regulators and enforcers in dealing with securities offerings and professionals. NSMIA preempted many state regulations and transferred significant enforcement responsibilities from the states to the federal government. NSMIA also prevented the states from taking preventative actions in areas that we now know to have been substantial contributing factors to the current crisis. It seems that some have

forgotten that the federal securities laws were enacted to supplement preexisting state securities laws based on enforcement dilemmas occasioned by the jurisdictional limitations on the states' police powers, or, as Justice William Douglas pointed out in *Travelers Health Association v. Virginia*, "to fill a gap." Now, more than 60 years later, Congress, federal regulatory agencies and the courts have created gaps in the securities laws of the states and in the entire investor protection regime.

Two examples clearly demonstrate these gaps in investor protection: Nationally Recognized Statistical Rating Organizations (NRSROs) and the private offering exemption.

Nationally Recognized Statistical Rating Organizations

Whether the rating agencies engaged in self-dealing or were simply incompetent, there is little question that they failed to investigate the securities offerings thoroughly and issued ratings that were, at best, highly inflated. Prior to NSMIA, all NRSROs were registered with the Securities and Exchange Commission (SEC) as investment advisers and subject to both state and federal oversight. NSMIA bifurcated the oversight of investment advisers between the SEC and the states. In rulemaking pursuant to NSMIA, the SEC exempted the NRSROs from investment adviser registration, thus removing them from review of any kind by the states.

Private Offering Exemption

NSMIA also preempts state regulation of securities offerings of so-called "covered" securities. If a security is one that is considered "covered" by the statute, states are prohibited from meaningful review of the offering and are left with ex-post fraud investigation and prosecution authority. The stated congressional purpose of these provisions was to preempt state regulation of offerings that were national in scope and to eliminate redundant or inconsistent state regulations. Predictably, under NSMIA, covered securities include those listed on national securities exchanges and the National

Market System of the National Association of Securities Dealers Automated Quotations (NASDAQ). The SEC generally regulates these national exchanges and NASDAQ offerings under federal law, making state regulation duplicative and largely unnecessary. Paradoxically, however, NSMIA also preempted state regulation of securities offerings and sales made pursuant to existing federal exemptions including private placements exempt from federal registration under SEC Regulation D Rule 506.

There is very little in the legislative history of NSMIA that discusses private placements. What commentary exists defends federal preemption on the grounds that private placements, like exchange listed securities, involve offerings that are "national in scope." Preemption of state regulation of private offerings, however, results in a very different consequence than preemption of state regulation of public offerings subject to SEC supervision under the 1933 Act. Unlike listed securities, private placements are exempt from federal registration and for all practical purposes exempt from federal oversight. NSMIA's preemption of state regulation of private placements, therefore, created a regulatory black hole - today no one regulates these offerings.

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

Also of note is that NSMIA, as originally conceived, stripped the SEC of two Commissioners and 20 percent of its budget.[2] Therefore it does not take an extreme cynic to view NSMIA's preemption primarily as deregulation, rather than a systematic apportionment of appropriate responsibilities between federal and state regulators. This politically driven reality lessens the temptation to view this issue as part of the broader philosophical debate on federalism and the recurring question of appropriate state and federal roles for securities regulation. Regardless of motivation or cause, for private

---

[2] *Capital Markets Deregulation and Liberalization Act of 1995*, H.R. 2131, 104th Cong. (1995) at § 9 (reducing number of SEC Commissioners from 5 to 3); H.R. 3005, 104th Cong. (1996), at Title IV (cutting SEC fees by $680 million over 5 years).

placements, there is currently no federal or state regulation. This regulatory failure calls for a meaningful and substantive solution.

State Regulatory Leadership

The resurgence of state securities regulators may have begun with the analyst independence cases, but it shows no signs of ending. Not surprisingly, the financial industry has not welcomed this new activism by state securities regulators and would be happy to constrain or preempt us. Reorganization of financial regulation could provide political cover for legislation curbing the reach of state regulators. There have been both agency and legislative proposals to this effect – most recently in the U.S. Treasury Department's "Blueprint for a Modernized Financial Regulatory Structure."[3]

Yet it has been the actions of state securities regulators, both as essential fraud detectors and arbitrators, which have compelled the SEC to take action. The Blueprint's assault on state enforcement was straightforward: It should be preempted. This suggestion is not new.[4] Industry has repeatedly urged preemption of state securities law and enforcement. H.R. 2179, the Securities Fraud Deterrence and Investor Restitution Act of 2003, would have preempted state securities regulators from bringing enforcement actions with appropriate remedies against those firms that violate securities laws in their jurisdictions. Thankfully, this misguided proposal, which was supported by the securities industry, did not become law.

The Blueprint focused not on state regulation in the sense of rulemaking and oversight, but on state enforcement of antifraud rules. Increasingly, state securities regulators have played a far more aggressive role in prosecuting systemic securities fraud. The

---

[3] The United States Department of the Treasury, The Department of the Treasury Blueprint for a Modernized Financial Regulatory Structure, Henry M. Paulson, Jr., Robert K. Steel, David G. Nason, and others. Washington, DC, March 2008.

[4] *See, e.g.,* Kathleen Day, *Brokerage Settlement Leaves Much Unresolved: SEC Acknowledges Need for New, Specific Rules*, Wash. Post, Apr. 30, 2003, at E1 (describing Wall Street's push "to make it clear that federal securities laws preempt state laws").

Blueprint's proposal, however, would have precluded state securities regulators from continuing to play their central role in fraud detection and prosecution. While the authors of the Blueprint argued for uniformity, recent experience suggests that regulatory competition among the states and the SEC works to the advantage of investors by promoting effective and efficient regulation. If one believes securities fraud tends to be under-enforced, then competition is desirable because it creates a failsafe check and balance against the prospect of regulatory capture.

