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THE ROLE OF STATE SECURITIES REGULATORS IN PROTECTING INVESTORS

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

SECOND SESSION

ON

EFFORTS TO ENFORCE SECURITIES LAWS, INVESTMENT ADVISER REGISTRATION AND LICENSING, STATE INVESTIGATIONS INTO MUTUAL FUND INDUSTRY ABUSES, AND INVESTOR EDUCATION PROGRAMS

JUNE 2, 2004

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THE ROLE OF STATE SECURITIES REGULATORS IN PROTECTING INVESTORS

WEDNESDAY, JUNE 2, 2004

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:10 a.m., in room SD–538, Dirksen Senate Office Building, Senator Richard C. Shelby (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN RICHARD C. SHELBY

Chairman SHELBY. The hearing shall come to order.

During this past year, this Committee has examined a range of issues confronting the securities industry. Much of the Committee's attention has been focused on the so-called Global Settlement of Wall Street analysts' conflicts of interest and the revelations of wrongdoing in the mutual fund industry. These scandals had much in common: They both involved egregious conflicts of interest, widespread misconduct, and inadequate disclosure to investors.

There was another common theme underlying these scandals: State securities regulators initiated both investigations. Although the SEC is the primary securities market regulator, time and again we have seen the need for vigorous State regulators to pursue investigations and enforcement actions.

Much of the misconduct at the root of the Global Settlement and mutual fund scandal was long-standing industry practice—"open secrets" on Wall Street but unknown to ordinary investors. State regulators were the first to initiate enforcement actions against these ingrained and questionable industry practices. State regulators are the local cops on the beat, and their proximity to investors enables them to serve as an early detection system for growing frauds and scams.

Recent enforcement cases demonstrate the benefits of a dual regulatory structure in which both State and Federal regulators protect investors' interests. Although Federal and State regulators have distinct roles to play in our securities markets, they share the same goal of stopping misconduct and assuring a fair deal for the ordinary investor. Successful State and Federal collaboration is essential to ensure vigilant protection of our securities markets.

State regulators have a mandate to protect investors that extends beyond enforcement actions and coordination with Federal regulators. Many States have proactively launched initiatives designed to preempt future frauds by educating investors as to how they can protect their assets and to identify signs of wrongdoing.

An educated investor is a better investor and the first line of defense against securities fraud.

I look forward to hearing more about State-sponsored investor education programs and the centralized broker-dealer and investment adviser registration systems that States have created. This morning, the Committee will hear from several regulators who are at the forefront of investor protection.

First, we have Peter Harvey, the Attorney General of the State of New Jersey. We welcome you, sir.

Mr. HARVEY. Thank you, Mr. Chairman.

Chairman SHELBY. Mr. Ralph Lambiase is the Director of the Securities and Business Investment Division at the Connecticut Department of Banking and President of the North American Securities Administrators Association. We welcome you, too.

Mr. LAMBIASE. Thank you, sir.

Chairman SHELBY. Mr. Joseph Borg is the Director of the Alabama Securities Commission and Chairman of the Enforcement Section Committee of the North American Securities Administrators Association. Mr. Borg, we welcome you, too.

Mr. BORG. Thank you, Mr. Chairman.

Chairman SHELBY. I look forward to hearing the regulators discuss current enforcement actions, Federal and State coordination, and other initiatives designed to protect investors. This morning, we will also hear from two witnesses who can address the day-to-day activities of State regulators that are critical to ensure investor confidence and integrity in our markets.

Mr. Charles Leven is the Chairman of the Board of Directors of the American Association of Retired People and Vice President for Board Governance. Older Americans have long been targets of securities fraud, and Mr. Leven will address how the AARP works with State regulators to educate investors and to reduce their risk of being a victim of fraud.

Finally, the Committee will hear from Ms. Juanita Periman. Ms. Periman is a resident of Montana and has traveled a long way to be with us today. Several years ago, Ms. Periman was victimized by a securities fraud in which her broker made unauthorized trades and liquidations in her accounts. Ms. Periman contacted the Montana Securities Department and has worked with the regulators to pursue the wrongdoer and to obtain restitution. I thank Ms. Periman for traveling to Washington in order to share her story with us and the rest of the Senate.

I thank each of you for coming, and we look forward to hearing your testimony.

Senator Sarbanes.

STATEMENT OF SENATOR PAUL S. SARBANES

Senator SARBANES. Thank you very much, Chairman Shelby, and I want to commend you for holding today's hearing.

The protection of securities investors has always been a high priority for this Committee and an issue on which I have placed a great deal of emphasis. It is my own view that State securities regulators perform an essential role in promoting the goal of investor protection. Their work is particularly important for protecting retail investors from those brokers and financial advisers that engage

in improper or fraudulent practices. And through registration, examination, and enforcement, and by various programs to educate the public, I think they render a very important service.

We regularly see instances of how important their work is. Let me give just a couple of examples, some of which will echo what the Chairman had to say.

In April 2002, New York State officials—the Attorney General, the Securities Bureau Chief, and others—led a settlement with major brokerage firms regarding misleading stock research recommendations. This led to a major enforcement effort in which State regulators joined forces with Federal regulators to negotiate a Global Settlement with 10 major securities firms.

In September 2003, the Massachusetts Secretary of the Commonwealth and Deputy Secretary for Securities found instances of late trading and improper market timing of mutual funds. This led to a comprehensive investigation of the mutual fund industry by Federal and State authorities, which is resulting in enhanced oversight and enforcement as well as in regulatory reforms.

In my own State of Maryland, Melanie Lubin, the Securities Commissioner, has been active in enforcing securities laws to protect citizens, as well as in promoting financial education to reduce the potential for investor abuse, working closely with the Maryland Coalition for Financial Literacy. Ms. Lubin has served as Securities Commissioner for 6 years, has worked with Maryland's Attorney General Joseph Curran for 18 years, and is doing a very good job.

Mr. Chairman, I think the State regulators have particular strengths that enable them to be effective and, as has often been said, "to be the first line of defense against investor fraud." They are geographically close to investors, have offices located in many instances throughout their States. Many investors find State regulators easily accessible and call them first about a securities problem. They are familiar with the securities activities taking place in their local areas and with the local brokers and dealers. And they can act quickly in response to phone calls or letters.

Recently, some have advanced the view that the authority of the States should be curtailed because of the presence of Federal securities regulation. It is my view that such preemption of State authority would not serve the public interest. Recent history, some of which I have just recounted, provides ample evidence of the value of State securities regulators in protecting the investing public.

Furthermore, State securities regulators have been in the forefront of investor education. A decade ago, they had the foresight to establish the Investor Protection Trust, which is designed to fund projects that educate investors. So, I look forward to hearing the testimony of the witnesses here this morning and hearing Ms. Periman, who will underscore exactly what they are trying to address. And as we continue to work with the States to protect securities investors, I am interested in any new initiatives they have undertaken, current trends in securities misconduct, the extent of cooperation with the SEC, the extent to which we are all working together for a common purpose.

Thank you very much, Mr. Chairman.

Chairman SHELBY. Senator Corzine.

STATEMENT OF SENATOR JON S. CORZINE

Senator CORZINE. Thank you, Mr. Chairman, and I appreciate very much your holding this hearing. Investor protection is something that all of us find at the top of our agenda with regard to oversight of the securities markets, and I no doubt believe that the cooperation that we need to see between State and Federal regulators is absolutely essential. So making sure that we have effectively functioning national markets with good checks and balances from both Federal regulators, obviously, but the underpinning role that our State regulators play is extraordinarily important, and finding the right balance there is what I hope that this hearing and other discussions about this will take us. The whole effort of registration, examination, enforcement, and education are things that I truly believe the State regulators have a role to play in, but making sure that we have deep and broad markets is also something that is important to encourage. And so some synergy across the national markets I think is absolutely essential.

I am also here because I have a very good friend and someone who I trust his judgment as much as anyone both in the legal world but in politics and public service, and that is New Jersey's State Attorney General Peter Harvey, who, by the way, was born and raised in Tuskegee, Alabama, so he has plenty of positive ingredients that you might identify with.

Chairman SHELBY. I knew you had a lot of redeeming features before you came today.

[Laughter.]

Senator SARBANES. And went to college at Morgan State University in Baltimore, Maryland.

[Laughter.]

Senator CORZINE. Good Lord, you wouldn't even let me get it out.

[Laughter.]

I thought I was really going to butter up to both the Ranking Member and the Chairman here quite effectively.

Let me just tell you that there is not a finer lawyer, there is not a finer public servant in New Jersey than Peter Harvey. He has had all kinds of accolades, just named Lawyer of the Year by the New Jersey Law Journal and was very active before he came into public service in all kinds of supporting roles. And I am really pleased to introduce him.

I also would just say that he has very practically just been involved in the PIMCO affiliate settlement that has been very much in the press, I think dealing with the kinds of trading abuses and investment protection issues that we are so interested in. I welcome him and all of the other witnesses and look forward to hearing your comments.

Chairman SHELBY. Thank you.

All of your written testimony has been made part of the record. We have that, if you will briefly sum up your best points that you want to make.

Mr. Harvey, we will start with you.

STATEMENT OF PETER C. HARVEY
ATTORNEY GENERAL, STATE OF NEW JERSEY

Mr. HARVEY. Thank you. Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee, I am Peter Harvey, Attorney General of the State of New Jersey, and thank you for inviting me here to testify today on the issue of State regulation and enforcement of securities laws.

As you know, the States play a critical role in regulating securities. By highlighting what we are doing in New Jersey, I hope to illustrate clearly why the States are a crucial component of investor protection in this Nation. I want to acknowledge and thank Senator Jon Corzine, who has been a wise and experienced leader in the investment industry and community and now devotes his wisdom and leadership in service of the Nation and New Jersey. I want to thank him particularly for being a strong advocate of investor education and protections.

Let me just give you some idea of State regulatory oversight in New Jersey. Many middle-class Americans seek to build their assets for retirement, as well as their children's college education by investing in stocks and bonds. These days, most of the money that Americans invest is not in banks. It is invested in securities, predominantly through pension plans, private retirement plans, including 401(k), Keough, IRA plans, and major mutual funds, and also through broker-dealers. Thirty years ago, only a small fraction of U.S. citizens ventured into the securities market. We now have nearly 100 million investors. That is certainly a lot of people and a lot of money.

Unfortunately, there are plenty of modern-day Willie Suttons—armed with a sales pitch instead of a gun—who know where the money is and have learned that many investors are easy marks for a scam. Those investors are spread over 50 States, which is really too much territory to cover without State securities regulators.

In New Jersey, the Bureau of Securities acts on behalf of the Attorney General. New Jersey is one of only five States to place such an agency directly under the control of the Attorney General. As Attorney General, I have both criminal and civil authority to prosecute securities fraud.

The bureau has a staff of about 60 people to enforce New Jersey's Uniform Securities Law. The bureau is funded through fees paid by the regulated community, as well as fines and other sums collected in enforcement actions. The bureau regulates the sale or offer of any security sold into or from New Jersey, as well as firms and persons engaged in the securities business in our State. The primary mechanisms for regulation are: One, registration of securities, firms, and agents; and, two, enforcement actions against those who fail to comply with registration or engage in fraud.

Since becoming Attorney General last year, I have dedicated increased staff and resources to the Bureau of Securities in order to handle the enormous workload. I will highlight a few facts and cases that illustrate the scope of the securities fraud problem we face in New Jersey alone.

New Jersey has a large amount of investment activity. It ranks fourth in the United States in total firms and agents registered, behind only California, New York, and Florida. The Bureau of securi-

ties registers approximately 2,700 broker-dealer firms, 155,000 agents, more than 2,000 investment advisers, and 12,200 investment adviser representatives.

Registration is important to States as it permits State regulators to weed out bad actors and fraudulent or suspect securities offerings.

Another critical component of the bureau's work is investor education. Bureau representatives regularly conduct seminars for senior citizens, a particularly vulnerable group, and community groups on avoiding securities fraud. State Attorneys General and securities regulators would welcome Federal assistance in the investor education area, whether in the form of national ad campaigns or grants for State programs.

Let me turn now to discuss briefly our enforcement efforts.

New Jersey has about 200 enforcement cases in the investigative stage at any given time and more than 40 in active litigation. New Jersey is no stranger to major securities fraud cases. A good example is Robert Brennan, the penny stock king who defrauded investors of millions of dollars. The high-profile bankruptcy fraud trial which led to Brennan's imprisonment in 2001 was a result of a cooperative effort involving the Bureau of Securities in New Jersey, the Securities and Exchange Commission, the FBI, and the U.S. Attorney's Office for the District of New Jersey. It was a direct outgrowth of two separate civil matters brought by the Bureau of Securities and the SEC. We have secured a $55 million claim in bankruptcy court against Mr. Brennan and a $45 million judgment, yet to be collected, but we are still working on it. I want to focus, however, on more recent activities.

New Jersey played a major role in the landmark multi-State settlement announced last year between securities regulators and 10 top Wall Street firms regarding stock analyst practices. New Jersey also was lead State for the investigation of Bear, Stearns, & Company. The case, as you know, brought major reforms to the industry to ensure that stock analysts are not subjected to pressure to report favorably on stocks and bonds of investment banking clients of their firms.

Just yesterday, I announced another major settlement with significant implications for the industry. New Jersey reached an $18 million settlement with Allianz Dresdner Asset Management and two affiliated companies regarding allegations of a fraudulent arrangement that permitted a large investor to market-time more than $4 billion in transactions in their mutual funds, in violation of fund policies and to the detriment of long-term investors. The settlement requires the defendants to implement corporate governance changes to ensure that portfolio managers for their mutual funds function independently of business managers and that the funds comply with their own policies barring market timing.

In between these milestones, New Jersey has filed eight major securities fraud cases involving, in the aggregate, more than 1,000 investors and more than $160 million in investments.

In February 2004, we filed suit against three men and their companies, including Clover Management Group, Inc., of Fort Lee, New Jersey, that engaged in an elaborate scheme to swindle investors in the United Kingdom out of more than $55 million. The defend-

ants falsely claimed to offer investments in the defense industry that would provide strong returns while supporting the British and United States war effort in Iraq and the worldwide war on terrorism. New Jersey has seized the assets of the defendants, including a $2 million yacht, bank accounts, luxury cars, and a painting by renowned artist Eduardo Arranz-Bravo. The seizures followed cooperative investigations by our Bureau of Securities, Federal authorities, and New Scotland Yard. The defendants duped sophisticated investors out of huge sums through slick marketing, which included touring investors around a defense industry plant and claiming to be advised by renowned military leaders and financiers.

As mentioned above, as Attorney General I also have the authority to criminally prosecute securities fraud. In June 2003, we simultaneously filed criminal and civil actions against more than a dozen New Jersey companies and their principles for allegedly stealing more than $80 million from investors. The scheme's principle architect was Thomas Giacomaro, who pleaded guilty to money laundering charges brought by the Division of Criminal Justice in the Attorney General's Office and Federal charges of mail fraud and tax evasion. Among the parties who lost money in this scheme was best-selling novelist Mary Higgins Clark.

Many of these cases have involved cooperation between State and Federal authorities, including the Brennan case, the Wall Street stock analyst settlement, the Clover case, and the Giacomaro case. State securities regulators and the SEC can accomplish a lot by working together, as our representatives in the North American Securities Administrators Association have been emphasizing in their ongoing discussions with the SEC and their cooperative initiatives. However, another point should not be lost. States also can be extremely effective on their own, as we have demonstrated in the Allianz Dresdner case. In a 4-month period, we filed and settled a case that addressed a serious industry problem and led to reimbursement of the affected funds. We secured needed reforms, but resolved the case quickly to avoid a lingering cloud that might harm the funds. Several other States have also shown their effectiveness on this front.

