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“The Role of State Securities Regulators in Protecting Investors ”

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Introduction

Chairman Shelby, Ranking Member Sarbanes and Members of the Committee, I'm Ralph Lambiase, Connecticut Securities Director and President of the North American Securities Administrators Association, Inc. (NASAA).¹ I'd like to thank you for inviting me to appear before the Committee today to present an overview on the many ways state securities regulators serve and protect the more than 100 million investors in North America. I also want to thank Connecticut's senior Senator, Chris Dodd, for continuing to serve as a strong advocate for investor protection and for listening to the concerns of the Connecticut Department of Banking, which includes the Securities Division.

States Have Protected Main Street Investors for Nearly 100 Years

Let me begin with a brief overview of state securities regulation, which actually predates the creation of the Securities and Exchange Commission and the NASD by almost two decades. States have protected Main Street investors from fraud for nearly 100 years.

The role of state securities regulators has become increasingly important as growing numbers of Americans rely on the securities markets to prepare for their financial futures, such as a secure and dignified retirement or sending their children to college. Securities markets are global but securities are sold locally by professionals who are licensed in states where they conduct business.

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

As the securities director for the state of Connecticut, I interact directly with investors who approach me at investor education seminars or call my office with concerns or complaints. Our agency works with criminal authorities to prosecute companies and individuals who commit crimes against investors, and brings civil actions for injunctions, restitution and penalties against companies and individuals who commit securities fraud.

Similar to the securities administrators in your states, our agency is also responsible for licensing firms and investment professionals, registering some securities offerings, examining broker-dealers and investment advisers, providing investor education, and most importantly, enforcing our state's securities laws. Eleven of my colleagues are appointed by their Secretaries of State, others by their governors; five come under the jurisdiction of their states' Attorney General; and some, like me, fall within their state's banking, financial institutions, or commerce departments. No matter where we are located in our state structure, each state securities administrator shares a common passion for protecting the citizens in our states from investment fraud and abuse.

How State Securities Regulators Serve and Protect Investors

We have been called the "local cops on the securities beat," and I believe that is an accurate characterization. We are here to serve and protect investors. State securities regulators respond to investors who typically call us first with complaints, or request information about securities firms or individuals. State officials are directly accountable to the electorate.

While some of our high profile enforcement actions make national headlines, I realize that not everyone fully understands the value added by state or provincial securities regulators. I'd like to focus my remarks this morning on the many other ways state securities regulators serve investors. In addition to enforcing your state's securities laws, we work within your state government to protect investors and help maintain the integrity of the securities industry by:

- *Licensing* stockbrokers, investment adviser firms (those managing less than \$25 million in assets), and securities firms that conduct business in the state;
- *Investigating* investor complaints and potential cases of investment fraud;
- *Examining* broker-dealer and investment adviser firms to ensure compliance with securities laws and maintenance of accurate records of client accounts;
- *Assisting* small businesses to raise capital and reviewing certain local offerings not covered by federal law.
- *Educating* investors about their rights and providing the tools and knowledge they need to make informed financial decisions, and;
- *Advocating* passage of strong, sensible, and consistent state securities laws and regulations.

Specifically, I'd like to outline significant accomplishments of state securities regulators in four areas: investor education; licensing broker-dealers and investment advisers; helping small businesses raise capital; and our efforts to build bridges with regulators and prosecutors here and abroad.

Adding Value by Building Financial Knowledge and Security Through Education

State and provincial securities regulators have a long tradition of protecting investors through financial education. We appreciate the Committee's long-standing advocacy of investor education programs to give Americans of all ages the ability to recognize and avoid investment exploitation and build good money management habits. I'd also like to commend Members of this Committee for championing the need for the coordination and implementation of economic and financial literacy programs in the United States.

Recognizing the value and impact of financial education, NASAA's Board of Directors elevated investor education to Section status in 1997 to help support the ongoing financial education efforts of state and provincial securities regulators. The Investor Education Section, along with a network of professionals from across the NASAA membership, develops, coordinates, delivers, and supports financial education initiatives used by securities regulators in their on-going efforts to improve the level of financial literacy in their jurisdictions.