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

More recently, state securities regulators have been the most aggressive enforcers in the auction rate securities (ARS) cases, negotiating settlements with the major investment banks totaling well over $150 billion. The New York Securities Bureau reached the first settlements with the credit rating agencies. State securities regulators have also played a significant role in resolving similar cases.[5]

Not only have the state securities regulators frequently been first, they have been tougher. A recent study of the restitution involved in mutual fund cases is particularly revealing. It compares restitution in cases involving both a state securities regulator and the SEC, with those involving the SEC alone. The study concluded that the cases with both "prosecutors" yielded considerably higher restitution ratios. The study controlled a

---

[5] *See, e.g.,* Jennifer Bayot, *Franklin Places Three on Leave for Fund Trading*, N.Y. Times, Dec. 23, 2003, at C12 (detailing the investigative roles of state regulators in Massachusetts and California).

variety of factors to reach the conclusion that the higher restitution in the cases with the state securities regulator may be attributed to its relative aggressiveness. Further, the study concludes that the "aggressiveness explanation" is consistent with the career concerns of the regulator as well as with regulatory capture theories. [6]

Ironically, in its own enforcement activities, the SEC has not met the standard of conduct that it requires of the broker-dealer firms it regulates. On numerous occasions, the SEC has failed to detect abuses or has failed to take appropriate action despite the appearance of "red flags," where similar conduct by a broker-dealer firm would invite SEC disciplinary action. When imposing sanctions on brokerage firms for inadequate supervision, the SEC has stated:

> We have repeatedly held that brokers and dealers are under a duty to supervise the actions of employees and that in large organizations it is especially imperative that the system of internal control be adequate and effective *and that those in authority exercise the utmost vigilance whenever even a remote indication of irregularity reaches their attention*. There must be adequate follow-up and review when a firm's own procedures detect irregularities or unusual trading activity. . . .

It appears that, far from monitoring the securities markets and securities industry in order to detect and terminate abusive and illegal practices, the SEC was often prompted into action only after state regulators had unearthed them.

Congressional and internal investigations of SEC enforcement policies and procedures, prompted in part by the sensational Madoff case, preliminarily indicate that the Commission's failure to enforce the securities law was a result of a combination of policy and ineffectiveness. Regardless, the sheer number and size of its failures point to a capture of the agency.

---

[6] *See,* Zitzewitz, Eric, An Eliot Effect? Prosecutorial Discretion in Mutual Fund Settlement Negotiations, 2003-7. Available at SSRN: http://ssrn.com/abstract=1091035

By way of example, on April 8, 2002, the New York Securities Bureau announced the results of an investigation of conflicts of interest of research analysts at Merrill Lynch (Merrill). The investigation showed that, from 1999 to 2001, Merrill did not publish a single “reduce” or “sell” recommendation on any stock in its Internet group.

Furthermore, internal Merrill emails by analysts referred to some stocks that the firm was recommending to its customers as a “piece of junk,” a “piece of crap,” or in even more disparaging language. The New York Securities Bureau discovered that, unknown to the general public, Merrill’s research analysts were not giving impartial investment advice to their customers, rather, that the advice was tailored to attract and keep the investment banking business of corporate clients.

Two weeks *after* New York’s announcement, the SEC announced that it was *making an inquiry* into the practices of research analysts at Merrill. Eventually, it became clear that the conflicts of interest of Merrill’s analysts were far from unique; the problem pervaded the securities industry. In April 2003, the New York Securities Bureau, NASAA, the NYSE, the then-NASD, and the SEC announced the details of a “global settlement” with ten of the largest investment banking firms and two individual analysts. The settlement with the firms included monetary relief of $1.4 billion, including civil penalties and disgorgement of profits, as well as various procedural reforms.

It does not appear that the SEC took any action in the research analyst scandal until an announcement by a state securities regulator prompted it to act. For at least two years, the largest broker-dealer firms made a practice of betraying their customers by publishing tainted research reports, apparently without the SEC noticing.

A more recent example is the ARS scandal mentioned previously. Auction rate securities are long-term bonds or preferred stock whose interest rates or dividends are reset by auctions that typically occur at intervals of between seven and thirty-five days. These auctions provide the primary source of liquidity for investors who wish to sell their

investments. Investors who buy ARS typically seek a cash-like investment that pays a higher yield than a money market fund or certificate of deposit.

During recent years, billions of dollars of ARS were sold to investors by major brokerage houses as cash alternatives. In February 2008, the ARS market collapsed, with the result that investors were left holding illiquid securities. In June 2008, William F. Galvin, Secretary of the Commonwealth of Massachusetts, brought a civil action against UBS Securities, LLC and UBS Financial Services, Inc. (together, UBS), charging that UBS had sold ARS to customers with false representations that they were liquid, safe, money-market instruments that could be sold at the next auction, whereas "no true auction existed for many of these securities." A month later, the New York Securities Bureau announced its own lawsuit against UBS, charging that "UBS customers are holding more than $25 billion in illiquid, long-term paper as a result of UBS's fraudulent misrepresentations and illegal conduct." On July 31, the state securities regulator from Massachusetts brought a similar action against Merrill Lynch; and on August 7, NASAA announced a settlement with Citigroup pursuant to an investigation led by the Texas State Securities Board under which the company would fully reimburse 40,000 customers who had been unable to sell their ARS since February 12, 2008, and pay civil penalties of $50 million each to the New York Securities Bureau and NASAA. On August 11, NASAA announced that it was expanding its investigation to JPMorgan Chase, Morgan Stanley, and Wachovia.

The SEC took no public action with respect to the ARS matter until August 7, 2008, when its enforcement chief announced a preliminary settlement with Citigroup compatible with the agreements already reached with members of NASAA.

It is both evidence of the efficacy of state securities regulators and support for the proposition that a federal agency has been permanently captured that, before the ARS market collapsed in February 2008, several of the largest brokerage firms were selling many billions of dollars of securities to their customers throughout the country by means

of misrepresentations as to the nature of these securities, while the SEC either was unaware of this or, if it was aware, took no action to stop them.