Although I have discussed high-profile cases that in some instances did catch the attention of Federal authorities, many of our securities fraud cases—both civil and criminal—would not be pursued by Federal regulators, leaving investors without recourse. There are simply too many cases out there, and sometimes the dollar amount of the fraud is not large enough to interest Federal securities regulators given their limited resources.

The bottom line is the task of protecting investors is too large to be handled by a single Federal agency, the SEC. Investors need the protection of State securities bureaus. We hope you will maintain, if not enhance, the authority of State securities regulators.

Thank you again for the opportunity to testify. I share your concern about this vital issue and stand ready to work with you to examine what areas need to be addressed in the future, and I look forward to working with you and other Members of the Committee with respect to this task.

Chairman SHELBY. Thank you, Mr. Harvey.

Mr. Lambiase.

**STATEMENT OF RALPH A. LAMBIASE
PRESIDENT, NORTH AMERICAN SECURITIES
ADMINISTRATORS ASSOCIATION, INC., AND
DIRECTOR, DIVISION OF SECURITIES,
CONNECTICUT DEPARTMENT OF BANKING**

Mr. LAMBIASE. Thank you. Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee, I am Ralph Lambiase, Connecticut Securities Director and President of the North American Securities Administrators Association, referred to as NASAA. I would like to thank you for this opportunity to present an overview on the many ways that State securities regulators serve and protect more than 100 million investors in North America. I also want to take this occasion to thank Connecticut's senior Senator, Christopher Dodd, for continuing to serve as a strong advocate for investor protection and listening to the concerns of the Connecticut Department of Banking, which includes the Securities Division.

Our securities markets may operate on Wall Street, but stocks, bonds, and securities are sold on Main Street, in our neighborhoods and even over our kitchen tables, from nearly 96,000 branch offices nationally. States have protected its residents from fraud for nearly a 100 years. We bring civil and administrative actions to penalize or to seek restitution from those who have violated our laws. We work with criminal authorities to prosecute those who would commit securities fraud. Ten of my colleagues are appointed by the Secretaries of State; five come under the jurisdiction of their States' Attorneys General; and some, like me, fall within their States' banking, commerce, and similar departments or commissions. No matter where we are located within our governmental structure, State securities administrators share a common passion for protecting their citizens from investment fraud and abuse.

While some of our high-profile enforcement actions make national headlines, I would like to focus today on our other equally important regulatory responsibilities. In addition to enforcing our securities laws, we license stockbrokers and investment firms; we investigate complaints and allegations of investment fraud; we examine broker-dealers and investment advisers to ensure compliance with securities laws and the maintenance of accurate records of client accounts; we assist small businesses in raising capital, and we review certain local offerings not covered by Federal law; we educate investors by providing tools and the knowledge they need to make informed investment decisions; and we advocate the passage of strong but sensible and consistent State securities laws and regulations.

State regulators are generally recognized as investors' first line of defense, and States have long been acknowledged as laboratories of innovation. Both of these characterizations are on point. As grass-roots regulators, we are accessible and accountable. Our ability to adapt successful programs initiated in one State and expanded to others benefits both the public and the industry.

States have a long tradition of protecting investors by helping them build financial knowledge and security through education. Our financial education professionals work in classrooms, the workplace, and senior centers, delivering financial education to constituents of all ages.

Last year, through NASAA, we launched a multifaceted education campaign to assist senior investors. We focused particular attention to the problem of Internet investment fraud directed at seniors.

To improve the level of youth financial literacy, we have developed a system for delivering training events that offer K–12 teachers the knowledge, resources, and tools that they will need to bring effective personal finance education into their curriculums.

I would also like to highlight a few other key points. The first is our sincere interest in working with our counterparts at the SEC and the SRO's, as well as regulators abroad, to collectively use our limited resources to protect investors. As the number of Americans who rely on the securities markets has grown, so, too, has the number of firms and individuals serving as investment professionals. Today, more than 5,200 firms offer and sell securities. Some 90 percent of these firms have fewer than 100 employees. Investing is clearly a local business. While we hear a lot about the globalization of our markets, virtually all of the Nation's 650,000 securities agents sell in our neighborhoods. Protecting investors is a significant challenge, and no single regulatory agency can go it alone.

We look forward to the continued progress of our discussions with the SEC to improve coordination and communication as part of a joint initiative launched last September. The research analyst cases of 2002 and 2003 and the more recent investigations of the mutual fund industry are good examples of the importance of our complementary State and Federal regulatory system. Now, as the SEC and the SRO's move forward in their rulemaking process, we stand ready to provide insight from our unique grass-roots perspective. These collaborative efforts have and continue to restore investor confidence in our financial markets.

Earlier this year, Congress removed Federal preemptive provisions from H.R. 2179, the Securities Fraud Deterrence and Investor Restitution Act of 2004. It is vitally important that Congress reject attempts to weaken State regulatory authority. When investors have confidence in the markets, issuers have access to needed capital, and our economy prospers. Greed and wrongdoing that goes unchecked undermines investor confidence. When it comes to investigation and enforcement of securities wrongdoing, investors are demanding more cops, not fewer.

Protecting investors against fraud and punishing those who would commit fraud are fundamental roles of Government, be it Federal or State, or provincial in the case of our neighbors to the north. We at home are deeply grateful to those Members of Congress who have been champions of investor protection. Congressional commitment to the integrity of our financial markets, accountability in corporate governance, and full and fair disclosure has helped make our Nation's markets the best in the world.

I pledge to you the continued support of the NASAA membership to work with the Committee to provide any additional assistance the panel may need. And I would like to thank you for the opportunity to testify here on the role of State securities regulators.

Chairman SHELBY. Thank you very much.

Mr. Borg, I just want to say again we are happy to have you here. Of course, Mr. Borg is the Director of the Alabama Securities

Commission and he is Chairman of the Enforcement Section Committee, the North American Securities Administrators Association.

STATEMENT OF JOSEPH P. BORG
DIRECTOR, ALABAMA SECURITIES COMMISSION AND CHAIRMAN, ENFORCEMENT SECTION, NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

Mr. BORG. Thank you again, Mr. Chairman. Chairman Shelby, Ranking Member Sarbanes, Senator Corzine, I am Joe Borg, Director of the Alabama Securities Commission and Chairman of the Enforcement Section for NASAA.

It is a particular honor for me to be here and have the opportunity to publicly thank my Senator, Richard Shelby, for his thorough and thoughtful approach to restoring investor confidence in our markets.

Today, I am delighted to have the chance to share with you some of the highlights from States' enforcement activity. Certainly, two of the most high profile enforcement matters to date have been the research analyst cases and the mutual fund cases. This Committee is familiar with the analyst conflict of interest global settlement. All 50 States, the District of Columbia, and Puerto Rico, in conjunction with the SEC, the New York Stock Exchange, and the NASD agreed to settle with the 10 firms involved. The level of State, Federal, and SRO cooperation was unparalleled, but I would like to stress, not unprecedented.

Those settlements achieved a number of very important objectives and resulted in much-needed change in the way the firms conduct their business. A rigorous separation between research and banking was affected by the settlement. Independent research will provide investors at the 10 firms with research procured by independent consultants and a total of $80 million will be directed for investor education purposes over a 5-year period.

With respect to the mutual fund scandals I would like to commend this Committee for its complete and deliberative examination of the trading abuses in the industry, and I can assure you that the States will continue to actively pursue inquiries into mutual fund improprieties, and we are committed to aggressively addressing mutual fund complaints raised by investors in our jurisdictions. But these high profile national cases are rare, and they should not obscure the more routine caseload that represents the bulk of States' enforcement work. State securities regulators are vigorously pursuing sales practice abuses and a variety of scams and frauds against unsuspecting investors. We often initiate investigations as a result of complaints from investors in your States who feel they have been wronged by a broker/dealer, securities professional, or those claiming to be securities or investment professionals.

Many investors understandably feel that the logical place to start with a grievance is their local State securities regulator, and as Chairman Shelby noted earlier, we are the local cop on the securities beat. Our offices are close to the investing public. We are responsive, and we can take immediate action without the time needed to obtain formal agency orders.

Now, this is evident from the States' impressive record in bringing enforcement cases, including criminal prosecutions. The chart

before you illustrates State enforcement statistics for the reporting period 2002 to 2003 with over 70 percent of the 52 jurisdictions responding. The States filed almost 3,000 administrative, civil, and criminal enforcement actions, assessed over $822 million of monetary fines and penalties, and procured more than $660 million in restitution, rescission, and disgorgement, and sentenced criminals to over 717 years of incarceration. NASAA sent out a recent survey to obtain this latest data, and I will be pleased to follow up with the Committee in a few weeks with more complete information.

For the past several years, NASAA has released its list of top 10 investment scams, schemes, and scandals to alert investors to increasingly complex and confusing investment frauds. The problem areas that we are pursuing with enforcement cases include unlicensed securities sellers who are pitching securities that are unregistered. Scam artist use high commissions to entice some insurance agents, investment advisers, and even accountants and lawyers into selling investments that they may know little about, such as bogus limited partnerships or promissory notes, all offering supposed high returns with little or no risk.

Prime bank schemes are a perennial favorite of con artists who promise investors access to secret high-yield instruments made through trades among the world's top or what they call "prime banks." Promoters falsely claim the investment is guaranteed or secured by some kind of collateral or insurance. The investors ultimately find out that prime banks simply do not exist.

Sales of variable annuities have increased dramatically over the last decade, and as sales have risen, so too have complaints from investors. We are concerned that investors are not being told about high surrender charges and the steep sales commissions agents often earn when they move investors into variable annuities. Often pitched to seniors through investment seminars, these products are unsuitable for many retirees.

Risky viatical settlement contracts, now expanded to life settlement contracts, are products that have been on our radar screens and subject to State securities enforcement actions for the past several years. In a typical transaction, the person who is terminally ill sells his policy to a third-party broker in return for a portion of the death benefit. State regulators are seeing deceptive marketing practices, numerous instances of fraud, and claims that viaticals offer safe, guaranteed returns like bank certificates of deposit.

Just last month the SEC and State regulators stepped in to shut down and revoke the license of Mutual Benefits Corporation. In addition, Florida regulators charged the company with racketeering and 15 counts of investor fraud, saying that the company lured tens of thousands of investors into an elaborate Ponzi scheme that raised more than one billion dollars.

In affinity fraud cases, scammers often use their victims' religious, social, or ethnic identity to gain their trust and then steal their life savings. So, many fall prey to affinity group fraud in which a con artist is or seems to be a member of the same ethnic, religious, career, or community-based group. For example, my office recently completed a criminal investigation into a religious affinity fraud case that resulted in six defendants being convicted. The case involved nonexistent church bonds, money laundering, and securi-

ties fraud that absolutely destroyed the Daystar Assembly of God Church located in Prattville, Alabama. Losses exceeded $3 million, and as a result, the congregation lost its church. Almost all those convicted were church members, and the ring leader received a 31-year prison sentence.

Even with the funding increase that Congress has allocated for the SEC, the Commission just cannot go it alone. There must be greater cooperation and division of labor among State, industry, and Federal regulators. To that end, as Mr. Lambiase mentioned earlier, representatives of NASAA and the SEC have been meeting on a regular basis as part of a joint initiative to study ways to improve Federal and State cooperation. I am a member of this working group, and I can assure you that discussions have been educational, thorough, and constructive.

In addition, along this line, we have formed a NASAA/NAIC enforcement subgroup to improve coordination and focus on the persistent problem of insurance agents engaged in the unlawful sale of various securities investments.

Mr. Chairman, State securities regulators are dedicated to pursuing those who have violated the trust of our citizens. We will fight to ensure that State securities regulators maintain the authority to regulate, at the local level, and bring enforcement actions with appropriate remedies against those firms and individuals who violate securities laws in our jurisdictions. State securities regulators wish to work with you and your Committee to provide you with any additional information or assistance you may need.

Thank you again for inviting me to speak on behalf of the States to discuss our efforts in protecting the investing public, and I will be happy to answer questions at the appropriate time.

Chairman SHELBY. Thank you, Mr. Borg.

Mr. Leven.

STATEMENT OF CHARLES LEVEN
VICE PRESIDENT, BOARD GOVERNANCE AND
CHAIR, BOARD OF DIRECTORS, AARP

Mr. LEVEN. Good morning, Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee. My name is Charles Leven. I am AARP Vice President for Board Governance and Chair of the Board of Directors.

I appreciate this opportunity to testify on a matter of keen interest to us, investor protection. My testimony today focuses on the role that State securities regulation and regulators play in securing essential marketplace conditions on fair play and practice.

The rapid growth in investment activity over the past decade has severely taxed the resources of Federal and State securities commissions. According to the North American Securities Administrators Association, there are at least 20,000 investment adviser firms in the United States, approximately only 8,000 of whom are large firms that register with the Securities and Exchange Commission. The remaining smaller firms are registered with the States.

NASAA also estimates that 150,000 to 175,000 individuals hold State licenses to act as investment adviser representatives. The need for complementary Federal and State investor protection efforts has never been more evident.

According to the 2001 Federal Reserve Survey of Consumer Finances, the percentage of households that own stocks, either directly or indirectly, increased from 32 percent in 1989 to 52 percent in 2001. This growth in investment has occurred even though in recent years the stock markets have weathered a sluggish economy, experienced steep market declines, trade deficits, and reports of numerous scandals ranging from illegal corporate accounting practices to insider trading. These shocks to the securities marketplace have resulted in serious consequences for ordinary saver/investors.

A 2004 survey of investors by AARP confirms a reduced confidence in financial service professionals, continuing concerns about the fairness of stock market conditions, and the desire for stronger regulation of the securities industry. We are reminded by recent market history just how vital the State securities commissions are in our dual system of market regulation and investor protection.

For AARP, the goal of providing American investors with market conditions of fair play and practice is advanced by promoting harmonization within our concurrent Federal/State system of securities regulation. Surely State securities regulatory commissions must and are playing an essential role. State securities regulators are responsible for the licensing of firms and investment professionals, registration of some securities offerings, branch office sales practice audits, investor education, and most importantly, the enforcement of State securities laws.

One of the principal virtues of our concurrent system of securities regulation is State authority to investigate and bring enforcement action with respect to fraud or deceit or unlawful conduct in connection with securities transactions. State securities administrators are frequently the first point of contact when an investor has a securities transaction-related complaint. State regulators often work very closely with criminal prosecutors at the Federal, State, and local levels to punish those who violate our securities law.

The New York State criminal case against research analysts, settled in 2003, is a useful illustration of the significant role that State securities regulators can play. Precisely because the States also had investigatory and enforcement powers, one State was able to take the initiative in what became a $1.4 billion settlement with 10 leading broker-dealer firms with funds set aside for investor education programs. Ultimately, NASAA, the State of New York, and Federal regulators worked cooperatively on the global research analyst settlement.

Also, in 2003, the regulators in Massachusetts began what would become a series of investigations by other State and Federal regulators into the Nation's $7.6 trillion mutual fund industry. Clearly, these examples serve to validate the rationale for maintaining a well-balanced and concurrent securities regulation system.