Most state and provincial securities regulators have established investor education programs within their agencies. The result is an effective network of dedicated professionals delivering financial education at the grassroots level. Our financial education professionals

can be found at work in classrooms, the workplace, and senior centers. They partner with teachers, employers, and peer-based volunteer groups to deliver financial education to our constituents of all ages.

For example, under the guidance of the Investor Education Section's Senior Outreach Project Group, NASAA initiated a major education campaign last fall aimed at senior investors. As part of the initiative, we launched an online Senior Investor Resource Center on the NASAA website to give senior investors the tools they need to reduce their risk of being a victim of fraud. And as part of a continuing effort to improve the level of youth financial literacy in our jurisdictions, the Investor Education Section's Youth Outreach Project Group recently developed a Teacher Training Event blueprint to provide a comprehensive, step-by-step system for developing and delivering a teacher training event that offers K-through-12 teachers the knowledge, resources, and tools they need to efficiently and effectively integrate personal finance education into their classroom curriculums.

State regulators, through NASAA, also have developed a series of investor awareness brochures to provide financial education to our residents. The brochures cover a variety of topics ranging from how to protect yourself from cold-calling investment sales pitches to how to select a financial planner.

State securities regulators also look for opportunities to join forces with other members of the financial education community. For example, we support and participate in a variety of national financial education programs to increase financial literacy, such as the American Savings and Education Council, the Investor Protection Trust, Jump\$tart Coalition

for Financial Literacy, and Financial Literacy 2010. Through NASAA, state securities regulators have collaborated with the Securities Industry Association to produce resources to help investors understand brokerage account statements; and with the Investment Company Institute and the College Savings Plan Network to produce the brochure, “A Guide to Understanding 529 Plans.” Last year we published a Fraud Awareness Quiz that the AARP will include in newly created speakers guides for their local offices. And, we recently entered into an agreement with the Department of Defense through which our members will work to deliver financial education to members of the military.

Educating and training our members also is a vital part of NASAA’s mission. This year NASAA is hosting 12 training seminars including the first-ever training session with insurance regulators with the goal of sharing information about laws and enforcement practices that can be put to practical use in combating securities fraud committed by insurance agents. Our emphasis on training helps promote uniformity by ensuring that state examiners, investigators and prosecutors are schooled in the current problem areas so that they can more effectively serve investors.

***Adding Value By Streamlining Broker-Dealer,
Investment Adviser Registration and Licensing***

Our securities markets may operate on Wall Street, but stocks, bonds and other securities are sold on Main Street, in our neighborhoods and even over our kitchen tables from nearly 96,000 branch offices nationwide. Today roughly half of all U.S. households rely on the securities markets to plan and prepare for their financial futures. And the number of firms and individuals holding themselves out as investment professionals has grown significantly in the past two decades. In Connecticut, for example, nearly 3,000 investment firms and more than 110,000 securities professionals are licensed to conduct business with

our citizenry. Nationwide, those numbers grow to more than 16,000 investment firms and nearly 825,000 securities professionals.

State securities regulators believe it is critical that information about these individuals and firms be readily accessible to the investing public, industry, and regulators. Two of the more notable success stories in accomplishing this accessibility have been the Central Registration Depository (CRD) and the Investment Adviser Registration Depository (IARD) systems. These powerful tools help state securities regulators weed out any “bad apples” seeking licenses to do business with their state’s investors.

Developed by NASAA and NASD and implemented in 1981, CRD consolidated a multiple paper-based state licensing and regulatory process into a single, nationwide computer system. Today, the CRD is arguably the best licensing system in existence. Its computerized database contains the licensing and disciplinary histories on more than 650,000 securities professionals and 5,200 securities firms. The IARD, developed jointly by NASAA and the SEC, is our newest licensing system and is to investment advisers what the CRD is to broker-dealers. Its database helps promote uniformity, through use of common forms, and efficiency through a paperless environment. It helps investors research the employment and disciplinary histories of more than 11,000 investment adviser firms and 173,000 individual investment advisers.