During a House Financial Services Committee hearing in September 2008, Chairman Barney Frank recognized the crucial role of state securities regulators intervening on behalf of ARS investors, stating that *"in a number of states, it has been the state securities officials and law enforcement officials that have taken the lead."*

Texas Enforcement

While NSMIA was touted as a way to reduce regulatory burdens on issuers in national securities offerings by preempting states' authority, it also had the consequence of severely limiting oversight of an offering made within a single state. A Rule 506 offering can be made in any number of jurisdictions. Regardless of whether the offering is made in several states or in only one state, the preemption applies.

Specifically, NSMIA prohibits a state from being able to scrutinize Rule 506 private offerings and those who market them. States are prohibited from conducting reviews and from regulating disclosure documents such as proxy statements and annual reports. No conditions may be imposed on offering documents, including advertising and sales literature used in connection with the offerings. No longer able to screen offerings on the front end, states retained jurisdiction only to investigate and bring enforcement actions with respect to fraud or deceit in connection with securities or securities transactions. Inherently, some indication of fraud or deceit is required to do that. Further hampering state law enforcement, certain securities violators, referred to as "bad boys," were given a green light by NSMIA to participate as issuers and promoters of unregistered offerings. Here are two examples from Texas:

Raymond Minardi

Minardi was the managing member of the issuer's general partner, i.e. a promoter, in a Rule 506 offering by RSM Forex Fund II, LP. After millions of dollars in investments were made by Texas citizens, it was found that Minardi made material misstatements and material omissions in relation to the offering. Pursuant to state action, RSM was placed in receivership and Minardi was ordered to cease from engaging in fraud. However, due to the restraints imposed by NSMIA, even while his prior offering was in receivership Minardi was not prohibited from participating in subsequent offerings. Due to the limitations on enforcement relative to 506 offerings, Texas could not investigate or require him to submit offering materials related to the new offering prior to its sale to the public. We are concerned that Minardi may be able to mislead new investors to their financial detriment.

Randy Weaver and TierOne Converged Networks, Inc.

An Emergency Cease and Desist Order was entered against Weaver and TierOne, based on findings of intentional failure to disclose material facts. Among the failures to disclose were: liability in an arbitration proceeding in excess of $300,000 and compensatory liability in excess of $100,000; a prior finding that Weaver had fraudulently misrepresented and omitted material facts in connection with the sale of securities, was barred from associating in any capacity with any FINRA member firm, and was ordered to pay $547,468 in restitution exclusive of interest to 23 individuals; and that Weaver had filed and been discharged in a voluntary bankruptcy proceeding, prior to which Weaver was subject to actual or potential creditor claims of over $900,000 based on additional arbitration actions. In addition, Weaver and TierOne represented that Weaver started his "Stock Broker" career in 1997 and thereafter maintained a successful business as a top-producing broker for several firms, which is materially misleading or otherwise likely to deceive the public in light of the material facts I just described.

The bottom line is that NSMIA hampers the states' ability to investigate known securities law violators when they become participants in subsequent offerings. We are constantly

faced with playing catch up and often the result is that new investors are harmed before we can investigate and take enforcement action. Criminals have been given the upper hand and regulators are forced to triage investor harm in a cycle that plays out again and again.

National Life Settlements LLC

On a much more positive note, another Texas enforcement case is well worth mentioning today, an investigation that resulted in an outstanding return of investors' funds. Defrauded investors in National Life Settlements LLC (NLS) received $19.8 million, or 69 percent of the amount they invested in the company. Many of the 320 investors were teachers and state retirees who turned over retirement funds to the company, which sold promissory notes that were purportedly backed by life insurance policies. It is very rare to have such a large recovery in a securities receivership case so I'm pleased to report that investors were able recoup a significant part of their losses.

The NLS case highlights two areas of concern for investors: The danger of speculative investments and the importance of knowing the background of investment salespeople. The chief executive and chairman of the board of NLS was a three-time convicted felon whose most recent conviction was in federal court in New York for conspiracy to commit wire fraud.

NLS sold about $30 million in unregistered investments, allegedly secured by life settlements, mostly through insurance agents. A life settlement is the sale of an insurance policy to a third-party in exchange for a one-time cash payment. The purchaser then continues to pay the premiums and becomes the beneficiary of the policy.

The company marketed their investments as safe products that would pay investors a steady return of 10% a year. The company solicited money from retired state employees and retired public educators; millions of dollars were rolled out of retirement plans and into NLS investments.

This case is an example of how state securities regulators are early detectors who act swiftly. We discovered the scheme by reading an investment advertisement that included a solicitation for employment of agents, offering significant sales bonuses. One of our investigators applied for a sales position and we were able to get a clear, immediate and inside view of how the investments were structured and marketed. In court, the receiver told the judge that "…the State Securities Board acted in this case before they had a single complaint."

Investigative techniques like the ones used in NLS are trademarks of state securities regulators: Watch Main Street closely, make early inquiries, then expend limited resources effectively. No lead is too small to warrant at least a cursory review. The failure, at times, is to see similarly swift action at the federal level on cases we refer because they are beyond our jurisdiction and/or resources. Even more significant in the recent financial crisis - and a problem going forward - is the policy position of some federal enforcement agencies not to conduct undercover investigations at all.

State Securities Enforcement

State securities regulators have a century-long record of investor protection, and NASAA has long supported that effort. The Enforcement Section Committee within NASAA helps coordinate large, multi-state enforcement actions by facilitating the sharing of information and leveraging the limited resources of the states more efficiently. Members of this Section also help identify new fraud trends such as scams disguised as offers to help homeowners caught up in the turbulent housing market "save" their homes or "fix" their mortgages usually for a fee paid in advance. Other trends we are seeing include leveraged Exchange-Traded Funds (ETFs), which are being offered to individual investors who may not be aware of the risks these funds carry, a rise in energy and precious metals scams, and fraudulent offerings of investments tied to natural gas, wind and solar energy and the development of new energy-efficient technologies.