Further, State regulators have been active in coordinating reviews of filings, developing uniform registration statement for offerings that are exempt at the Federal level, and in crafting policy statements on the number of review issues that strengthen uniformity of review in the States.

For example, in 2002, a new version of the Uniform Securities Act was adopted by the National Conference of Commissioners on

Uniform State Laws. The Uniform Securities Act has been the model for nearly 40 States' securities laws.

AARP has been impressed by State efforts in the area of investor education. For example, the Investor Protection Trust, whose trustees are chosen from among State regulators, is chartered to provide objective, noncommercial investor information. The IPT uses funds collected in settlements against investment companies that have been charged with violating securities laws. Last year, complementing its existing investor education section, NASAA initiated a major investor education campaign aimed at older investors by launching an online senior investor research center.

In closing, we believe there are demonstrated benefits to the dual system of securities regulation and to the role and value that State securities regulators play in that system. I will be happy to answer any questions when appropriate.

Chairman SHELBY. Thank you, Mr. Leven.

Ms. Periman.

STATEMENT OF JUANITA PERIMAN OF BUTTE, MONTANA

Ms. PERIMAN. Good morning. My name is Juanita Periman of Butte, Montana. I want you to know what an honor and privilege it is for me to appear before you this morning.

I am here to tell you how much I appreciate the help I got from my State's securities regulators. I am not alone. I was among over 30 people, including 7 widows, 21 retired individuals or couples, and 3 in assisted living facilities, who fell victim to what turned out to be one of the State of Montana's largest securities cases.

My story began following the death of my husband in 1998, when I opened an IRA through a broker named Tom O'Neill at the local office of Piper Jaffrey in Butte. I also transferred the proceeds of my husband's IRA and other retirement savings to my new IRA. I had no previous investment experience, and my only investment objectives were income, safety, and growth. I was at a vulnerable point in my life, and Tom was a long-time family friend and former business associate of my husband.

To cope with the loss of my husband I traveled a lot with the Christian Youth Ministries and also visited family. After returning home from one of these extended trips I found my mailbox filled with letters from my broker's office. Regrettably, I did not pay much attention to these letters.

When I finally opened them I saw that they were confirmation notices of trade in my account. I knew something was not right because I had not authorized these trades.

At first, I questioned my broker, but he told me not to worry. He even made me feel stupid and guilty for questioning him.

The more I thought about it, the more I realized I was in trouble. At least half of my account has been wiped out and I really did not know where to turn for help. My sister suggested I contact the Montana Securities Department, and I did that in December 2000. I explained my situation. They listened and told me to immediately close my account.

The Securities Department investigated my complaint and found that it appeared that my broker was illegally trading in my ac-

count. As they dug deeper into my case, the Department found 38 other people that might also be victims. Montana securities regulators suspended the broker in March 2001, putting a halt to any further illegal activity, and they also took action against his firm.

Through a negotiated settlement we got our money back and the stockbroker was banned from the securities industry for life. The State also negotiated for changed business practices on the part of the firm so that other people will never have to be victimized in that way.

My case demonstrates the quick response and effectiveness of State securities regulators in protecting investors. Five weeks after I first contacted my State securities regulators, the State had concluded its investigation.

I really believe that being close to the investing public is an advantage for State regulators. The person I first spoke to was the same person that conducted the investigation. Calling someone who could immediately investigate the case and who could come to Butte and talk to me was really important. They are the first responders, and I felt a real connection to the State staffers who were available to help me throughout the entire case.

It is really scary being a victim of fraud, but the staff in Montana helped me to understand it was not my fault and that I did the right thing when I called them for help. These are local people helping their neighbors. They are local heroes. I am glad my State had the authority and the regulatory tools to pursue my case to a successful conclusion.

If I do nothing else this morning, I want to get the message across that no one has to be a victim of investment fraud, especially seniors.

Common sense tells you that if something sounds too good to be true, it almost always is. But you do not have to rely on common sense alone. If you have the slightest suspicion of what is going on, contact your State securities regulator. They will know when something is not right. They can tell you whether the investment product is licensed for sale in your State, and whether the salesperson has a history of wrongdoing.

I am very grateful that my State securities regulators responded so quickly and successfully to my call. I only wish that I had contacted them sooner.

Thank you again for the opportunity to tell my story.

Chairman SHELBY. Ms. Periman, I want to thank you for coming all the way from Montana here today. You have a great story and I think it reinforces the roles of the State regulators. So we thank you very much.

Ms. PERIMAN. Thank you, Mr. Chairman.

Chairman SHELBY. Much of the focus on State securities regulation is centered on the headline grabbing investigations such as mutual fund investigations and the Global Settlement. We will start with Mr. Harvey. Would you describe the day-to-day investigations and enforcement actions generally that comprise the bulk of your enforcement cases, and how do you determine when a routine State enforcement action should be shared with the Federal regulators?

Mr. HARVEY. I think Ms. Periman's case——

Chairman SHELBY. It is a good illustration, is it not?

Mr. HARVEY. Very much so, and it is quite appropriate for this Committee's consideration. This is the kind of complaint that State regulators get all the time and we certainly get in New Jersey. I have often said—and I continue to believe—that the investor about whom I am most concerned and about whom I am most fearful, is the senior citizen because broker-dealers will frighten senior citizens into believing that they are going to run out of money, that there is a race against time between their death and their assets. They prey upon their fear to get them to invest in all kinds of ridiculous schemes.

Some of them have been outlined for you by Mr. Borg, these promissory note schemes, investments in nonexistent partnerships. These are the kinds of complaints we get on an ordinary basis. We investigate them and find out that these broker-dealers are engaging in transactions that are not authorized, contrary to their own printed material, that they are selling unregistered, unlicensed securities. In some instance the brokers themselves are unlicensed. They are essentially nothing short of swindlers.

What happens to a senior citizen is their entire life savings are wiped out for good. They are embarrassed to go and tell their children that this has happened to them, and they are very fearful that they are going to become destitute, and worst of all, be put in a nursing home and left to die.

So these are the types of cases that we encounter on a daily basis, and we investigate them. They are much too great in number for any one agency to investigate. Many times they spread across multiple States. We have found that the same investment scheme that we have investigated in New Jersey, New York may be investigating it, Connecticut may be investigating it, Florida may be investigating it, because the same conduct is occurring.

With respect to cooperation, I think that there has been better cooperation between the Securities and Exchange Commission and the States, and we are still looking for ways that we can collaborate more efficiently and effectively. I am optimistic about it. I think that Federal authorities sometimes can be of great value to State regulators, but I do not think that by any stretch of the imagination they should supplant State regulators.

Chairman SHELBY. Mr. Lambiase, could you briefly give us your view on why the Global Settlement was seemingly such a success?

Mr. LAMBIASE. I think it was a success, because it took a limited number of resources and it took the expertise of both the States and at the Federal level and the SRO's, and was divided up in such a manner as to be able to address all issues. Each party to the settlement brought a particular expertise. The rulemaking, as you know, was looked at by the SRO's and the SEC. The States focused on enforcement and a lot of the conduct that was going on at the local level.

I would like to point out another issue about State regulation and our ability to look at issues which really stems from customer complaints we receive, the Ms. Perimans that call us, written complaints and sales practice activity we uncover during our branch examination procedures. This is what will ultimately trigger States to pursue further inquiry, and I would like to point that up.

Chairman SHELBY. Mr. Borg, would you just touch for a few minutes on why it is important not to have Federal preemption here? I think it is obvious, but I would like for you——

Mr. BORG. Mr. Chairman, I could go on all day on that issue. But let me point out——

Chairman SHELBY. That is an important issue here.

Mr. BORG. It certainly is. The scams that we see on a local level vary. I could give you examples of catfish farm investments in Tuskegee. I can give you foreign currency with Swiss bank accounts out of Montgomery, Alabama. I can give you examples of local cases that do not involve publicly traded companies or registered broker-dealers, which generally is not the purview of the SEC. These are local frauds, regional frauds, unlicensed, unregistered, that go into the billions of dollars. The type of cases we see will be phony gold mines, oil, and gas scams.

During the anthrax scare we were seeing things along the Internet that said, "We have the cure for anthrax." These are things that happen maybe in a small community. I can think of one case which you are familiar with in Phoenix City, where here a little operator, in 90 days, got 33,000 participants in a program and never took out a single ad, all through the Internet. That is the purview of the State securities regulators. We are on the spot. We are there quickly.

Chairman SHELBY. That is why we do not need preemption, is it not?

Mr. BORG. That is exactly so.

Chairman SHELBY. Thank you.

Mr. Leven, you are here on behalf of, I guess, everybody but a lot of us that are older Americans.

Mr. LEVEN. Well, some of us a bit older than others.

[Laughter.]

Chairman SHELBY. Absolutely. But we all know that older Americans have been, for a long time, targets of fraud, but it seems today even maybe more so, especially in the securities field. Elaborate, if you would for a minute, on how the State regulators coordinate with your group, AARP, to better protect and educate the older Americans as far as investments.

Mr. LEVEN. We have a very close relationship with them and a great deal of respect for them. They are primarily very active for us, both as a first line of defense for our people 50 and older—remember, the people 50 and older is where the disposable income is, and so, the sharks move into that direction as quickly as they can. And these people are our first line of defense, both in terms of helping us in prosecuting and getting recoveries and probably even more important, educating the investor, which is a very important part of what they do, and we certainly appreciate that.

Chairman SHELBY. Thank you.

Senator Sarbanes.

Senator SARBANES. Thank you very much, Mr. Chairman.

Ms. Periman, I want to thank you for your testimony. I know it is sometimes difficult to tell that story, but I hope you appreciate how important it is for us to have on the record specific cases that actually occurred. It is enormously helpful in setting out what the problem is.

I am interested in increasing the resources, if at all possible, and then maximizing them to try to deal with these various securities frauds. I want to ask some questions in that regard to the administrators.

I am interested in the extent of the Federal and State cooperation amongst the regulators. For example, when a State securities regulator pursues an enforcement case, does the regulator inform the SEC? When the SEC is pursuing an enforcement case in a State, does the State regulator receive information about this from the SEC? That is just one example. You may have others in mind. What is your take on the state of interplay between the State regulators and the Federal regulators?

Mr. HARVEY. Senator, here is one of the enduring tensions with regulators, and it does not matter whether they have enforcement authority or not. Everybody wants to look good at a certain point.

Senator SARBANES. Yes, politicians suffer from the same thing.

[Laughter.]

Mr. HARVEY. So you have occasions where we are not communicating as well as we should be, so investigations may be commenced in a State and States are not advised of them. There are times that States will undertake their own investigations and not advise the SEC. We are working to improve that communication.

I think we need better coordination because it avoids duplication of effort, and there are some cases that are better handled through a multi-State effort, the brokerage cases that we have all discussed earlier today.

Where I think that we need additional resources is not necessarily in enforcement—that helps—but in investor education. Part of what is happening to our senior citizens and to ordinary Americans is that they are getting pieces of data about the stock market and the growth of the equity markets and why their investments are better put there than in certificates of deposit. All that is true. But unless you are a significant investor with a mutual fund company, you do not go to investment seminars. And we have to find a way to take that message to senior citizen centers, to planned retirement communities where we can go into these communities and explain to seniors what the scams are and how to go about the business of determining whether someone is legitimate or not.

I think if we can find Federal resources to supplement what the States are doing as well as perhaps on the Federal level, that would be one of the most important things that I think this Committee and this Congress could do for ordinary Americans.

Senator SARBANES. Does anyone want to add to that?

Mr. LAMBIASE. I would like to make an observation. The level of cooperation between the States and Federal is somewhat looked at within a regional context. Different regions within the country—the Northeast region has a different relationship with the SEC and the SRO's than you might see in another area. But I do think that the model that should be followed on cooperation is that which we have amongst our own States. There is a complete trust and cooperation among State regulators. We will share information. We will share resources together. We will work jointly. We have a complete trust and respect for each other. And it is that trust and respect for each

other that allows us to work effectively as well as we do. I would like to see that model a little bit more extended to the Federal and State side.

Mr. BORG. Senator Sarbanes, if I may, certainly Mr. Lambiase is correct. There are some regional differences, and I would like to speak strictly to the Southeastern region. We have a very good effort of cooperative participation with the SEC. For example, just last month, not only did we bring a case together, but we also do joint press releases together. This was on the Heyman International case. The SEC, when we met with them, realized we were looking at the same case from both ends. They took care of the asset freeze and the filing—we went to court with them—while we took care of the local agents with a cease and desist order. So we were able to cooperate and coordinate.

This is the type of thing that will come out, I think, of the joint initiative between the SEC and NASAA over time. But there is an educational curve. We have to learn a little bit more about their procedures and their methodology. They have to learn a little bit more about our abilities and what we can do on a quick regional or State-level basis.

This is not unusual. Most of the past work has been on an informal basis, and I can think of even public company cases in 1995 that we brought with the SEC against the Comptronics Company, where they took a parallel track. They did the Federal; we did the State. We combined them at the proper moment. Everyone pled guilty.

Chairman SHELBY. How big a fraud was that, Mr. Borg?

Mr. BORG. The stock losses to investors was $378 million, if my memory serves correct. As you may recall, it was the largest employer in the Guntersville area of north Alabama at the time. But that would be an example.

I think as we continue doing regional meetings with the SEC, we are doing a lot more joint conferences and exchanging information and ideas, and I think the initiative will help bring about a more efficient method as opposed to starting it, because we have done cooperative efforts with the SEC for a long time.

Senator SARBANES. When we passed the Fair Credit Reporting Act at the end of last year, we included in it a title on financial literacy and it was strongly supported by Chairman Shelby, and strongly supported, actually, by all Members of this Committee in a very strong bipartisan effort. That, amongst other things, established a Federal coordinating committee to coordinate the efforts directed toward financial literacy on the part of the Federal departments and agencies. Many of them have various programs of one type or another directed toward financial literacy, but they have never tried to bring them all together and develop a concerted strategy.

Part of the charge given to that coordinating commission, which is under the chairmanship of the Secretary of the Treasury, is to coordinate and work with State officials on financial literacy, which, of course, you all are very much engaged in.

Have they reached out to you yet in order to try to establish such working relationships? We very much want them to do that, and I am just interested whether that has occurred or is in the process

of occurring. Because if it is not, why, we need to prod and push the coordinating committee.

Mr. LAMBIASE. I have some information on that. Karen Tyler, North Dakota Securities Commissioner and Chairman of the Investor Education Section for NASAA, made a public presentation at the most recent meeting of the Financial Literacy and Education Commission on behalf of NASAA. So we appreciate the follow-up on that, sir.

Senator SARBANES. Good. Well, I think you should keep an eye on that because it really could be quite productive if it is really done the way it is supposed to be done. And I think if you all keep pushing it and getting in there into that venue, it would be very helpful to your efforts and to an overall coordinated effort.

Thank you, Mr. Chairman. I see my time has expired.

Chairman SHELBY. Senator Dodd.

STATEMENT OF SENATOR CHRISTOPHER J. DODD

Senator DODD. Thank you, Mr. Chairman, and our witnesses.

I will begin just by thanking you and Senator Sarbanes, Mr. Chairman, for doing this. This is—I do not know—maybe the fourth or fifth subject matter on which this Committee has held very worthwhile oversight hearings. This was not occurring with great frequency up here in the last number of years by Committees doing good oversight. There have been some stories written recently about the absence of good oversight, and that complaint I think has a great deal of legitimacy with regard to an awful lot of Committees. It is not true about this Committee, and it is a great tribute to the Chairman and the Ranking Member that we have just had a series of hearings on going back and reviewing legislation which this Committee has adopted or passed and determining whether or not it is working as well as we would like. I want to begin my brief comments by thanking both of you. It has been tremendously worthwhile, and I thank our witnesses.