Adding Value Through Coordinated Review

States are traditionally recognized as laboratories of innovation. Our ability to adapt successful programs launched in one state to benefit all has led to regulatory initiatives that have benefited both the investing public and industry. For example, a simplified program

developed in Washington State to help small businesses raise capital through a public offering has evolved into a program of coordinated review now in place in 37 states. Under NASAA's SCOR program, comments from various state regulators are consolidated into one comment letter from the "lead" state examiner. This allows the company to resolve all issues regarding multi-state filing through that one examiner and allows other states in which a company wants to sell its securities to provide comment. Regional SCOR programs have been established in the mid-Atlantic, New England, Midwestern, Southwestern, and Western states.

The similar national Coordinated Review-Equity Program (CR-Equity) for larger offerings provides a uniform state registration procedure designed to coordinate the blue-sky registration process in all of the states in which the issuer seeks to sell its equity securities. CR-EQUITY generally is intended for initial public offerings. Of the 42 jurisdictions that register equity offerings, all but one currently participates in this program. A third review program, CR-FRAN, is available to a franchisor filing an initial application to register its offering in two or more participating states.

Enhancing Cooperation and Coordination

NASAA welcomes the opportunity to continue to work with our regulatory counterparts at the SEC and the SROs to collectively use our resources to protect investors. We also look forward to the continued progress of our ongoing series of constructive discussions with the SEC as part of the joint initiative launched in September 2003 to explore ways to improve coordination and communication. We stand ready to provide insight from

our unique perspective to the SEC and SROs as they move forward in their rulemaking process.

This ongoing initiative with the SEC is not our only opportunity to discuss issues of common concern between state and federal securities regulators. NASAA and the SEC co-sponsor 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 corporation finance, broker-dealer regulation, investment advisers, investor education, and enforcement. Each group discusses methods to enhance cooperation in its subject area and to improve the efficiency and effectiveness of federal and state securities regulation.

NASAA also is taking steps to reach out to other regulators at both the state and federal levels. For example, last month, NASAA successfully joined forces with the National Association of Insurance Commissioners to conduct the first-ever joint training program to benefit state insurance and state securities regulators who want to work together more effectively to solve the persistent problem of securities fraud by insurance agents. Earlier this year, 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 coordinate 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).

A strong need exists to develop cooperative information sharing programs, policies and laws to move toward greater enforcement and protection from fraud. NASAA's Board last fall created an International Project Group to facilitate this effort. We also have taken steps to work more closely with our Canadian colleagues by adding liaisons to each of our sections: broker-dealer, corporation finance, enforcement, investment adviser, and investor education. And, we are exploring the feasibility of expanding NASAA's membership to include a number of other North American jurisdictions.

When considering state, federal, and industry cooperation, I think one of the best examples is the Securities Industry Regulatory Council on Continuing Education. In the months following the market crash of 1987, I recall Senator Dodd raising the issue of the importance to both industry and investors of knowing how various financial products react in periods of market volatility. Continuing advocacy from the states helped prompt the industry in 1995 to create the Council, which is comprised of representatives of the securities industry, self-regulatory organizations, the SEC, and NASAA. Our joint efforts have resulted

in a national continuing education program that is accepted by all regulatory agencies. Each year, more than 175,000 financial professionals participate in the continuing education program's computer-based training.

Preserving State Regulatory Authority

The initiatives I have outlined clearly demonstrate the value-added benefits of state securities regulators. We focus on Main Street investors. We are grassroots regulators. We are the first line of defense for investors in our states. I would like to emphasize my belief that in cases where state securities regulators investigate and resolve enforcement cases, our judgments regarding appropriate outcomes *must* be respected and upheld.