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

Attached to my testimony is a chart, "*States: On the Frontlines of Investor Protection,*" which illustrates many examples where the states initiated investigations, uncovered illegal securities activity, then worked with federal regulators or with Congress to achieve a national solution.

These high profile national cases receive greater public attention, but they should not obscure the more routine and numerically much larger caseload representing the bulk of the states' enforcement work. Those cases affect everyday citizens in local communities across the country.

In the past three months alone, state securities regulators in California obtained a court order to stop a multi-million dollar investment fraud in which two men defrauded investors through a series of sham companies and diverted investor funds for their personal use. In Massachusetts, state securities regulators won the return of more than $3.6 million to investors after stopping a scheme involving the sale of unregistered, high-risk securities to seniors through an unregistered broker who targeted victims at various senior centers and churches.

Montana securities regulators secured the return of nearly $1.3 million to victims of a Ponzi scheme perpetrated against investors in Montana and Idaho who thought they were investing in a "day-trading" program. In fact, the investors received proceeds taken from money contributed by newer investors. The New Jersey Bureau of Securities helped

secure a guilty plea from a financial adviser who stole nearly $10 million from mostly elderly clients in yet another Ponzi scheme. The adviser abused the trust of his longtime clients by representing that their investments were safe, free from federal income tax, and promised semi-annual interest payments of 7.5 percent to 9 percent. The investments did not exist.

And in Oregon, state securities regulators levied fines in excess of $2 million against American-, Mexican-, and Panamanian-based companies and individuals for unlawfully soliciting funds from Oregon residents in a complex investment scheme that raised more than $428 million from investors nationwide. The securities involved the sale of time shares in Mexico's Yucatan Peninsula. Oregon is not the only government entity to take action against some of those involved: at least 10 state securities regulators also have filed or concluded civil action. Federal civil and criminal cases are pending.

Our proximity to individual investors puts state securities regulators in the best position, among all law enforcement officials, to deal aggressively with securities law violations. Just one look at our enforcement statistics shows the effectiveness of state securities regulation. Over the past few years, ranging from 2004 through 2008, state securities regulators have conducted more than 11,700 enforcement actions, which led to $238 million in monetary fines and penalties assessed and more than $3.7 billion ordered returned to investors. And, we are responsible for sending fraudsters in those actions away for a total of more than 4,030 years in prison.

Impediments to State Securities Regulation

In thinking about the roles of state and federal enforcement authorities, it is instructive to examine the regulatory responses to the major financial scandals over the past decade. From the investigation into the role of investment banks in the Enron fraud, to exposing securities analyst conflicts, "market timing" in mutual funds, and the recent ARS cases, state securities regulators have consistently been in the lead. Indeed, in some cases, at the time the states began their investigations, it was unclear whether the federal regulators

intended to pursue any investigation at all. There have been numerous accounts in the press and in academic journals detailing the criticism of the SEC for its failure to investigate fraud allegations as quickly as state regulators.[7]

State securities regulators are often first to discover and investigate our nation's largest frauds. When we bring enforcement actions pursuant to these investigations, the penalties states impose are more meaningful and the restitution component is significantly greater. In fact, it has been shown that in cases where state and federal regulators work cooperatively, the more aggressive actions of state securities regulators cause a significant increase in the penalty and restitution components of the federal regulator's enforcement efforts.[8]

And yet, over a number of years there has been a concerted industry assault on state securities regulation, with calls for the preemption of both state regulation and enforcement. Some of the more recent attempts to preempt state regulation have resulted in a strain between federal and state regulators. In some instances, state investigations into corporate abuses that federal officials missed resulted not in reform at the federal level, but in criticism of the states. Some federal agencies have responded by issuing

---

[7] *See, e.g.,* Susan Antilla, *Bankers Would Love to Kneecap State Regulators*, Bloomberg News, Nov. 14, 2008 ("This year, regulators from Massachusetts and 11 other states brought cases against major banks and securities firms that had marketed auction-rate securities to investors as `safe,' only to see that market collapse. The states negotiated agreements that got customers' money back. The SEC hopped on those auction-rate cases after the tough work already had been done"); Gretchen Morgenson, *Call In the Feds. Uh, Maybe Not,*The New York Times, Feb. 29, 2004 (the SEC's failure to protect investors in Washington State is Exhibit A for why state regulators should stay in the oversight mix); Editorial, *Wall Street and the States*, The Washington Post, Wednesday, July 23, 2003 ("ANYONE WHO'S WATCHED the scandals that engulfed Wall Street over the past few years understands the importance of the role played by state officials in going after corporate wrongdoing. While the Securities and Exchange Commission snoozed, New York state Attorney General Eliot L. Spitzer led the way in cracking down on firms whose stock analysts simultaneously evaluated companies for investors and milked them for investment banking business."); Susanne Craig, *Local Enforcers Gain Clout on Street,* The Wall Street Journal, June 21, 2002 ("'States have stepped up to fill the void' left by what some perceive to be weak federal regulators, says John Coffee, a U.S. securities-law professor at Columbia University.")

[8] Eric Zitzewitz, *An Eliot Effect? Prosecutorial Discretion in Mutual Fund Settlement Negotiations*, 2003-

7, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1091035.

regulations broadly preempting state law.[9] Federal agencies have also aggressively moved to preempt state law by bringing suit against state officials.[10] It is troubling that states have faced efforts to preempt state authority through federal rules and regulations that ignore clear statements of Congressional intent. States have found themselves engaged in a battle with certain federal authorities simply to retain the authority to protect the interests of investors and consumers.