Ralph, it is wonderful to see you.

Mr. LAMBIASE. Thank you, sir.

Senator DODD. I was not here to hear you say nice things about me, so I appreciate it on the record.

[Laughter.]

You have done a tremendous job. I do not know if the Committee Members are aware of this, but a long and distinguished record of service in Connecticut, and now as the national President of NASAA. So we are very proud of you. You have done a great job in our State, and it is an honor to have you before the Committee.

Mr. LAMBIASE. Thank you, sir. It is an honor to be here.

Senator DODD. Just a couple of questions. Some of this you have already addressed, but picking up on the point that Senator Sarbanes was addressing, and that is the educational efforts. Under the Global Settlement, part of that $1.4 billion was to go back to State regulators for this education effort. I do not know how much of that $1.4 billion actually comes back to you. I do not know if you have an exact number. But I wonder if you could pick up on it.

And then this subject was raised by the Chairman as well, and that is regarding the elderly, Mr. Leven, the perfect storm has occurred. You list your top 10 scams and schemes and scandals list,

NASAA does each year. And this year it includes a new listing. It is called senior investment fraud, and it states—and I think this is very well put. It says, "Volatile stock markets, low interest rates, rising health care costs, and increasing life expectancy combine to create a perfect storm for investment fraud against senior investors." And I think that says it well.

I wonder if you might just pick up on the two questions; that is, the amount of money you are getting back for investor education, and then speak to me a bit about what is going on. What schemes are you seeing? You have addressed this a little bit already, Mr. Borg, and you did, Ralph, but give us a range of the kind of scams we are looking at that seniors should really be aware of. This is a hearing which is being covered, I think, by C–SPAN, and if it is, people watch these programs and we say to them all the time check with people, you know, when you are alone and you do not get many phone calls, you do not get a lot of mail, you are just ripe for being abused by people who take advantage of you.

So share with us a bit more information about these scams that are out there.

Mr. LAMBIASE. Yes, I would like to address the first question about the amount of funds which States will ultimately receive for purposes of investor education. I think that approximates $27 million in the aggregate of all the States which will be dedicated toward furthering investor education.

The second question really is a question of time and what is going on in the marketplace. Nowadays, with interest rates being historically low in terms of the return that an investor would get, the scams that you see really are focused toward the elderly with the returns. You get a very minimal, a meager return from putting money in a savings account or in some kind of certificate of deposit, and, hence, you get into the prime bank notes, which my colleague Joe mentioned, offering greater returns.

What people prey upon now is the elderly's inability to collect at this time an income stream which is sufficient to carry them through, so they look for greater returns. The best frauds are really the ones which say, well, we will give you or we will guarantee a 10-percent-a-month return or some kind of 21-percent annual return, something which is outlandish to us but certainly would be something that a person on a limited or fixed income would need right now to survive.

Senator DODD. Those are like magic words, if you are out there, people start guaranteeing you a return on investment. The bells should start ringing.

Mr. LAMBIASE. Absolutely.

Mr. BORG. Absolutely, Senator. I might also add, when it comes to seniors, in the 1990's or before the market crash, it was a matter of preying on, "Don't you want to make things better for your grandkids? Let's go ahead and find these great investments with these tremendous returns."

Now it is a fear factor. "You are going to run out of money. You do not have enough money coming in from your bank CD's. You have to move out of them. You cannot trust the market. You have to go with me. I am the guy that is going to give you that 30-percent return, that 8-percent guaranteed because it is collateralized,

it is insured by some insurance company. And look at this. We are going to put the money in a prime bank in Europe"—which doesn't exist, as I mentioned earlier. So now they are preying on the fears of seniors running out of money.

The best frauds are ripped right out of the headlines. Gas prices are going up. "Look, I can get you into this oil and gas venture where you are going to make a lot of money. How can you lose? Look at gas prices."

Technology. "Well, you know, gee, we are at war. We have these new technology devices. The Government is going to buy them all. Here is where you should invest your money. It is a guaranteed return."

That is the type of tactic that is being used.

Added to that, when it comes to seniors—and I am sure Mr. Leven will back me up on this—the slick operators talk to their customers, talk to their victims. They will make them comfortable. They will get to know them. They won't pressure them on the first call. They will make them feel like they are part of the family. And those seniors—my parents are very cordial. They would not think of hanging up on a person. And they will use that courtesy to sucker them into these investments.

That is what we are fighting, and we have to get seniors to understand that if they are taken, it is not their fault. They have been conned.

Senator DODD. Does anyone else want to add anything? Mr. Harvey or Mr. Leven, do you want to add anything?

Mr. LAMBIASE. I just would like to point out from the seniors' point of view, you know, we are in a very interesting position. We are on fixed incomes. We have low returns on pretty much any investment you would care to name. Taxes are going up consistently and constantly, at local levels, certainly, education, county taxes, whatever, you name it. And we are getting a constant drain on whether we can keep our homes.

So when someone comes along and offers anything that is a little bit tantalizing or creates an opportunity, you can well understand the state of mind that would lead you to participate. And so we need help, and these people are, again, as I said before, the first line of giving us help. But it is education more than anything else. We need more and more financial education.

Senator DODD. Absolutely.

Mr. Harvey, do you want to comment?

Mr. HARVEY. Yes. I would urge seniors to ask essentially three questions.

One is: Is this particular broker-dealer or offeror licensed with a State securities entity? And ask for permission to get the license number and call the State Bureau of Securities. They should give you the number if they are legitimate.

Second, are the securities registered with a State Bureau of Securities?

Then, third, I would ask: Do I have to decide this today? Any dealer or purported dealer who says you have to get into this today or this week or you are going to lose it forever, you know it is phony. There is no such investment that you must invest in today or it will forever be lost in time. You have to assume that he gave

that pitch 30 days ago and that he is going to give it 30 days in the future.

So these are the kinds of questions. Slow it down. Remember, seniors have to keep in mind, this is your money and you do not have to give it to him if you do not wish to. Take your time, slow it down, and ask more questions. Because if you lose it, it is gone forever. Many of these individuals are judgment-proof. Even with the multimillionaire and, some argued, billionaire Robert Brennan, he had a lot of money. It is true that we signed a $45 million judgment and obtained a second $55 million judgment in bankruptcy. We have been chasing the money for the past several years because it has been hidden in Europe and elsewhere.

Senator DODD. Mr. Chairman, could I ask one more question?

Chairman SHELBY. You go right ahead.

Senator DODD. I appreciate this. Ms. Periman, thank you. Let me echo Senator Sarbanes' comments and the Chairman's comments.

Ms. PERIMAN. Thank you very much.

Senator DODD. Very special to have you here. It is a long way to come, and it is always painful to have to tell a story that sounds embarrassing because somehow—even in your voice, you almost said you did something—you did nothing wrong at all. You did everything right. There are an awful lot of people who would have done nothing and just taken this broker's admonitions that somehow you were at fault in all of this. But you did exactly the right thing, and the people out there watching, listening, or reading about this, we need more people like you because without you, it is hard for these people to do the job. You provide the evidence and the facts that make it possible for them to go after these people.

Ms. PERIMAN. Thank you for the opportunity. Unfortunately, in my instance, this was not a total stranger. This is someone that I had known for more than 20 years.

Senator DODD. I want to ask about the mutual fund issue, if I could just briefly, Mr. Chairman. In the past year, due to the hard work of State securities administrators and regulators, numerous mutual fund abuses have been brought to light. And, obviously, your colleague in New York, Attorney General Spitzer, has been very involved. My Attorney General, Dick Blumenthal, in Connecticut has been very involved, as Ralph knows.

I wonder if you can describe the current feeling among investors toward mutual funds. And has the work of yourselves and the SEC helped to restore any confidence? What is your read out there on how investors are feeling about mutual funds today?

Mr. BORG. My read, Senator, is that the mutual fund industry, although it has taken some hits because of these abuses that are out there, most Americans, I think, are sitting still. They are going to wait and see what happens.

The difference between the mutual fund issues and, say, the research analysts or the theft cases is that there is not an immediate significant drop in the value of the underlying securities, because the losses to the investor on a per account basis are slight in reference to someone who steals your retirement savings account. So, I think there is a perception that things are being done to correct the abuses. Also, mutual funds have been the bulwark of middle-class America for a long time. They understand that there was risk

in technology stocks and some things here, and maybe the analysts should have told the truth. But be that as it may, mutual funds still are the mainstream investment vehicle of choice. And I think there is some skittishness. There is some concern. But I do not believe there is panic. And that is an important factor. And the quicker the mutual fund issues are resolved and what Americans want is they want to know that it has been disclosed and cleaned up and things are in place. I do not think there has been a big panic in the mutual fund industry.

Senator DODD. Ralph.

Mr. LAMBIASE. Yes, I would like to make a statement on that. I really think the public sees the role of this Committee and its oversight, and I think that has had a tremendous support structure for the public. Once they know that the Senate is looking at this—and, indeed, there were at least four different bills that were sponsored, even you yourself, sir, with the transparency on the mutual funds, the disclosure, the fees. I think once you get that visibility, the comfort level of the public is what was—I do not think it was simply us, but clearly, it was not the SEC alone. I think a tremendous amount is the guidance that this Committee does through its proposals and the guidance that it gives out to the rest of us on the industry side and the public.

Senator DODD. Anyone else? Well, any points here and comments on the legislation, you may want to submit, Mr. Chairman, some comments on these bills. You would have a pretty good idea. Are we going overboard? Obviously, as you point out, Mr. Borg, this has been a great wealth creator. Mutual funds have been a tremendous success, and I think we want to be careful I how we react to it. The Chairman, I think, has acted very responsibly, along with Senator Sarbanes. We have not pushed this overly aggressively, but at some point I would be very interested in whether or not you think we need to act or whether or not you think the SEC is acting sufficiently enough on its own through the regulatory process that our actions may not be necessary. But I would be very interested in how you would react to the current response to it and whether or not we should step up to the plate.

Mr. LAMBIASE. To be honest with you, I think the introduction of the bills, the topic areas that were brought up and the subject matter, to see how the SEC or the Federal regulators will react is one thing, but I think clearly the message was sent to regulators that deal with this and Congress will not have to deal with this. But, clearly, you gave them adequate direction by identifying within the bills what the problems are, and I do think that waiting to see what rules come out that are necessary, but I think also in addition to rules, you also need aggressive enforcement of the current laws. And I think that is very important.

I think the Committee has actually moved in a very deliberate and thoughtful process, and I truly compliment the Committee for this.

Senator DODD. Thank you.

Thank you, Mr. Chairman.

Chairman SHELBY. Thank you. We appreciate your remarks. I think the message was to the SEC we are going to give you an opportunity to do your job, and I believe they are on the right track.

But if you do not do your job, we are going to be here. We are going to be watching. Our oversight is important.

Mr. Harvey and Mr. Borg, would you briefly address any investment schemes or products where you would expect to see increased enforcement activity? Are State regulators conducting any investigations of 529 plans or hedge funds?

Mr. HARVEY. I cannot tell you that we have any investigations going on of 529 funds. We are beginning to study them to determine whether or not there is inappropriate activity occurring. With hedge funds, we have been examining those funds for some time, and we intend to continue to do so.

A lot of what is new is still old. A lot of the schemes that we see are packaged differently, but they are the same old schemes. And Mr. Borg has outlined them quite thoroughly and in detail. But with respect to the two areas that you have asked about, one we are going to begin to examine very carefully and the other we are examining on a regular basis.

Chairman SHELBY. What about payments to insurance brokers, illegal trading in variable annuities products, stuff like that? Are you all involved in some of that?

Mr. HARVEY. We are beginning to look at that activity. It is curious. We share responsibility for that as well with the Department of Banking and Insurance in the State of New Jersey, so we are going to take a closer look at it going forward.

Chairman SHELBY. Mr. Borg.

Mr. BORG. Senator, with regard to the 529 plans, as you know, they are designed by States to provide a tax-advantaged means of saving for college. Because they are of that type, they fall into a type of municipal fund securities that is generally regulated by the MSRB. They are a unique class, this 529, which is named after the Internal Revenue Code provision, of course. They are not subject to most Federal securities laws that, say, would be applicable to mutual funds. And that is because they are issued by State or local authorities.

There is usually a component in the Uniform Securities Act, which means it applies to most States, where local or State-sponsored funds, issued funds, are also exempt from registration and licensing. So there is a question about where the authority lies, if you will.

One thing I am fairly convinced of is they are not exempt from antifraud authority, such as the 10(b)–5 used against, you know, artifice to defraud. But I think what States are starting to look at for the issues, if you will, in the 529's are that the disclosures are not sufficient or uniform; that the costs may vary from State to State on the various 529 plans. And I know there is concern, although I have not seen it, that high fees could actually overshadow the tax benefits.

We have seen a push to sell more of these things, and I think they are doing that. There may be some evidence that there are higher fees being paid. So, I think the tax treatment may differ. An Alabama resident buys a 529 in Rhode Island there may be some differentials.

I think there is a lot of confusion in this area right now. There is possibly a limit to what State securities regulators can do. We

are studying the issue. We do have a group that is looking at it, and I understand there are other hearings going on, maybe concurrently, regarding 529 plans.

Chairman SHELBY. Thank you.

Could you elaborate just briefly on the centralized registration databases for broker-dealers?

Mr. LAMBIASE. Yes, sir.

Chairman SHELBY. How is it working?

Mr. LAMBIASE. The Central Registration Depository system was created in 1981 with the NASD and the States, and really what it did was it took a system of manually filing an application in every State and established a central filing system, and ultimately you eliminated the State filings being made in every jurisdiction where someone wanted to conduct business.

That system of CRD was ultimately emulated recently with the IARD, as Senator Sarbanes asked about. That is the Investment Adviser Registration Depository. It is modeled after the CRD, and that is the system where you have 11,000—that is done in conjunction with the SEC. They are paperless filings to people. You mark the license where you want to maintain it, in Connecticut and, say, multiple jurisdictions. You send one check in. It is reviewed on a screen. It provides to the public a tremendous database of information regarding disciplinary events and histories of individuals. It maintains that record.

There are currently 660,000 people that are on the CRD database and 172,000, I believe, on the IARD database. And that is only the ones currently licensed, not including information on individuals that previously were licensed. And that is what has made this industry very effective in terms of licensing, uniformity, paperless environment.

Chairman SHELBY. Ms. Periman what would be your single, strongest message to deliver to other senior investors that are thinking about investing?

Ms. PERIMAN. If you have any questions at all, go to your State securities regulators.

Chairman SHELBY. Promptly.

Ms. PERIMAN. Promptly.

Chairman SHELBY. As you did. Thank you.

Senator Sarbanes.

Senator SARBANES. Thank you very much, Mr. Chairman. First of all, let me say I think this has been an enormously helpful panel, and it only reinforces my view that there is a very critical and essential role to be played by the State securities regulators in terms of protecting the investors. That role need not be in conflict or inconsistent with the SEC role of setting national standards that apply in the securities industry or carrying out its responsibilities as well. In fact, the two working together can provide a strong protective environment for the investor.