Our state-federal system of regulation is collaborative and complementary, and above all, we all want what is best for investors. The research analyst cases, and the recent investigations of the mutual fund industry, are good examples of the value of our complementary regulatory system. In these massive undertakings, state regulators worked on enforcement issues while the SEC and SROs devoted resources both to enforcement and, most importantly, rulemaking.

Congress made clear in its passage of National Securities Markets Improvement Act of 1996 its intent to foster a cooperative rulemaking process between state and federal securities regulators. The recently enacted SEC books and records rule is an example of this cooperative process. Some, however, continue to portray our state-federal regulatory system as duplicative. Our actions have been and will remain consistent with the intent of Congress. When it comes to investigation and enforcement of Wall Street wrongdoing – *Investors need*

more cops on the beat, not fewer. There must be continued cooperation and shared efforts among state, federal, and industry regulators.

Earlier this year, Congress recognized that state securities regulators are essential partners to federal regulators in protecting investors when it removed federal preemptive provisions from H.R. 2179, the “Securities Fraud Deterrence and Investor Restitution Act of 2004.” We continue to remain vigilant and prepared to face attempts by special interests to neutralize state regulators who are aggressively protecting investors. These interests will continue to complain about the “patchwork quilt” they think they see whenever they look out across the country. What they are seeing is 50 state agencies working collaboratively to keep the industry free of wrongdoing and instilling consumer confidence in the marketplace. It is not regulation that keeps investors away from the marketplace — it is greed and wrongdoing that goes unchecked that undermines investor confidence.

We’ve heard industry make an issue about the cost of regulatory compliance. I submit to you that despite all of the publicized problems, 2003 was one of the most profitable years ever for Wall Street. According to the Securities Industry Association, profits in the securities industry were \$15 billion last year, nearly double those of 2002 and the third best year ever for Wall Street.

We’ve heard industry say, “trust us.” Just last year, the president of the mutual fund industry’s trade association, praised industry executives for their “unshakeable commitment to putting mutual fund shareholder interests first.” Three months later, state regulators

launched the first of many investigations into the mutual fund industry for, in essence, putting its own interests ahead of those of its shareholders.

We've heard investors say enough is enough. And we agree.

Protecting investors against fraud and punishing those who would commit fraud are fundamental roles of government, be it federal, state, local or in the case of our neighbors to the north, provincial. For state securities regulators, "putting investors first" is more than just a slogan. It is what we do for our citizens on a daily basis.

Conclusion

Mr. Chairman and Members of this Committee, I would like to offer you my personal opinion based on more than 30-plus years as a securities regulator. Protecting investors is a significant challenge and no single regulatory agency can go it alone. I firmly believe that now is the time to strengthen, not weaken our unique complementary regulatory system of state, industry and federal regulation. Collectively, we can all work together—government, self-regulators and industry—to achieve positive results. More than 100 million North American investors expect us to remain vigilant, to stay the course and to make sure that Wall Street puts investors first. We cannot let these millions of investors down.

I firmly believe that tough and consistent regulatory oversight is the key to helping investors maintain their confidence in the market. And just as strongly, I believe that straight-talking investor education, coupled with hard-hitting and unfailing enforcement, are the keys to investor protection. The citizens in my state depend on me to protect them by *enforcing*

the securities laws on our books. I can speak for all my North American colleagues in stressing the importance of securities regulators continuing to protect the citizens in our jurisdictions. Our job is straightforward — protecting investors and doing right on their behalf.

It is vitally important that Congress reject attempts to weaken state enforcement authority. I am deeply grateful to those Members of Congress who have been champions of the rights and protection of investors. Congressional commitment to integrity in our financial markets, accountability in corporate governance, and full and fair disclosure has helped make our nation's markets the best in the world. When investors have confidence in the markets, issuers have access to needed capital and our economy prospers.

I pledge the continued support of the NASAA membership to work with the Committee to provide any additional information or assistance the panel may need. Thank you for the opportunity to testify on the role of state securities regulators.