These calls for preemption or for more SRO authority at the expense of state jurisdiction defy common sense, if only because the evidence clearly demonstrates that the state-federal regulatory structure actually works for the investor. State involvement drives the performance level of all participants upwards and provides protection against the possibility of regulatory capture.

Recommendations

Restore State Authority of Regulation D Rule 506. Since the passage of NSMIA, we have observed a steady and significant rise in the number of offerings made pursuant to Rule 506 that are later discovered to be fraudulent. Further, most hedge funds are offered pursuant to Rule 506, so state securities regulators are prevented from examining the offering documents of these investments, which represents an enormous dollar volume. Although Congress preserved the states' authority to take enforcement actions for fraud in the offer and sale of all "covered" securities, including Rule 506 offerings, this power is no substitute for a state's ability to scrutinize offerings for signs of potential abuse and to ensure that disclosure is adequate *before* harm is done to investors. In light of the

[9] *See* Office of Comptroller of the Currency, Investment Securities: Bank Activities Operations; Leasing, 66 Fed. Reg. 34784, 34788 (2001); *see also* Office of Comptroller of the Currency, Notice: Preemption Determination and Order, 68 Fed. Reg. 46264 (Aug. 5, 2003) (declaring state Consumer Protection laws dealing with mortgage lenders preempted); *see also* Office of Thrift Supervision Opinion Letter No. P-2004-7, "Authority of a Federal Savings Association to Perform Banking Activities through Agents Without Regard to State Licensing Agreements" 10 (Oct. 25, 2004), *available at* http://www.ots.treas.gov/docs/5/560404.pdf.

[10] *State Farm Bank, FSB v. Reardon*, No. 07-4260 (Aug. 22, 2008), (Opinion Letter from the Chief Counsel for the Office of Thrift Supervision effective to preempt state law as it affects exclusive agents for a federal thrift) *See also, State Farm Bank v. Reardon,* --- F.3d ---, 2008 WL 3876196 (6th Cir. Aug. 22, 2008)

growing popularity of Rule 506 offerings 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 all Rule 506 offerings by repealing Subsection 18(b)(4)(D) of the Securities Act of 1933.

State securities regulators enthusiastically support Section 928 of Senate Banking Committee Chairman Chris Dodd's Committee Print, the *Restoring American Financial Stability Act of 2009,* which would reinstate the authority of state regulators over Rule 506 offerings. We urge its prompt enactment into law.

Restore Provisions of Glass-Steagall. Enacted in 1933 in the wake of the 1929 stock market crash, the Glass-Steagall Act established a wall between commercial and investment banking to protect depositors' money from being put at risk by Wall Street speculation. Since the repeal of Glass-Steagall through the enactment of the Gramm-Leach-Bliley Act of 1999, we have seen an excessive risk taking culture emerge within institutions with federally insured deposits. When the wall dividing banks and securities firms was dismantled, we saw the focus turn toward short-term gains through risky trading strategies rather than long term gains through sound banking principles.

Key activities of investment banks are incompatible with the special character of commercial banking, namely: 1) operating the payments system; 2) taking deposits; 3) making commercial loans, and; 4) serving as the transmission belt for monetary policy. These investment banking activities include underwriting and dealing in corporate debt and equities, asset-backed debt and certain other securities, derivatives of such securities including credit default swaps, principal investing and managing in-house hedge funds. These activities are also incompatible with access to Federal Reserve discount facilities, debt guarantees and other sources of government support intended to safeguard the public utility attributes of commercial banking.

With a return to a Glass-Steagall-type model, the legacy investment banks that converted to bank holding companies in the crisis to gain full access to the government safety net

(Goldman Sachs and Morgan Stanley) would revert to broker-dealer status and would be functionally regulated as such alongside oversight by a systemic risk regulator. The investment banking divisions of commercial banks would be sold, floated or spun-off to shareholders, and similarly regulated. Investment banking divisions of foreign financial conglomerates would have to be similarly divested or operate in the US as separately capitalized subsidiaries

The survival and even prosperity of financial specialists in the presence of government supported and subsidized bank holding companies suggests that a modern version of Glass-Steagall would not be ruinous when benchmarked against the four aforementioned criteria. In asset management and private equity, the dominant players like BlackRock, Vanguard, TPC and Carlyle have performed well against competing units of financial conglomerates, and in some cases have turned from clients to competitors in corporate finance. All of this is only anecdotal evidence, but it suggests that a powerful non-bank financial intermediation industry would quickly emerge following Glass-Steagall type re-regulation, one populated by transparent firms that lend themselves to straightforward oversight by functional regulators in tandem with a systemic risk regulator.

The bipartisan bill recently introduced by Senators Maria Cantwell (D-WA), John McCain (R-AZ), Russ Feingold (D-WI) and others would prohibit commercial banks from affiliating in any manner with investment banks. By separating the commercial banks from the investment banks, the Cantwell-McCain bill would end speculation with depositors' money and return stability and confidence to Main Street.

Increased State Regulation of Investment Advisers. As evidenced by the Inspector General's report on the Madoff affair[11] and the testimony of SEC Chairman Schapiro and other SEC staff before Congress,[12] the bulk of federally covered investment advisers are

[11] *See,* Report of the Office of Inspector General, U.S. Securities and Exchange Commission, Review and Analysis of OCIE Examinations of Madoff Investment Securities, LLC, September 29, 2009 at Page 8.

[12] *See,* Testimony of SEC Chairman Mary L. Schapiro before the Subcommittee on Financial Services and General Government, June 2, 2009, Testimony of Andrew J. Donohue, Director, SEC Division of Investment Management before the Subcommittee on Securities, Insurance, and Investment of the U.S.

examined infrequently. To the extent examinations are conducted, the SEC has demonstrated a lack of fundamental understanding as to the business of registrants, even with experienced staff.[13] A clear "oversight gap" has existed for some time and is now emerging into public view. NASAA members are fully prepared and equipped to fill this gap by accepting responsibility for the oversight of investment advisers with up to $100 million in assets under management.