Let me ask you this question. I am interested in this. How much cooperation do you receive from the industry, from the broker-dealers and so forth? After all, their reputation, the reputation of the good people, and there are many good people in the industry, is tarnished and affected by the activity of these sharp operators. When you talk to the good people in the industry, they condemn

these activities, but I am not clear how much they do or how forthcoming they are in trying to check this activity from happening, somehow excising these people out of their industry. Of course, they have their own self-regulatory organizations, but what is your perception of the amount of support and cooperation you receive generally from those who are playing by the rules with respect to those that are playing outside the rules and causing the kinds of cases that we heard from Ms. Periman this morning?

Mr. HARVEY. Let me categorize cooperation in two forms. One is the firm that is not the subject of an investigation versus the firm that is the subject of an investigation. In the latter case we get a lot of cooperation for obvious reasons.

With respect to firms that are not engaged by a securities enforcer, I think they would just as soon be left alone. Generally, you will find former employees who may come forward and give you information that leads to an investigation, but by and large, while we have conversations with a number of broker-dealers in informational forums, it sometimes may lead to an investigation, sometimes not.

In the latter case again, where you have a firm engaged in an investigation, we generally find that they have been very cooperative. And we in New Jersey almost insist upon a continuing cooperation provision in any settlement that we reach with the firm, because we have discovered that while we may have discovered one type of conduct with the firm, there may be other types of conduct that are going on, or there may be other parties about whom the firm has knowledge that they can share with you if you ask them. So when we resolve our differences with a firm, we almost always insist upon continuing cooperation.

But in terms of a firm out of the blue volunteering cooperation to tell you about the ills of the industry, that is not a common occurrence.

Senator SARBANES. We have these self-regulatory organizations. What is your perception of how effective they are? What gaps do you see in terms of what they do, and how much help do you receive from the self-regulatory organizations?

Mr. LAMBIASE. The self-regulatory organizations are not governmental bodies, so when we look at it, we look at it as individuals. It is a professional standard that they try to set, but they are also guided very much by what the standard practice is within the industry. When we look at cooperation, to go back to the Attorney General's comments on cooperation, we look at cooperation from the grass roots side with the local investor that has a problem. You can get more cooperation. When you start moving up into the cultural environment of the firm, what we call the compliance culture of a firm, that is really looked at more by the SRO and the overall SEC.

And generally, you do not get cooperation because what you get is a statement that we are acting no differently than everyone else would in the industry and that is the standard that we all go by. So really we are not going to change our procedures, our way of doing business unless you get this broad range of reform that we see at your level. So, I think the SRO's serve an important role, but I do keep in mind that they are not governmental bodies, and

I think that their focus is the member and the operational standards of their members, the financial capability. Ours is solely investor protection.

Senator SARBANES. Mr. Chairman, could I ask one final question?

Chairman SHELBY. Go ahead.

Senator SARBANES. I am curious, and it may be a little awkward, but I want to hear from the security administrators about this. If you had a ranking 1 to 10 of the effectiveness of the State securities administrator State-by-State, what would the profile of the State securities administrators look like? I do not want you to identify the States, but assuming that 9 or 10 is the best, and I would concede that to the people at the table just for the sake of this question. How effective are the State securities administrators across the country?

Mr. LAMBIASE. At the grass roots level, sir, they are the best there is. We are not setting national policy. That is being handled by the SEC or the SRO's under the SEC oversight. I do not think that there is a finer group of people dedicated to protecting the citizens at home than State securities regulators, as you have heard from Mrs. Periman. But you can go across every State. They are all committed to protecting their constituents.

Senator SARBANES. How professional do you think the offices are? How well-trained and educated and how well-resourced are the State securities administrators State-by-State?

Mr. BORG. Certainly with regard to resources that is an individual State decision.

Senator SARBANES. Mr. Leven, I think in your testimony you said not enough resources were being committed at the State level, as I understand it.

Mr. LEVEN. I think that was related as much to the growing number of investors in the pool and the growing number of obvious things that are happening, so no matter how much these fellows strive, there is a limit on how much they can do with the monies they have today and the staffs they have today. I do not think we are recognizing the future here to that degree.

Senator SARBANES. What about the professionalism and the training, and how equipped are the State securities administrators?

Mr. BORG. Through the NASAA organization, not only do we run conferences, but we also run regular training programs for each section, broker/dealer, enforcement, etc. There are coordinating conferences that NASAA itself funds for the States so that the States do not have to pick up the tab. At any given time, you have over 300 volunteers working from the State securities regulators with the NASAA committees and project groups, whether it is international, multi-State, investor education, broker/dealer, or CRD. Therefore, through the NASAA organization, we have been able to arrange training that does not tax the resources of the State securities regulators.

Now, that being said, there is always room for improvement. We are always looking for opportunities. We are, as I mentioned earlier, now working with the NAIC on some joint training programs. We are trying to understand what they look at and how they examine. They are going to look at what we look at and examine it to help further coordinate. There is always room for improvement and

we can always use more resources. Do I have enough resources? No, I do not.

Senator SARBANES. Is there pretty good continuity of personnel so you have really seasoned experienced people in these offices or is it constant turnover and a difficulty of holding on to good experienced people?

Mr. BORG. On the staff level, I suffer more from retirements than I do from turnover. That being said, you have to remember that a number of State securities regulators are subject to appointment by governors or other elected officials, and they may change as the administration moves on. That is not the case in my State and a number of other States. I would say after the top level, the staff members generally do not change. You will have the usual turnover for other jobs, but I think you will find less of a turnover, and this is my opinion, less of a turnover in State securities regulators than you will find in most other areas.

Mr. LAMBIASE. I would like to echo those comments, sir, and I would also like to point up that NASAA sponsors over 12 training programs a year, everything from conducting examinations at broker-dealers, it does training on investment advisers, corporate finance issues, enforcement, how to prosecute cases. This year, we did the first joint training with the NAIC, National Association of Insurance Commissioners and State securities regulators, looking at common areas. And as Joe pointed out, there are over 250 volunteers right now that we have simply assigned to committees. We have a greater number that will volunteer with us. I think it is what is devoted at the local level that matters. NASAA will do everything it can to help support the States' roles in its protection.

Senator SARBANES. Thank you very much, and continue on in your good work.

Chairman SHELBY. Senator Dodd.

Senator DODD. Just one. I cannot resist, Ralph, since you are here. Anything unique? What are you looking at in Connecticut right now, for instance?

Mr. LAMBIASE. Our particular issue in Connecticut right now really would focus a lot on what we have seen with mutual funds and variable annuities. Variable annuities are regulated by insurance regulators and not securities in Connecticut, but yet, you look at the annuity being wrapped, wrapping a mutual fund in it, and securities division does not really have jurisdiction, but you look at what is happening. And it is very gratifying in some respects to look at some of the institutions, the mutual funds that we are seeing, that actually stopped market timing, that we call had their own market timing police. I mean what is grabbing the headlines today are the examples where there were breakdowns, but yet there are many firms that actually prohibited, caught, and stopped market timing, and I am pleased to say that we have seen that in many instances within our own Connecticut-based firms.

Senator DODD. Good. Thank you again, Mr. Chairman.

Chairman SHELBY. No other questions.

I want to thank first, Ms. Periman. Thank you as a citizen for your story, and I hope things work out for you. I really do.

Ms. PERIMAN. Thank you very much.

Chairman SHELBY. I want to thank the others for your contribution too here today. You do play an important role. And Senator Sarbanes and a lot of us on the Committee, we understand it and we are concerned when people try to talk about preemption. Thank you so much.

The hearing is adjourned.

[Whereupon, at 11:50 a.m., the hearing was adjourned.]

[Prepared statements and responses to written quesdtions supplied for the record follow:]

PREPARED STATEMENT OF PETER C. HARVEY

ATTORNEY GENERAL, STATE OF NEW JERSEY

JUNE 2, 2004

Chairman Shelby, Ranking Member Sarbanes and Members of the Committee. I am Peter Harvey, Attorney General for the State of New Jersey. Thank you for inviting me to testify today on the issue of State regulation and enforcement of securities laws.

The States play a critical role in regulating securities. By highlighting what we are doing in New Jersey, I hope to illustrate clearly why the States are a crucial component of investor protection in this Nation. I want to acknowledge and thank Senator Jon Corzine, who was a wise and experienced leader in the investment industry and now devotes his wisdom and leadership in service of the Nation and New Jersey. I want to thank him particularly for being a strong advocate for investor education and protection.

State Regulatory Oversight

The securities markets have attracted investors large and small. Many middle-class Americans seek to build their assets for their children's college education and retirement by investing in stocks and bonds. These days, most of the money is not in banks. It is invested in securities, predominantly through pension plans, private retirement plans (401(k), Keogh, IRA) and major mutual funds, but also through private broker-dealers. Thirty years ago, only a small fraction of U.S. citizens ventured into the securities markets. Now, we have nearly 100 million investors. That is a lot of people and a lot of money.

Unfortunately, there are plenty of modern-day Willie Suttons—armed with a sales pitch instead of a gun—who know where the money is and have learned that many investors are easy marks for a scam. Those investors are spread over 50 States—too much territory to cover without State securities regulators.

In New Jersey, the Bureau of Securities acts on behalf of the Attorney General. New Jersey is one of only five States to place such an agency directly under the control of the Attorney General. As Attorney General, I have both criminal and civil authority to prosecute securities fraud.

The Bureau has a staff of about 60 people to enforce the New Jersey Uniform Securities Law. The Bureau is funded through fees paid by the regulated community as well as fines and other sums collected in enforcement actions. The Bureau regulates the sale or offer of any security sold into or from New Jersey, as well as firms and persons engaged in the securities business in our State. The primary mechanisms for regulation are (1) registration of securities, firms, and agents, and (2) enforcement actions against those who fail to comply with registration or engage in fraud.

Since becoming Attorney General last year, I have dedicated increased staff and resources to the Bureau of Securities in order to handle the workload. I will highlight a few facts and cases that illustrate the scope of the securities fraud problem we face merely in the State of New Jersey.

New Jersey has a large amount of investment activity. It ranks fourth in the United States in total firms and agents registered, behind only California, New York, and Florida. The Bureau of Securities registers approximately 2,700 broker-dealer firms, 155,000 agents, more than 2,000 investment advisers, and 12,200 investment adviser representatives. In addition to the large industry presence, New Jersey has the second-highest per capita income in the country, with many people seeking to invest their money to protect and increase it. New Jersey also has an aging population, and many of the elderly are particularly vulnerable to those engaged in securities fraud.

Registration is important to States as it permits State regulators to weed out bad actors and fraudulent or suspect securities offerings. Our Bureau of Securities has the power to deny, suspend, or revoke the registration—and consequently the ability to do business in or from New Jersey—of any broker-dealer, agent or investment adviser and to issue a stop order against any securities offering sold in or from the State. In addition, the Bureau Chief has broad investigative powers and the power to subpoena records and compel testimony or other statements under oath. The Bureau conducts examinations of books and records of broker-dealer and investment adviser firms to determine if they are in compliance with New Jersey's Uniform Securities Law.

Another critical component of the Bureau's work is investor education. Bureau representatives regularly conduct seminars for senior citizens and community groups on avoiding securities fraud. In this area, an ounce of prevention truly is worth a pound of cure. There are many people entering the market who do not know

what to invest in, how to choose a broker, or how to recognize a swindle. We teach basic precautions, such as checking whether brokers and investments are registered, and realizing that if a deal sounds too good to be true, it is not true in most instances. State attorneys general and securities regulators would welcome Federal assistance in the investor education area, whether in the form of national ad campaigns or grants for State programs.

Finally, the Bureau has a full-time staff devoted to fielding complaints from investors. The Bureau receives thousands of complaints and inquiries each year. Customer complaints are frequently resolved with the Bureau acting as a middleman between the investor and the broker-dealer firms. Those kind of complaints often involve problems with accounts or account statements or with a nonresponsive broker. Other complaints are more serious and lead directly to full-scale investigations.

New Jersey's Enforcement Efforts

New Jersey has about 200 enforcement cases in the investigative stage at any given time and more than 40 in active litigation. New Jersey is no stranger to major securities fraud cases. A good example is Robert Brennan, the penny stock king who defrauded investors of millions. The high-profile bankruptcy fraud trial which led to Brennan's imprisonment in 2001 was a result of a cooperative effort involving our Bureau of Securities, the SEC, the FBI, and the U.S. Attorney's Office. It was a direct outgrowth of two separate civil matters brought by the Bureau of Securities and the SEC. We secured a $55 million claim in bankruptcy court against Brennan and a $45 million judgment, which we are working to collect. I want to focus, however, on our more recent efforts.

New Jersey played a major role in the landmark settlement announced last year between securities regulators and 10 top Wall Street firms regarding stock analyst practices. New Jersey was co-chair, with California and New York, of the steering committee for the multistate task force organized by the North American Securities Administrators Association that investigated the firms. New Jersey also was lead State for the investigation of Bear, Stearns & Co. The case, as you know, brought major reforms to the industry to ensure that stock analysts are not subjected to pressure to report favorably on stocks and bonds of investment banking clients of their firms.

Just yesterday, I announced another major settlement with significant implications for the industry. New Jersey reached an $18 million settlement with Allianz Dresdner Asset Management and two affiliated companies regarding allegations of a fraudulent arrangement that permitted a large investor to market time more than $4 billion in transactions in their mutual funds in violation of fund policies and to the detriment of long-term investors. The settlement requires the defendants to implement corporate governance changes to ensure that portfolio managers for their mutual funds function independently of business managers, and that the funds comply with their own policies barring market timing.

In between those milestones, New Jersey has filed eight major securities fraud cases involving, in the aggregate, more than one thousand investors and more than $160 million in investments.

While some con artists target small, inexperienced investors, the reality is that wealth and sophistication are no guarantee that an investor will not be defrauded. In February 2004, we filed suit against three men and their companies, including Clover Management Group Inc. of Fort Lee, N.J., that engaged in an elaborate scheme to swindle investors in the United Kingdom out of more than $55 million. The defendants falsely claimed to offer investments in the defense industry that would provide strong returns while supporting the British and United States war effort in Iraq and the worldwide war on terrorism. New Jersey has seized the assets of the defendants, including a $2 million yacht, bank accounts, luxury cars, and a painting by renowned artist Eduardo Arranz-Bravo. The seizures followed cooperative investigations by our Bureau of Securities, Federal authorities, and New Scotland Yard. The defendants duped sophisticated investors out of huge sums through slick marketing, which included touring investors around a defense industry plant and claiming to be advised by renowned military leaders and financiers.

Elaborate marketing also was involved in the case of Michael R. Casey. We filed suit in December to seek restitution for at least 195 investors who we allege were defrauded of up to $15 million in a real estate investment scheme run by Casey. We allege Casey set up a complex network of business entities to front his scheme and recruited investors through his tax preparation business and a series of investment workshops held under the name Midas Financial Planning Services Group.

As mentioned above, as Attorney General, I also have the authority to criminally prosecute securities fraud. In June 2003, we simultaneously filed criminal and civil

actions against more than a dozen New Jersey companies and their principals for allegedly stealing more than $80 million from investors. The scheme's principal architect was Thomas Giacomaro, who pleaded guilty to money-laundering charges brought by the Division of Criminal Justice in the Attorney General's Office and Federal charges of mail fraud and tax evasion. Among the parties who lost money in the scheme was best-selling novelist Mary Higgins Clark.