Again, NSMIA is a cause in the creation of the "oversight gap" of investment advisers. With respect to the regulation of investment advisers, Congress developed a "dividing the pie" approach, allocating regulatory authority to the states for investment advisers with less than $25 million in assets under management and to the SEC for all others. The Congressionally mandated inability of the states to examine *any* investment adviser with assets under management of over $25 million, combined with the ill-equipped examination staff at the SEC have constructed a perverse synergy that served as the foundation for the current "oversight gap" with respect to investment advisers.

NASAA members possess a number of unique qualifications that ensure the permanent closure of the "oversight gap." NASAA members are geographically close to the investment adviser population, and this proximity ensures accessibility. Investors may walk into the offices of state securities regulators and be assured that their complaint will be evaluated. Because of this accessibility, state regulators are most often the investor's first point of contact when there is a problem with their adviser. NASAA members have frequent contact with registrants, which in turn, allows for the detection of wrongful conduct in its nascent stage. Further, wrongful conduct is generally prevented in the first instance due to the frequent contact with state examiners. Plus, NASAA members are the

---

Senate Committee on Banking, Housing, and Urban Affairs, July 15, 2009. *See also,* Appendix to Testimony of Chairman Mary L. Schapiro before the United States Senate Committee on Banking, Housing and Urban Affairs, March 26, 2009 (noting 86 percent of SEC registered investment advisers were unexamined in 2008).

[13] Testimony of H. David Kotz, Inspector General, U.S. Securities and Exchange Commission before the U.S. Senate Committee on Banking, Housing and Urban Affairs, September 10, 2009. *See also*, Report of the Office of Inspector General, U.S. Securities and Exchange Commission, Review and Analysis of OCIE Examinations of Madoff Investment Securities, LLC, September 29, 2009.

only regulators that license investment adviser representatives – the individuals providing investment advisory services. Our members thereby have a view of not only the entities providing investor advisory services, but also the individuals who interact with investors.

Additionally, NASAA members have nearly 50 years of experience conducting examinations and taking enforcement actions against investment advisers. The experience of NASAA members in the application of fiduciary duty sets them apart from SROs whose experience is limited to the suitability standard. Because investment adviser regulation is complex and substantively different from the regulation of broker-dealers, the experience of NASAA members is all the more critical. It is vital that the "oversight gap" be closed as quickly as possible, yet training to the level of basic competence would take years. NASAA members are trained in investment adviser regulation and are already experts in such oversight. NASAA members are ready to deploy their resources now.

State securities regulators have a long record of investor protection and adviser oversight that is superior to the federal regime and any contemplated SRO model because of the advantages of proximity, experience, and knowledge.

Establishment of a Systemic Risk Council. Because individual behavior is not reliably rational during just those times when systemic safety is in jeopardy, NASAA believes that optimal communication and associated systemic risk mitigation could best be accomplished by establishing an independent "Systemic Risk Council," in which both state and federal financial services regulators would conduct high-level strategy meetings where analyses would be shared and prophylactic risk assessments and recommendations would be made.

Any solution ultimately decided by Congress must provide enhanced communication among state and federal regulatory authorities. A "Systemic Risk Council" would effectively establish a crisis management protocol with clear and regular lines of communication among all regulators.

State and federal governments are the natural providers of systemic safety including the need to insure liquidity, stability and reliability, and a well-functioning financial system. The private sector cannot provide such systemic safety.

Including state regulators on the council is necessary and appropriate. In all financial sectors, state regulators gather and act upon large amounts of information from industry participants and from investors. Consequently, they serve as an early warning system. As a general proposition, state regulators are usually the first to identify risks and related trends that are substantial contributing factors to systemic risk. The complexity of financial markets has exceeded the competency capacity of federal regulators alone. This provides further evidence for the need of a state banking, insurance, and securities regulator on the "Systemic Risk Council." By formalizing regulatory cooperation and communication among state and federal regulators, the oversight of our intertwined financial markets will be infinitely more effective.

State securities regulators support amended Sec. 1001 of the *Wall Street Reform and Consumer Protection Act of 2009*, which establishes a Financial Services Oversight Council including a state banking supervisor, a state insurance commissioner and a state securities administrator as nonvoting members who shall not be excluded from any of the Council's proceedings, meetings, discussions and deliberations.

Securities Prosecutions. In many states, criminal prosecutors may request that a duly employed attorney of a state securities division be appointed a special prosecutor to prosecute or assist in the prosecution of criminal violations on behalf of the state. Deputizing a state securities attorney gives a prosecutor the ability to formally utilize the expertise of the state securities division attorney in prosecuting complex securities cases. This is a valuable leveraging of talent and resources and should be encouraged in all jurisdictions and at the federal level.

Resources. There are a number of legislative proposals now pending to significantly increase funding for federal law enforcement agencies responsible for investigating and prosecuting financial fraud. State securities regulators have the determination, willpower and experience to pursue perpetrators of financial crime. We've learned how to accomplish more with less. However, there's little doubt that additional resources would enhance our ability to uncover and prosecute securities fraud during this economic downturn, which has resulted in vulnerable investors looking to recover their losses.

One innovative approach proposed last year is the *Senior Investor Protection Act of 2009*, which has been incorporated into H.R. 4173, the *Wall Street Reform and Consumer Protection Act of 2009*. It would make grant funding available to states that adopt NASAA's model rule prohibiting the misleading use of "senior designations," which are titles that unscrupulous agents often used to defraud senior investors. The bill addresses a serious form of elder abuse while at the same time making significant funding available to the states for enforcement.

The current levels of funding for law enforcement agencies is low, given the billions upon billions of dollars being used to shore up distressed banks and other institutions, some of which undoubtedly contributed to the current financial crisis through illegal or reckless behavior. Increasing enforcement and more effectively deterring fraud is vastly more cost effective than trying to compensate victims and repair the damage to our economy once the frauds have occurred.