A common theme in each of these cases is that the securities sold by the defendants were not registered with the New Jersey Bureau of Securities, as required by law. If the victims had called the Bureau before investing, as we urge all investors to do, they could have avoided their losses. Again, the need for investor education is highlighted.

Another frequent theme in these cases is cooperation between State and Federal authorities. That theme can be seen in the Brennan case, the Wall Street stock analyst settlement, the Clover case and the Giacomaro case. State securities regulators and the SEC can accomplish a lot by working together, as our representatives in the North American Securities Administrators Association have been emphasizing in their ongoing discussions with the SEC and their cooperative initiatives. However, another point should not be lost. States also can be extremely effective on their own, as we demonstrated in the Allianz Dresdner case. In a 4-month period, we filed and settled a case that addressed a serious industry problem and led to reimbursement of the affected funds. We secured needed reforms, but resolved the case quickly to avoid a lingering cloud that might harm the funds. Several other States also have shown their effectiveness on this front.

Although I have discussed high-profile cases that in some instances did catch the attention of Federal authorities, many of our securities fraud cases—both civil and criminal—would not be pursued by Federal regulators, leaving investors without recourse. There are simply too many cases out there, and sometimes the dollar amount of the fraud is not large enough to interest Federal securities regulators given their limited resources. The States serve as valuable partners in securities regulation and in recent years have provided early warnings about dangers in the marketplace, sounding the alarm on day trading, penny stocks, microcap funds, and analyst conflicts.

The bottom line is that the task of protecting investors is too large to be handled by a single Federal agency, the SEC. Investors need the protection of State securities bureaus. The task of protecting investors is only going to grow as trends push individuals to deal directly with their retirement costs and as discussions proceed at the Federal and State levels about giving people increased control over investment of their Social Security and other retirement funds, beyond 401(k), Keogh, and IRA plans.

We hope that you will maintain if not enhance the authority of State securities regulators. Further, any additional resources you can provide to us will, I can assure you, be money well spent. Investor protection is the key to investor confidence, and investor confidence is the key to raising the capital that fuels this Nation's economic engine. We can make the Nation stronger by working together.

Thank you again for the opportunity to testify. I share your concern about this vital issue and stand ready to work with you as you examine and address it in the future. I look forward to answering any questions that you might have for me today.

PREPARED STATEMENT OF RALPH A. LAMBIASE

DIRECTOR, DIVISION OF SECURITIES
CONNECTICUT DEPARTMENT OF BANKING AND
PRESIDENT, NORTH AMERICAN SECURITIES
ADMINISTRATORS ASSOCIATION, INC.

JUNE 2, 2004

Introduction

Chairman Shelby, Ranking Member Sarbanes and Members of the Committee, I am Ralph Lambiase, Connecticut Securities Director and President of the North American Securities Administrators Association, Inc. (NASAA).[1] I would like to

[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

Continued

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.

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 would 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 would 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.

Rico. NASAA is the voice of securities agencies responsible for grassroots investor protection and efficient capital formation.

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 would 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 the 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 ongoing 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 num-

bers 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 multistate 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

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 is 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 SRO's 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 have 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 Associa-

tion, 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 have 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 have 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. 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.

PREPARED STATEMENT OF JOSEPH P. BORG

DIRECTOR, ALABAMA SECURITIES COMMISSION AND
CHAIRMAN OF THE ENFORCEMENT SECTION OF THE NORTH
AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

JUNE 2, 2004

Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee, I am Joe Borg, Director of the Alabama Securities Commission and Chairman of the Enforcement Section of the North American Securities Administrators Association, Inc. (NASAA).[1] It has been a privilege for me to serve as Director of the Commission since 1994, and to have been elected as NASAA's President for during 2001–2002. It is a particular honor for me to have the opportunity to publicly thank my Senator, Richard Shelby, for his thorough and thoughtful approach to restoring investor confidence in our markets. You just heard an overview of State securities regulation

[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 grassroots investor protection and efficient capital formation.

from NASAA's President, Ralph Lambiase, and I am delighted to have the chance to share with you some highlights from the States' enforcement activities.

Overview

The Enforcement Section assists the NASAA Board and membership in coordinating enforcement efforts regarding multistate frauds by facilitating the sharing of information and leveraging the fixed resources of the States more efficiently. Members of this Section act as points of contact for other Federal agencies and the self-regulatory organizations (SRO's), and help identify new fraud trends such as those involving promissory notes, viatical settlements, and microcap securities. The Section has eight project groups under its jurisdiction, with over 40 volunteer members who focus on planning NASAA's annual enforcement conference, the enforcement portion of the 19(d) conference with the Securities and Exchange Commission (SEC) mandated by the Securities Act of 1933, maintaining our enforcement databases, coordinating special projects, and identifying enforcement trends.

The enforcement role of States securities regulators differs in some ways from the SEC and the self-regulatory organizations (SRO's). Because our local offices are often the first to receive complaints from investors, State securities regulators serve as an early warning system, working on the front lines, investigating potentially fraudulent activity, and alerting the public to the latest scams. After identifying a problem, many States can take immediate enforcement action without the time-consuming need to obtain formal agency orders. States also have a history of taking enforcement actions against the very worst fraudsters, often those selling unlicensed products and Ponzi and pyramid schemes of all types.

In addition to investigating cases and bringing enforcement actions, States work with national regulators on marketwide solutions when they are needed. Although States do not engage in rulemaking for the national markets—that is rightly the purview of the SEC and the SRO's—the State regulators are active participants in the SEC's rulemaking process. That was the pattern followed with penny stock fraud, microcap fraud, day trading, and the analyst cases discussed below.[2] We meet on a regular basis with SEC staff and provide written comment to the Commission as it receives information from the States' front lines during its deliberative rulemaking process. In the past 2 years, NASAA has submitted more than two dozen formal comment letters to the SEC regarding rule proposals and concept releases. NASAA staff, frequently joined by State regulatory personnel, also has held numerous informal discussions with Commissioners and SEC staff on issues of mutual interest, both in Washington, DC and the field.

Wall Street Analyst Conflict of Interest Global Settlement

Since the early 1990's, long before the recent Research Analyst Global Settlement, NASAA members were involved in a number of coordinated multistate settlements with firms including Prudential Securities, Salomon Brothers, D.H. Blair, and Stratton Oakmont, amongst others.

Let me take just a moment to provide an update on the States' component of the Wall Street analyst conflict-of-interest Global Settlement. Christine Bruenn of Maine, then NASAA President, testified last May before this Committee on the States' role in the investigation and settlement with the Wall Street firms.

All 50 States, plus the District of Columbia and Puerto Rico, agreed to settle with the 10 firms involved. Every jurisdiction, but one, has completed the process by executing the settlement documents. The Global Settlement was a model for State/Federal cooperation and the process was completed in conjunction with the SEC, the New York Stock Exchange, and the NASD. If you include the Merrill Lynch settlement, which was reached by the States almost a year before the others, the firms executed agreements with 52 State jurisdictions for a total of 520 settlements.

Those settlements achieved a number of very important objectives. For example, in addition to penalties and disgorgement, a portion of the payments required under the Global Settlement were earmarked for investor education. Specifically, 7 of the firms agreed to pay a total of $80 million for investor education with $27.5 million directed to the States over 5 years for investor education purposes. That amount comprises the "Investor Education Fund" that will be overseen by the Investor Protection Trust (IPT), a charitable trust, classified by the IRS as a public charity.

The settlements also resulted in much needed change in the way the firms conduct their business. The independent research component is scheduled to be implemented in July and will provide investors at the 10 firms with research procured by independent consultants. The consultants are also charged with providing a track record of research success or failure that can be evaluated over time.

[2] See State/Federal Dynamic Chart Attached.

Finally, a rigorous separation between research and banking was effected by this settlement for the 10 firms involved, and by NASD and NYSE rules for the rest of the industry. Over the last several years, NASAA members have been active participants in the rulemaking and legislative process in the area of analysts' conflicts of interest. The States worked closely with the SEC and the SRO's, both to leverage limited investigative resources and to formulate new, marketwide rules that were needed to fix this problem. In addition, we commented on the NASD/NYSE's proposed rules relating to research analysts, making suggestions that we felt could make the rule stronger in some areas. Many of our original proposals were incorporated in the final rule. Also, NASAA was strongly supportive of Title V in S. 2673, which became the Sarbanes-Oxley Act of 2002.

States' Investigations into Mutual Fund Industry Abuses

I commend this Committee for its thorough and deliberative examination of trading abuses in the mutual fund industry. State securities regulators, the SEC, NASD, and mutual-fund firms themselves have launched inquiries into mutual fund trading practices. To date, more than a dozen mutual funds are under investigation and several mutual fund employees have either pleaded guilty, been charged, or settled with State regulators. I will not dwell on this subject because this Committee has already conducted comprehensive hearings demonstrating that some in the mutual fund industry were putting their own interests ahead of America's 95 million mutual fund shareholders. I can assure you that the States will continue to actively pursue inquiries into mutual fund improprieties and are committed to aggressively addressing mutual fund complaints raised by investors in our jurisdictions.

State Securities Enforcement Activity

These high profile national cases arise periodically, but they should not obscure the more routine caseload representing the bulk of the States' enforcement work. As always, State securities regulators continue to vigorously pursue sales practice abuses and a variety of scams and frauds against unsuspecting investors. State securities regulators have a long history of protecting investors at the local level day in and day out. We often initiate investigations as a result of complaints from investors in your States who feel they have been wronged by a broker-dealer, securities professional, or those claiming to be a securities specialist. Each NASAA member has one or more offices within their State, with contact information readily available on the web. Many investors understandably feel that the logical place to start with a grievance is their local State securities regulator.

The States have compiled an impressive record in bringing enforcement cases, including criminal prosecutions. The chart before you, and attached to this testimony, illustrates State enforcement statistics for the reporting period 2002 to 2003 with over 70 percent of the 52 jurisdictions responding. The States filed a total of 2,964 administrative, civil, and criminal enforcement actions; assessed $822,315,470 of monetary fines or penalties; collected $660,109,508 in restitution, rescission, and disgorgement and sentenced criminals to over 717 years of incarceration. NASAA sent out a recent survey to obtain this latest data, and I would be pleased to follow-up with the Committee in a few weeks with more complete information.

Because we are grassroots regulators, we often serve as an early warning system of emerging corporate frauds and investment scams before they are detected at the Federal level. Other frauds, generally relating to companies not traded on any exchange, never reach the Federal level and are handled by State regulators. The Alabama Securities Commission's Enforcement Division opened an investigation on Francis Clark Sr., CEO and President of U.S. Fabtec LLC, located in Alabama. U.S. Fabtec, LLC was to be a joint venture with Mitsubishi Aluminum Fabtec Holding, Inc., a subsidiary of Mitsubishi International Corporation. Complaints alleged that Clark spent corporate funds on personal items such as country club dues and his hobby of stock car racing. Mr. Clark solicited seven domestic investors for $1,407,676 and two Japanese companies to invest $1,287,553 for a total of $2,695,229. It was determined that Clark thereafter continued to solicit additional investments and embezzled money from the company. In 2003, Mr. Clark was sentenced to 12 years and to pay restitution of $1,603,117.04 for two counts of Securities Fraud and two counts of Theft of Property I.

For the past several years, NASAA has released its list of top 10 investment scams, schemes, and scandals to alert investors to increasingly complex and confusing investment frauds. I will briefly describe several of these scams and provide a State enforcement case example for each.

UNREGISTERED/UNLICENSED

One problem area inundating State regulators is unlicensed securities sellers pitching securities that are unregistered. Scam artists use high commissions to en-

tice some insurance agents, investment advisers, and even accountants and lawyers into selling investments they may know little about, such as bogus limited partnerships or promissory notes, offering high returns with little or no risk.

Unlicensed/Unregistered Case Example

The State of New Jersey is proceeding with efforts to obtain restitution for at least 195 investors who may have lost up to $15 million in a real estate investment scam run by a Michael Casey in Upper Saddle River. The suit filed in December 2003 alleges fraud and the sale of unregistered securities through a complex set of real estate based investments. New Jersey alleges that the monies raised were illegally co-mingled, mismanaged, and/or diverted to pay Casey's personal expenses and for other purposes unrelated to what investors were promised.

Casey allegedly used his tax preparation business and a series of investment workshops under the name Midas Financial Planning Services Group to recruit investors. These workshops, held as recently as August 2003, involved numerous oral and written misrepresentations to potential investors. Casey allegedly continued to conduct the workshops in violation of a consent order he entered into with the Bureau of Securities on April 7, 2003 that barred him from "issuing, selling, offering to sell, purchasing or offering to purchase, promoting, negotiating, advertising or distributing from or within New Jersey any securities or investment advisory advice concerning securities."

Unlicensed/Unregistered Case Example

In Delaware, an insurance agent, who had been the subject of a prior Delaware Cease and Desist Order prohibiting him from selling unregistered securities, once again began selling unregistered securities in violation of the existing order. Subsequent to the filing of the Order, the Delaware Securities Division received a complaint from a senior citizen who had invested $35,000 after responding to an anonymous advertisement in a senior citizen newspaper. The seller of the unregistered fraudulent offshore securities (certificate of deposit issued by the First International Bank of Grenada and Wellington Preferred Stock) was the same insurance agent who had been ordered to stop selling unregistered securities. This $35,000 investment represented the victim's entire life savings. She received the $35,000 by the sale of her marital home which she sold before moving in with her son after her retirement. The victim was a retired State employee who was forced to return to the work force as a result of the crime.

Through the use of a search warrant, Delaware seized the offender's computer and business records and was able to find 14, primarily elderly, victims who had invested in these fraudulent offshore investments sold by the insurance agent. He was convicted in Delaware Superior Court of 29 felonies and received a term of incarceration of 7 years. While the Court ordered over $600,000 in restitution, the offender has not repaid any of his victims.

Unlicensed/Unregistered Case Example

In Alabama, an individual without use of ads, commercials, or flyers was able to get 30,000 participations in an advance fee loan investment by use of the Internet within a period of less than 100 days. The Alabama Commission issued 18,682 checks to reimburse investors at 70 percent of their investment. The Commission, moving quickly, was able to freeze bank accounts before the funds could be transferred overseas.

PRIME BANK

Prime bank schemes are a perennial favorite of con artists who promise investors access to secret, high-yield investments made through trades among the world's top or "prime" banks. Promoters falsely claim the investment is guaranteed or secured by some kind of collateral insurance or bank guarantee. The investors ultimately find out that the prime banks simply do not exist. Negative publicity attached to these schemes has caused some promoters in recent cases to avoid explicitly referring to prime banks. Now it is common to avoid the term altogether and underplay the role of banks by referring to these schemes as "risk free guaranteed high yield instruments."

Prime Bank Case Example

The Arizona Corporation Commission shut down a prime bank scheme and ordered 6 companies and their representatives to pay over $4.5 million in restitution and penalties for State securities violations. The State has already recovered $3 million for investors. This case is unusual because it is rare that large amounts of money are recovered for investors in prime bank cases. The perpetrators told investors their money would be safely held in bank certificates of deposit while funds

were traded in foreign banks. The duo also promised returns greater than 500 percent. They continually sent newsletters to investors trumpeting their million-dollar returns, but all the claims were false. The case involved 102 investors from Arizona and other States as well as from Germany and Japan. Most of the money was funneled through a bank in Arizona to a bank in Texas and ultimately to the Turks and Caicos Islands.

VARIABLE ANNUITIES

Sales of variable annuities have increased dramatically over the past decade. As sales have risen, so too have complaints from investors. State securities regulators are concerned that investors are not being told about high surrender charges and the steep sales commissions agents often earn when they move investors into variable annuities. Often pitched to seniors through investment seminars, these products are unsuitable for many retirees. Some investors also are misled with claims of guaranteed returns when variable annuity returns actually are vulnerable to the volatility of the stock market. The benefits of variable annuities—tax-deferral, death benefits among others—come with strings attached and additional costs. High commissions often are the driving force for sales of variable annuities.

Variable annuities are considered to be securities under Federal law. Some States consider variable annuities to be insurance products and others consider them to be both insurance and securities. NASAA is encouraging changes in State laws that would allow State insurance regulators to continue to oversee the insurance companies that sell variable annuities while authorizing State securities regulators to investigate complaints about variable annuities and to take action against the companies and individuals who sell them. State securities regulators look only at the sales practices of those selling variable annuities as opposed to the licensing and registration of the product.

Variable Annuities Case Example

The Alabama Securities Commission and Mississippi Secretary of State recently announced a joint enforcement action against AmSouth Investment Services, a subsidiary of AmSouth Bank, which had acquired a broker-dealer in a bank merger with First American of Nashville, Tennessee. In this joint investigation involving two State regulators, and information sharing with the SEC and the NASD, we found a number of cases of poor oversight and, in one case, serious violations by an AmSouth Investment Services representative. Most of the problems that we found related to variable annuities and their unsuitability for most investors. The case began after a routine examination by State investigators discovered improper activity.

Under the agreement, AmSouth Investment Services paid a $25,000 fine, reimbursed the States $75,000 in investigative costs, contributed $125,000 for investor education programs in Mississippi and Alabama, and set up an uncapped fund to handle claims for those who wish to surrender these policies if unsuitable. The broker-dealer must also pay for an independent review of all internal policies and procedures designed to detect and prevent securities law violations, and improve access to compliance and supervisory rules at every branch office including obtaining a new, state of the art computer compliance system.

On a negative note, there has been a major push by certain insurance industry associations to remove variable annuities from State securities review, even though variable annuities are securities under Federal law. These efforts have been successful in preventing or eliminating securities review in several States, hindering progress in the uniform treatment of what are essentially stock funds with an insurance element.

VIATICALS

Risky viatical settlement contracts are products that have been on our radar screen and subject to State securities enforcement actions for the past several years. The viatical industry began around 1990 as a way to help the terminally ill, most notably AIDS patients. In a typical transaction, the person holding a life insurance policy sells it to a third party "broker" in return for a portion of the death benefit. The broker then sells shares of the policy to investors, who collect a share of the death benefit from the broker when the original policyholder dies.

A viatical settlement transaction is a hybrid transaction that implicates both insurance and securities law. The securities law component of a viatical settlement transaction arises when a viatical settlement provider solicits investors to raise money to fund the payout to the insured. Although in some jurisdictions State insurance authorities have sole authority over viatical settlement transactions, in the States where securities and insurance regulators share oversight, securities regu-

lators uniformly have stated that viatical settlement transactions constitute securities under State securities law and have vigorously pursued enforcement actions.

Viaticals Case Examples

In February 2002, NASAA issued a press release[3] about viatical settlements, citing deceptive marketing practices, numerous instances of fraud, and warning investors not to be misled by claims that viaticals offer safe, guaranteed returns like certificates of deposit. The release cites a Vermont investigation into practices at Mutual Benefits Corporation (MBC). The Vermont Securities Division currently has a civil lawsuit pending in Superior Court alleging that MBC violated the Vermont Securities Act by: (1) selling unregistered securities; (2) employing unregistered sales reps (mostly insurance agents); (3) misrepresenting to investors the risks involved in the purchase of viatical settlements; (4) misrepresenting the life expectancies of viators; and (5) violating the suitability provisions of Vermont law. The lawsuit seeks a civil penalty and restitution of approximately $2 million. The Superior Court denied MBC's motion to dismiss several months ago and the case is currently scheduled for trial during the first week of December.

Just last month, State and Federal regulators stepped in to shut down and revoke the license of Mutual Benefits Corporation, for securities and insurance law violations, fraud and misrepresentation. Florida's Office of Statewide Prosecution has charged the company with racketeering and 15 counts of investor fraud, saying the company lured tens of thousands of investors into an elaborate Ponzi scheme that raised more than $1 billion.

AFFINITY FRAUD

Con artists know that its only human nature to trust people who are like yourself. That is why scammers often use their victim's religious or ethnic identity to gain their trust and then steal their lifesavings. Unfamiliar with the financial markets, too many people do not know how to thoroughly research an investment and its salesperson. So, many fall prey to affinity group fraud in which a con artist is, or seems to be, a member of the same ethnic, religious, career, or community-based group.

Affinity Fraud Case Example

The Alabama Securities Commission initiated an investigation into an affinity fraud case that resulted in six defendants being sentenced to jail by a judge for the Nineteenth Judicial Circuit. The charges surrounded financial activities including nonexistent bonds, money laundering, and securities fraud involving the proposed expansion of the former Daystar Assembly of God church located in Prattville, Alabama. It is estimated that the congregation lost about $3,000,000. As a result of this scam, the congregation lost their church building because funds were not available to meet mortgage payments. This case clearly shows the power of cooperation and communication among the local police department, county, and State legal authorities to work together and take strong actions against white collar crime and people who steal from members of their own community. The principal perpetrator received a 31-year prison sentence.

International Efforts

My colleague, Ralph Lambiase, has already summarized most of the States' international outreach efforts. In addition, I recently represented NASAA at the United Nations Commission on International Trade and Law's Colloquium on International Commercial Fraud. The Colloquium was convened to address various aspects of the problem of commercial fraud from the point of view of private law and to permit an exchange of views from various interested parties, including those working in national governments, intergovernmental organizations, and relevant private organizations with a particular interest and expertise in combating commercial fraud, what we generally call "investment fraud." The idea was to begin an exchange of views with the international criminal law and regulatory sectors that combat commercial fraud and to identify matters that could be coordinated or harmonized. I was invited to present issues related to securities fraud including the difficulties we experience in conducting investigations, document production, and bringing civil and criminal prosecutions due to "red tape" across international borders. I believe we will see greater efforts made to share information and expedite investigations with a view to freezing and preserving assets for investors.

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[3] NASAA press release dated February 26, 2002; "Risky 'death futures' draw warning from State regulators, Congressional scrutiny."

Coordination

As we move forward, NASAA will enhance its existing cooperative relationships and launch new projects to coordinate enforcement activities. Even with the funding increase Congress allocated for the SEC, the Commission cannot go it alone. That is why there must be cooperation and division of labor among State, industry, and Federal regulators.

In September 2003, the NASAA President and SEC Chairman announced a joint initiative to address issues of coordination and cooperation between Federal and State securities enforcement authorities. Since December 2003, a working group consisting of six representatives of the Commission staff and six representatives of NASAA has been meeting on a regular basis to study ways to improve Federal and State cooperation. I am a member of this working group and assure you that the discussions have been thorough, constructive, and educational.

Another entity that NASAA works closely with is 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 tri-annual meetings and other information sharing activities. For example, the Group maintains a "Directory and Resource Guide" containing contact information for a broad range of law enforcement and regulatory agencies.

State securities regulators routinely work and cooperate with other agencies such as the Department of Justice, the National White Collar Crime Center, the U.S. Postal Service, the Department of Homeland Security, the Regional Organized Crime Information Center, and others.

In December 2001, the NASAA/NAIC Enforcement Coordination Subgroup was formed. Comprised of delegates from each association, its mission is to improve enforcement coordination between insurance and securities regulators at the State level. A key focus of the group is the persistent problem of insurance agents engaged in the unlawful sale of various securities investments. Last month, the group hosted its first joint training seminar for the benefit of regulators from both disciplines.

Conclusion

Mr. Chairman and Members of the Committee, State securities regulators are dedicated to pursuing those firms and individuals who have violated the securities laws. We will fight to ensure that State securities regulators maintain the authority to regulate at the local level and bring enforcement actions with appropriate remedies against those firms that violate securities laws in their jurisdictions.

The NASAA membership wishes to work with the Committee to provide you with any additional information or assistance you may need. Thank you again for inviting me to speak on behalf of the States to discuss our efforts to protect the investing public. I am happy to answer any questions you may have.

STATE/FEDERAL DYNAMIC:
HOW STATE DETECTION OF INVESTOR PROTECTION ISSUES LEADS TO NATIONAL RESPONSE

Issues Identified by State Securities Regulators	Problem	National Response
1989 - States determined Penny Stock offerings by newly formed shell companies to be per se fraudulent.[4] These "blank check" companies had no business plan except a future merger with an unidentified company.	**$2 billion/yr. Losses in Penny Stocks**[5]	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 of shares in Blank Check companies (SEC Rule 419).[6]
1991 - States found that rollups of poorly performing public limited partnerships disadvantaged individual investors by not providing meaningful dissenters' rights.	**Lack of dissenters' rights**	1993- Congress passed the Limited Partnership Rollup Act which mandated that NASD adopt rules containing specific provisions to protect dissenters' rights.[7]
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.	**$6 billion/yr. Losses in Micro-cap Stocks**[8]	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.[9]

[4] *Resolution of the North American Securities Administrators Association Declaring Blank Check Blind Pool Offerings to be Fraudulent Practices* (4 April 1989), NASAA Reports (CCH) ¶7028.

[5] *NASAA Investor Alert*: Penny Stock Fraud (December 1989).

[6] 15 U.S.C. §78o(g); 15 U.S.C. §77g(b)(1).

[7] 15 U.S.C. §78o(b)(12) and (13).

[8] Opening Statement of Senator Susan Collins, Chair, Senate Permanent Subcommittee on Investigations (22 September 1997).

[9] U.S. Senate Permanent Subcommittee on Investigations (22 September 1997 and 10 February 1998); 15 U.S.C. §78o(b)(4)(H); 15 U.S.C. §80b-3(e).

1996-97 - States were the first regulators anywhere to issue uniform interpretative guidance on use of Internet for legitimate securities offerings and dissemination of product information by licensed financial services professionals.[10]	**Risks of Securities offerings on The Internet**	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.[11]
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.[12]	**Risks of Online Trading**	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.[13]
1999 - In a first-ever 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.[15]	**Risks of Day Trading**	2000- SEC approved new NASD rules making day trading firms give written risk disclosure to individual investors.[14] 2001 - SEC approved new NASD and NYSE rules governing margin extended to day traders.[16]

[10] *Resolution of the North American Securities Administrators Association Regarding Securities Offering on the Internet* (7 January 1996), NASAA Reports (CCH) ¶7040; *Resolution of the North American Securities Administrators Association Regarding Internet Advertising of Information on Products and Services* (27 April 1997), NASAA Reports (CCH) ¶2191.

[11] *Statement of the Commission Regarding use of Internet Websites to Offer Securities, Solicit Securities Transactions, or Advertise Investment Services Offshore,* U.S. Securities and Exchange Commission, Release No. 33-7516 (23 March 1998).

[12] *From Wall Street to Web Street: A Report on the Problems and Promise of the Online Brokerage Industry*, Office of the New York Attorney General (22 November 1999).

[13] *Delivery Requirement of a Margin Disclosure Document to Non-Institutional Customers*, U.S. Securities and Exchange Commission, Release No. 34-44223 (26 April 2001).

[14] NASD Rules 2360 and 2361.

[15] *Report of the NASAA Project Group on Day Trading*, North American Securities Administrators Association (August 1999).

[16] NASD Rule 431; NYSE Rule 2520.

STATE SECURITIES REGULATORS ENFORCEMENT STATISTICS

(2002/2003 Reporting Period)

ENFORCEMENT ACTIONS (Includes administrative, civil, and criminal)	**2,964**
MONETARY FINES & PENALTIES (Includes civil and criminal)	**$822 million**
MONEY ORDERED RETURNED TO INVESTORS (Includes restitution, rescission, and disgorgement)	**$660 million**
YEARS OF INCARCERATION SENTENCED	**717.91 years**

NOTES

All data are for the 2002/2003 reporting period, which is reflected either as calendar year 2002 or most recent fiscal year, July 1, 2002 through June 30, 2003. Totals are preliminary as of May 28, 2004 and are based on responses from 37 of 52 jurisdictions.

SOURCE: North American Securities Administrators Association

PREPARED STATEMENT OF CHARLES LEVEN

VICE PRESIDENT, BOARD GOVERANCE AND
CHAIR, BOARD OF DIRECTORS, AARP

JUNE 2, 2004

Good morning Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee on Banking, Housing, and Urban Affairs. My name is Charles Leven. I am AARP Vice President for Board Governance and Chair of our Board of Directors. I appreciate this opportunity to testify on a matter of keen interest to us—investor protection. My testimony today focuses on the role that State securities regulation and regulators, and the North American Securities Administrators Association (NASAA), play in securing essential marketplace conditions of fair play and practice.

Your letter of invitation asked for AARP's perspective on the role played by State securities regulators in restoring public trust and providing effective oversight of investment markets. More specifically, you asked for our views on the:

- Enforcement actions State securities regulators have taken,
- Coordination efforts they have made with Federal regulators, and
- Investor education programs they have undertaken.

The rapid growth in investment activity over the past decade has severely taxed the resources of Federal and State securities commissions. According to NASAA there are at least 20,000 investment advisor firms in the United States. Approximately 8,000 of these are larger firms that register with the U.S. Securities and Exchange Commission (SEC) because they have more than $25 million in assets under management or are active in at least 30 States. The remaining smaller firms are registered with the States. NASAA also estimates that 150,000 to 175,000 individuals hold State licenses to act as investment advisor representatives.

According to the 2001 Federal Reserve's Survey of Consumer Finances, the percentage of households that own stocks, either directly or indirectly (through mutual funds, retirement accounts and other managed assets), increased from 32 percent in 1989 to 52 percent in 2001. The shift to defined contribution plans places significant responsibilities on individuals to make appropriate investment choices so that they will have adequate income when they reach retirement. It also heightens their risk if losses are incurred due to bad advice, abusive practices, or fraud.

In recent years, stock markets have weathered a sluggish economy, the steep market declines exacerbated by the September 11 terrorist attacks, trade deficits, and reports of numerous scandals—ranging from illegal corporate accounting practices to insider trading. These shocks to the securities marketplace have resulted in serious consequences for ordinary saver-investors. Suffice it to say, a lifetime's worth of saving is not a renewable resource for older Americans.[1] A recent 2004 survey of investors by AARP confirms a reduced confidence in financial services professionals, continuing concerns about the fairness of stock market conditions and practices, and the desire for stronger regulation of the securities industry.[2] This is the legacy from a still recovering marketplace.

Others can speak more authoritatively about the evolution of the Federal-State relationship over time—including the periodic tensions that have surfaced between State and Federal regulators. We can understand how some differences might surface with Federal regulators—and among States—when a timely response to an emerging market problem is needed. Nevertheless, we are reminded by recent market history just how vital the State securities commissions are in our dual system of market regulation and investor protection. The sensitivities and concern associated with "prior consultation" will no doubt periodically resurface.

For us, however, the goal of providing American investors with market conditions of fair play and practice is advanced by promoting harmonization wherever possible within our concurrent Federal-State system of securities regulation. Clearly State securities regulatory commissions and NASAA must and are playing an essential role. We believe State regulatory authority must be maintained as an integral component of our concurrent system, and refreshed as evolving market circumstances warrant.