Remedies. The nature and extent of the unlawful conduct occurring in our financial markets today requires that there be a thorough review all of the civil and criminal remedies that apply in all sectors to ensure they more effectively deter misconduct.

In 1990, Congress granted the SEC its first comprehensive authority to seek monetary penalties in both administrative and civil enforcement actions for violations of the federal securities laws. For the most serious or "third tier" offenses, penalties for each violation may be up to, but not more than, $100,000 for natural persons and $500,000 for

entities.[14] It does not appear that these penalty amounts are high enough, at least relative to the scope of the fraud still evident in our markets.

In 2002, Congress substantially increased the criminal penalties under the Exchange Act of 1934.[15] Fines rose to a maximum of $5 million for individuals and $25 million for entities, and jail terms rose to a maximum of 20 years. Yet, these criminal penalties have not had the deterrent effect that one might expect.

The effectiveness of stronger sanctions hinges in large part on the willingness of regulators to use them. In 2006, the SEC issued a release explaining the factors that it considers when determining the appropriate monetary penalty to seek against a corporate wrongdoer. *See* "Statement of the Securities and Exchange Commission Concerning Financial Penalties," SEC Release 2006-4 (Jan. 4, 2006). While that release includes some helpful guidance, it also reflects an attitude of restraint in the use of monetary sanctions, especially where the impact on corporate shareholders may be adverse. If Congress provides federal regulators with better enforcement tools, then it is equally important that regulators use them aggressively.

Reexamine and Remove Hurdles Facing Private Plaintiffs. Private actions are the principal means of redress for victims of securities fraud, but they also play an indispensable role in deterring fraud and complementing the enforcement efforts of government regulators and prosecutors. Congress and the courts alike have recognized this fact. The Senate Report accompanying the *Private Securities Litigation Reform Act of 1995* (PSLRA) described the importance of private rights of action as follows:

> The SEC enforcement program and the availability of private rights of action together provide a means for defrauded investors to recover damages and a powerful deterrent against violations of the securities laws. As noted by SEC

---

[14] *See* 15 U.S.C. Sec. 78u (codifying provisions of the *Securities Enforcement Remedies and Penny Stock Reform Act*).

[15] *See* The *Sarbanes-Oxley Act of 2002*, Sec. 1106 (codified at 18 U.S.C. Sec. 1513).

> Chairman Levitt, "private rights of action are not only fundamental to the success of our securities markets, they are an essential complement to the SEC's own enforcement program." [citation omitted][16]

The problem, of course, is that over the last 15 years, Congressional actions and Supreme Court decisions have restricted the ability of private plaintiffs to seek redress in court for securities fraud. These restrictions have not only reduced the compensation available to those who have been the victims of securities fraud, they have also weakened a powerful deterrent against misconduct in our financial markets.

The Supreme Court has issued decisions that further limit the rights of private plaintiffs in two important ways. The Court has narrowed the class of wrongdoers who can be held liable in court, and at the same time, it has expanded the pleading burdens that plaintiffs must satisfy to survive immediate dismissal of their claims. As Justice Stevens lamented in his dissent in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.,* 128 S. Ct. 761, 779 (2008), the Court has been on "a continuing campaign to render the private cause of action under Section 10(b) toothless."

In short, the pendulum has swung too far in the direction of limiting private rights of action. It's essential to examine whether private plaintiffs with claims for securities fraud have fair access to the courts. In that process, I'd like to see a Congressional review of the PSLRA and passage of the *Liability for Aiding and Abetting Securities Violations Act of 2009* to reverse one of the Supreme Court's most anti-investor decisions in Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 114 S.Ct. 1439 (1994). The Court ruled that the private right of action under Section 10(b) of the Securities Exchange Act of 1934 cannot be used to recover damages from those who aid and abet a securities fraud, only those who actually engage in fraudulent acts. The Court's decision insulates a huge class of wrongdoers from civil liability for their often critical role in support of a securities fraud.

[16] *See* S. Rep. No. 104-98, at 8 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 687; *see also Basic Inc. v. Levinson*, 485 U.S. at 230-31 (observing that the private cause of action for violations of Section 10(b) and Rule 10b-5 constitutes an "essential tool for enforcement of the 1934 Act's requirements").

It bears repeating that removing excessive restrictions on access to the courts would not only provide more fair and just compensation for investors, it would also benefit regulators by restoring a powerful deterrent against fraud and abuse: the threat of civil liability.

State/Federal Coordination

State securities regulators welcome the opportunity to work with our federal regulatory counterparts to collectively use our resources to protect investors. To facilitate communication and coordination on all financial services issues, NASAA believes the President's Working Group on Financial Markets should be expanded to include representatives from the state agencies that regulate banking, insurance, and securities.

Our current coordination and cooperation ranges from statutorily mandated meetings to working cases together to informal information sharing networks. NASAA and the SEC cosponsor an annual Conference on Federal-State Securities Regulation in accordance with Section 19(d) of the *Securities Act of 1933*. As part of the conference, representatives from the SEC and NASAA divide into working groups in the areas of enforcement, corporation finance, broker-dealer regulation, investment advisers, and investor education. Each group discusses methods to enhance cooperation in its subject area and to improve the efficiency and effectiveness of federal and state securities regulation.

A NASAA representative attends meetings of the Securities and Commodities Fraud Working Group, which is an informal association of law enforcement departments and regulatory agencies at the federal, state, and international levels. Organized under the auspices of the Justice Department in 1988, the Group seeks to enhance criminal and civil enforcement of securities and commodities laws through meetings and other information sharing activities that include discussions of current developments, and presentations on specific topics such as a major cases, sting operations, and policy initiatives.

All U.S. members of NASAA are members of the National White Collar Crime Center (NW3C). The NW3C is a non-profit, federally funded support organization for state and local law enforcement that has been in existence for the past 26 years. NW3C provides enforcement tools such as training for securities regulatory staff, investigative support services, and case research assistance. NW3C offers on-site classroom and computer-based trainings that have been utilized by securities regulators in 45 states. Every year, the NW3C also hosts economic crime conferences that enable state and local regulators to keep abreast of the latest trends and techniques in fighting economic crime.

NASAA is also a participant in the National Examination Summits. These are quarterly meetings attended by representatives from NASAA, the SEC, and FINRA in which complaint data and trends are shared and discussed. The information shared at these meetings often results in cross-referrals for potential enforcement action or scheduling of joint examinations.

Several years ago, NASAA accepted an invitation from the U.S. Treasury Department to become a member of the Financial and Banking Information Infrastructure Committee (FBIIC), which is sponsored by President's Working Group on Financial Markets. As an active FBIIC member, NASAA helps coordinates public-sector efforts to improve the reliability and security of the U.S. financial system. FBIIC also develops procedures and systems to allow federal and state regulators to communicate among themselves and with the private sector during times of crisis.

NASAA also serves as a member of the Federal Reserve's Cross-Sector Group. The group's bi-annual meetings are hosted by the Federal Reserve and include representatives from the state and federal banking, insurance and securities regulators.

As you know, investment fraud knows no borders. That's why state and provincial securities agencies, through NASAA, have reached out to their colleagues in the international arena. NASAA plays an active role in the International Organization of

Securities Commissioners (IOSCO) and the Council of Securities Regulators of the Americas (COSRA).

Conclusion

The unique experiences of state securities regulators on the front lines of investor protection have provided the framework for my testimony. As the regulators closest to investors, state securities regulators provide an indispensable layer of protection for Main Street investors. As you continue to examine the causes of our current financial crisis and develop recommendations to prevent a reoccurrence, I respectfully suggest that you consider how the role of state securities regulators may be expanded through the restoration of authority that was preempted over the past 14 years. Our presence did not contribute to the crisis; rather, the fact that our regulatory and enforcement roles had been eroded was a significant factor in the severity of the financial meltdown.

States: On the Frontlines of Investor Protection

PROBLEM: $2 billion/yr. Losses in Penny Stocks	
State Initiative	**1989:** States determined penny stock offerings by newly formed shell companies to be per se fraudulent. These “blank check” companies had no business plan except a future merger with an unidentified company.
National Response	**1990:** Congress passed Penny Stock Reform Act, which mandated SEC to adopt special rules governing sale of Penny Stocks (<$5.00 per share) and public offerings of shares in blank check companies (SEC Rule 419).
PROBLEM: $6 billion/yr. Losses in Micro-cap Stocks	
State Initiative	**1996-97:** 33 States participated in sweep of 15 broker-dealer firms that specialized in aggressively retailing low priced securities to individual investors. States found massive fraud in firms’ manipulation of shares of start-up companies, most of which had no operating history.
National Response	**1997-98:** Congress held hearings on fraud in the micro-cap securities markets (shares selling between $5-10). **2002:** Congress passed Sarbanes-Oxley Act, which made certain state actions a basis for federal statutory disqualification from the securities industry.
PROBLEM: Risks of Securities offerings on the Internet	
State Initiative	**1996-97:** States issued uniform interpretative guidance on use of Internet for legitimate securities offerings and dissemination of product information by licensed financial services professionals.
National Response	**1998:** SEC issued interpretative guidance based on the States’ Model on the use of Internet for securities offerings and dissemination of services and product information by licensed financial services professionals.
PROBLEM: Risks of Online Trading	
State Initiative	**1999:** In a report on trading of securities on the Internet, States found that investors did not appreciate certain risks, including buying on margin and submitting market orders.
National Response	**2001:** SEC approved a new NASD rule requiring brokers to provide individual investors with a written disclosure statement on the risks of buying securities on margin.
PROBLEM: Risks of Day Trading	
State Initiative	**1999:** In a report on individuals engaged in day trading, States found that day trading firms failed to tell prospective investors that 70% of day traders would lose their investment while the firm earned large trading commissions.
National Response	**2000:** SEC approved new NASD rules making day trading firms give written risk disclosure to individual investors. **2001:** SEC approved new NASD and NYSE rules governing margin extended to day traders.
PROBLEM: Research Analyst Conflict of Interest	
State Initiative	**2002-03:** States investigated and helped focus attention on conflicts of interest between investment analysts and major Wall Street firms.
National Response	**2002-03:** The SEC, NASD, NYSE, and states reached a landmark $1.4 billion global settlement and firms agree to reform practices.
PROBLEM: Illegal Mutual Fund Trading Practices	
State Initiative	**2003:** States uncovered illegal trading schemes that had become widespread in the mutual fund industry.
National Response	**2003-2004:** SEC, NASD and NYSE launch investigations; reform legislation introduced in Congress but fails to gain support; SEC initiates wide-ranging effort to reform certain fund regulations.
PROBLEM: Senior Investment Fraud	
State Initiative	**2008:** After calling attention to widespread fraud against senior investors, NASAA members approved a model rule prohibiting the misleading use of senior and retiree designations and numerous states have adopted the model through legislation or regulation.
National Response	**2008:** Sen. Herb Kohl, chair of the U.S. Senate Special Committee on Aging, introduced legislation that would provide grants to states to enhance the protection of seniors from being misled by false designations.
PROBLEM: Auction Rate Securities	
State Initiative	**2008:** Based on investor complaints, states launched a series of investigations into the frozen market for auction rate securities. The investigations led to settlements with 11 major Wall Street firms to return $50 billion to ARS investors.
National Response	**2006:** SEC looked into underwriting and sales practices of auction rate securities. While it did discover and try to remedy certain manipulative practices, the SEC failed to identify or correct fundamental conflicts of interest and self dealing that pervaded the auction rate market.

SOURCE: North American Securities Administrators Association
Updated: January 2009