State regulation of securities is based on statutes that serve three primary functions. These are the:

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[1] See: "Impact of Stock Market Decline on 50–70 Year Old Investors," an AARP survey report published, December, 2002 (available at: *http://research.aarp.org*).

[2] See: "Investor Perceptions and Preferences Toward Selected Stock Market Conditions and Practices: An AARP Survey of Stock Owners Ages 50 and Older," published March 2004 (available at: *http://research.aarp.org*).

- Registration of certain securities;
- Registration of broker-dealers and their agents and more recently of investment advisers and investment adviser representatives; and
- Enforcement of fraud and other remedies.

The State securities regulators are responsible for the licensing of firms and investment professionals, the registration of some securities offerings, branch office sale practice audits, investor education, and most importantly, the enforcement of State securities laws. Securities regulatory commissions are located in all 50 States, the District of Columbia, and Puerto Rico.

Enforcement

One of the principle virtues of our concurrent system of securities regulation is State securities commission authority to investigate and bring enforcement actions with respect to fraud or deceit or unlawful conduct in connection with securities transactions. State securities administrators are frequently the first point of contact when an investor has a securities transaction-related complaint. State regulators often work very closely with criminal prosecutors at the Federal, State, and local levels to punish those who violate our securities laws.

The New York State criminal case against research analysts, initiated in early 2003, is a useful illustration of the significant role that State securities regulators can play in enforcement. Precisely because the States also had investigatory and enforcement powers, one State was able to take the initiative in what became a $1.4 billion settlement with 10 leading broker-dealer firms. Ultimately NASAA, the State of New York and the Federal regulators worked cooperatively on the Global Research Analyst Settlement.

Later in 2003, the securities regulators in Massachusetts began what would become a series of investigations by other State and Federal regulators into the Nation's $7.6 trillion mutual fund industry. Clearly, these examples serve to validate the rationale for maintaining a well-balanced and concurrent securities regulatory system.

From our perspective, the most serious ongoing State enforcement issue is inadequate enforcement budgets—a challenge not unknown to Federal regulators. We support increased State budgets to combat the significant increases in fraud being found in many States. We believe that Congressional and judicial oversight can mitigate disagreements that periodically emerge.

Coordination

State regulators have been active in coordinating reviews of filings, developing a uniform registration statement for offerings that are exempt at the Federal level, and in crafting policy statements on a number of review issues that strengthen uniformity of review in the States. There are over 60 of these NASAA statements of policy which have been adopted at the State law level as State rules or guidelines. These statements of policy provide flexibility in the rapidly changing securities marketplace, and can provide a basis for Federal-State cooperation and coordination.

Two additional examples of the cooperative role that NASAA has played with Federal regulators involve working with:

- NASD to computerize and maintain the licensing and disciplinary histories on more than 650,000 securities professionals (broker-dealers) and 5,200 securities firms (referred to as CRD for Central Registration Depository); and more recently with the
- SEC to develop a licensing, registration, and enforcement database for investment advisors. This database, the Investment Adviser Registration Depository (referred to as IARD), provides employment and disciplinary histories on more than 11,000 investment adviser firms and 173,000 individual investment advisers.

In 2002, a new version of the Uniform Securities Act was adopted by the National Conference of Commissioners on Uniform State Laws. The Uniform Securities Act has been the model for nearly 40 States' securities laws including a reciprocal provision to the Securities Act of 1933 that provides that the securities administrators "shall, in its discretion, take into consideration in carrying out the public interest . . . maximizing uniformity in Federal and State regulatory standards."

As a practical matter, the SEC's annual conference on Federal securities regulation, to which State securities regulators are invited, provides a forum for addressing a range of mutual concerns. And NASAA has been a frequent and influential commenter on SEC rule and form proposals, and State regulators are often called to testify before Congress on matters pertaining to securities regulation.

Education

AARP recognizes State securities regulators and NASAA for their impressive efforts to enhance the capacity of individual investors and their agencies to detect, report, and eliminate abusive and fraudulent behavior. This effort at capacity-building is based on better investor education and through improved agency staff training. Investor education is the ordinary investor's first and sometimes their ultimate line of defense against exploitive securities sales practices. Our dynamic stock market makes upgrading investment skills a necessity.

Last year, complementing its existing Investor Education Section, NASAA initiated a major education campaign aimed at older investors by launching an online "Senior Investor Resource Center." NASAA also offers training to its members on an average of one seminar a month. It also offers K through 12 teacher training academies.

Conclusion

While a range of statutory conventions and informal policy discussion venues are available for harmonizing Federal-State regulatory enforcement, stimulating coordination, and upgrading investor education and investment skills, this does not mean that every difference of view can or should be summarily resolved. By the same token, our dual system of securities regulation provides a great deal of flexibility for each State to address local concerns. There may be modest costs associated with the concurrent system of regulation, as well as redundant regulatory efforts including multiple fees for securities issuers and professionals. But we believe that there are demonstrated benefits to the dual system, and to the role and value of State securities regulators. State securities regulatory authority helps fill what would otherwise be important enforcement gaps.

I appreciate this opportunity to testify on behalf of AARP on the important role that State securities commissions play in efforts to secure marketplace conditions of fair play and practice. We look forward to working with Members of this Committee in pursuit of these shared goals. I would be happy to answer any questions you may have.

RESPONSE TO A WRITTEN QUESTION OF SENATOR MILLER FROM RALPH A. LAMBIASE

Q.1. I asked Chairman Donaldson in a hearing on the "State of the Securities Industry" what kind of working relationship he had with the State securities administrators and the State attorneys general on resolving the various enforcement issues that have arisen, and whether he thought there were any changes that might be needed to be made in the SEC's relationship with the States.

Let me quote Chairman Donaldson's response to me. He said

> That is an excellent question. It is one that we are very concerned about. Let me say this, that we need and encourage all the help we can get from local regulators in the securities industry at the local level where they can uncover and investigate things that go beneath our screen, so that if there is malfeasance or fraud or whatever at a local level, we welcome the local administrators, securities administrators, and so forth.
>
> At another level, and that is the level of the structure of the markets themselves, we believe and I believe very strongly that we cannot have 50 different structural solutions, we cannot have 50 different ways, perspectives as they are put out, and trading rules and so forth, I believe that that has to be done by the Federal administrators.
>
> Having said that, we need to and we have cooperated with local securities regulators, andjust 2 weeks ago in connection with the chairwoman of the National Regulators Trade Association, we agreed to enter into a joint arrangement with them to see if we could not improve the communication between what they are doing and improve the cooperation between what they are doing. I think that will go a long way.
>
> I will say it again and in frank answer to what you said, there are areas where a local authority can step in too late to an investigation that is already under way and in so doing interrupt a carefully put-together investigation by a Federal functionary, and this is where I think we get into trouble, where there is considerable work that has been done, cases being built, and someone comes in from left field and does not really add anything and in fact might create an environment where the accused will get off because of a technicality.

I would like to ask each of you basically the same question.

What kind of working relationship does each of you have with the SEC on resolving the various enforcement issues that have arisen, and whether you thought there were any changes that might be needed to be made in the SEC's relationship with the States? And do you have any other comments on Chairman Donaldson's response to me?

A.1. In September 2003, the NASAA President, Christine Bruenn, and Securities and Exchange Commission (SEC) Chairman Bill Donaldson announced a joint initiative to address issues of coordination and cooperation between Federal and State securities enforcement authorities. Since November 2003, a working group consisting of six representatives of the Commission and six representatives of NASAA has been meeting on a regular basis to study ways to improve Federal and State cooperation.

I believe the relationship between State securities regulators and the SEC is already more open and cooperative than it was when Chairman Donaldson appeared before the Banking Committee on September 30, 2003. We are working on various ways to exchange information on cases, and make a determination as to when and how to work together on cases. Developing trust between the States and the SEC is a key component of this effort. As I said in my testimony, there is complete trust and cooperation among State regulators. We share information, we share resources, and we work jointly. We have a trust and respect for each other that allows us

to work as effectively as we do. I would like to see that model extended to the State and Federal working relationship.

Last fall, I stated that my foremost goal as President of NASAA is to work with the SEC and the SRO's to use our resources collectively to protect investors. This process has to be a two-way street with information flowing back and forth between our organizations, and I continue to work toward reaching that goal.

Since Chairman Donaldson's September 2003 testimony, the NASAA leadership has met several times with the Chairman and we have had open, frank discussions on a variety of subjects. He and his staff have been most receptive to our thoughts and concerns. I agree with him that the SEC is the lead regulator when it comes to establishing national rules for the securities marketplace. Over the last several years, NASAA members have been active commenters in the rulemaking and legislative process. The States worked closely with the SEC and the SRO's both to leverage limited resources and to formulate new, marketwide rules on a variety of issues.

Also, NASAA invited Chairman Donaldson's Managing Executive for Policy and Staff to a number of our meetings and gave him the opportunity to address our membership on key topics of interest to both organizations. In addition, the NASAA Section Chairs meet regularly with corresponding SEC Division staff to discuss issues of common interest.

RESPONSE TO A WRITTEN QUESTION OF SENATOR MILLER FROM JOSEPH P. BORG

Q.1. I asked Chairman Donaldson in a hearing on the "State of the Securities Industry" what kind of working relationship he had with the State securities administrators and the State attorneys general on resolving the various enforcement issues that have arisen, and whether he thought there were any changes that might be needed to be made in the SEC's relationship with the States.

Let me quote Chairman Donaldson's response to me. He said

> That is an excellent question. It is one that we are very concerned about. Let me say this, that we need and encourage all the help we can get from local regulators in the securities industry at the local level where they can uncover and investigate things that go beneath our screen, so that if there is malfeasance or fraud or whatever at a local level, we welcome the local administrators, securities administrators, and so forth.
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> At another level, and that is the level of the structure of the markets themselves, we believe and I believe very strongly that we cannot have 50 different structural solutions, we cannot have 50 different ways, perspectives as they are put out, and trading rules and so forth, I believe that that has to be done by the Federal administrators.
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> Having said that, we need to and we have cooperated with local securities regulators, andjust 2 weeks ago in connection with the chairwoman of the National Regulators Trade Association, we agreed to enter into a joint arrangement with them to see if we could not improve the communication between what they are doing and improve the cooperation between what they are doing. I think that will go a long way.
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> I will say it again and in frank answer to what you said, there are areas where a local authority can step in too late to an investigation that is already under way and in so doing interrupt a carefully put-together investigation by a Federal functionary, and this is where I think we get into trouble, where there is considerable work that has been done, cases being built, and someone comes in from left field and does not really add anything and in fact might create an environment where the accused will get off because of a technicality.

I would like to ask each of you basically the same question.

What kind of working relationship does each of you have with the SEC on resolving the various enforcement issues that have arisen, and whether you thought there were any changes that might be needed to be made in the SEC's relationship with the States? And do you have any other comments on Chairman Donaldson's response to me?

A.1. I agree with Mr. Lambiase's comments and want to elaborate on the cooperative enforcement efforts between State securities regulators and the SEC. Even with the funding increase Congress allocated for it, the SEC cannot go it alone. The scope of the fraud and the other violations occurring in the financial marketplace today is unfortunately just too large for one regulator to handle. That is why there must be cooperation among State, Federal, and industry regulators. And NASAA is committed to that principle. As we move forward, NASAA will enhance its cooperative relationships and launch new projects to coordinate enforcement activities.

The advantages of having State as well as Federal enforcement of the securities laws are many. As noted above, the dual system simply brings more needed resources to bear. In addition, States have historically played an important role "an indispensable early warning system for fraud." Because of their proximity to local investors, State regulators often are the first to detect an emerging scam or pattern of violations. Also, in some cases, States may have jurisdiction over an investment or an activity while the SEC does not—and vice versa. Further, some violations are more local in nature and therefore more appropriately handled by the States. In addition, some State securities regulators can bring criminal prosecutions, which is especially important where the case is not sufficiently national in scope or even in national cases where agent activity is of such a local nature not to warrant involvement by the U.S. Attorney's office. For many reasons, therefore, investors benefit from having a dual system of State and Federal enforcement.

The benefits of this dual system are often seen when the States and the SEC work together *in the same case.* In my own State of Alabama, we have had an effective working relationship with our SEC Regional Office in Atlanta and the District Office in Miami, Florida. As an example, in April 2004, after extensive discussion and investigation by the SEC and Alabama Securities Commission (ASC), the ASC issued its Cease & Desist Orders against Heymen International and other parties for their involvement in a Ponzi scheme. The SEC simultaneously filed their injunctive action in the U.S. District Court, with both the SEC and Alabama Securities Commission lawyers appearing in court. The joint SEC/ASC press release acknowledged the investigative and cooperative efforts of the SEC, the State of Alabama Securities Commission, the FBI, and the IRS. Cooperative efforts such as these go back many years, including one ofthe first of the "cooking the books" accounting scandals within Comptronix, a publicly held company, in Guntersville, AL. That case was prosecuted in 1996 and resulted in felony convictions for corporate officers.

The working relationships between any State and any regional office of the SEC, or other regulators, is determined by a number of factors, including the type of case, the personal relationships

that have been developed over time between respective offices, and the relative interest in the case by Federal and State regulators. At certain times the focus of Federal regulators may be on areas other than a particular securities fraud, while at the State level there may be occasions where State securities regulators are inundated with other matters and therefore resources are stretched to the limit precluding extensive efforts in a specific case.

As others have observed, however, enforcement of the law should be distinguished from writing the rules. In Mr. Donaldson's response in September 2003, he stated that there cannot be "50 different structural solutions . . . cannot have 50 different ways . . . trading rules." And he is correct. State enforcement efforts target a specific fraud or rule violation that affects the bedrock of our economy—the investor. Enforcement actions and conduct remedies specifically target a particular set of circumstances where the law has *already been transeressed.* These responses to misconduct cannot be confused with the formulation of new rules and regulations that govern the national markets generally.

State regulators do work with national regulators on marketwide solutions when they are required, but they do not impose solutions. This is the pattern followed with penny stock fraud, microcap fraud, day trading, and other areas all of which were first "uncovered" by State securities regulators. The States investigate and bring enforcement actions. They do not engage in rulemaking for the national markets. The States comment regularly on proposed market rules and meet with various divisions of the SEC to share their experiences in the "laboratories" of the States and to discuss the implications of new rules and procedures. The final result of these discussions and commentaries is that the States have input into the SEC's determinations of what will finally emerge as rules for the national markets.

Finally, Chairman Donaldson mentioned concern that a local authority could "interrupt a carefully put together investigation by a Federal functionary." This, of course, works both ways, and in the instance referred to by the Chairman in his testimony, the participant in the Federal investigation was not a State securities regulator. Nevertheless, State and Federal regulators alike should be mindful ofthese concerns and should certainly try to assist, rather than hamper, each other. This is a main focus in our current NASAA/SEC meetings. It should be also be noted that Chairman Donaldson's September 2003 testimony on this point occurred prior to the joint initiative meetings between the SEC and State regulators, and since that time there has been extensive dialog and the lines of communication between the SEC and State regulators have opened up considerably.

These communications continue as SEC and NASAA representatives meet on a monthly basis. As I stated in my testimony, these meetings are productive, giving both regulators enhanced insight into each other's operations, needs, and concerns. The future of cooperation between the SEC and State securities regulators continues to be effective, and with additional refinements now in process, should become more efficient to the benefit of all investors.