

**Final Report:**

**2002 Conference on Federal-State  
Securities Regulation**

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## **I. Summary**

The United States Securities and Exchange Commission (the "SEC" or "Commission") and the North American Securities Administrators Association, Inc. ("NASAA") held their annual conference in Washington, D.C. on April 15, 2002. The 2002 meeting was the 18th annual conference held under Section 19(d) of the Securities Act of 1933.<sup>1</sup> That provision requires an annual conference to promote the following goals:

- maximizing uniformity in federal and state securities regulation;
- maximizing the effectiveness of such regulation;
- reducing the costs and paperwork of raising investment capital; and
- minimizing interference with capital formation.

The SEC and NASAA issued a joint release<sup>2</sup> before the meeting announcing the proposed agenda and seeking comments from interested members of the public concerning the proposed topics as well as other relevant matters.<sup>3</sup>

Approximately 228 representatives from the states and the SEC attended the 2002 meeting.<sup>4</sup> The participants divided into five working groups in the subject areas of corporation finance, investment management, market regulation, enforcement, and investor education and assistance to discuss matters of common interest. Part II of this report describes the discussions of each group. During the group meetings, the participants outlined current state and federal regulatory efforts and initiatives. They also identified areas where joint cooperation would be beneficial and discussed ideas and plans for more effective cooperation, coordination and communication.

## **II. Reports of the Working Groups**

### **A. Corporation Finance**

The working group made up of staff from the SEC's Division of Corporation Finance and state representatives discussed the following topics:

#### 1. Transactions Involving "Qualified Purchasers"

In the National Securities Markets Improvement Act of 1996 ("NSMIA"), Congress included as a "covered" security any security offered or sold to a "qualified purchaser." States are not permitted to require the registration and review of transactions involving covered securities. Congress left it to the Commission, however, to define the term "qualified purchaser." Congress instructed the Commission to consider that such persons should include "sophisticated investors, capable of protecting themselves in a manner that renders regulation by State authorities unnecessary."<sup>5</sup>

On December 19, 2001, the Commission approved a release proposing to define the term "qualified purchaser" under NSMIA by adding a definition of the term to Rule 146 under the Securities Act of 1933 (the "1933 Act").<sup>6</sup> As proposed, "qualified purchaser" would have the same meaning as the term "accredited investor" in Rule 501 of Regulation D.<sup>7</sup> In response to the rule proposal, the SEC received 23 comment letters. The comment period ended on February 25, 2002.

The SEC staff in the working group provided a general overview of the proposed definition and related issues concerning the treatment of Rule 504 offerings. The staff noted that they currently are considering the views expressed in the comment letters in determining what approach they should recommend to the Commission in the adopting phase.

State representatives reiterated several concerns raised in the comment letters they sent to the SEC. The first was that the Commission should consider raising the individual net worth test within the Rule 501 definition of "accredited investor." State representatives also expressed concern that the current Rule 501 definition does not exclude retirement plans and personal residences. They emphasized that individuals lacking financial sophistication might be deemed "qualified purchasers" by virtue of market appreciation in retirement portfolios and residential real estate. Some state representatives also supported excluding transactions by persons who would otherwise qualify as qualified purchasers if the transactions involve certain classes of securities that are excluded from the registration provisions of the 1933 Act.<sup>8</sup>

Participants agreed that under Section 18 of 1933 Act, issuers would continue to be required to file notices in accordance with the respective state laws.

#### 2. AMEX Proposal

Section 18(b) of the 1933 Act provides that securities listed or authorized for listing on the NYSE, AMEX, or Nasdaq National Market System are "covered" securities for purposes of NSMIA, and thus preempted from state regulation.<sup>9</sup> Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934, and Rule 19b-4 thereunder, AMEX

filed a proposed rule change that in part would provide new initial and continued listing standards for securities traded on the AMEX.<sup>10</sup> State representatives discussed the proposed rule change and its possible implication under Section 18(b). Participants acknowledged that the Division of Market Regulation should be consulted, given its oversight of rule changes by the stock exchanges.

### 3. Regulation A

Regulation A provides an exemption from the registration requirements of the 1933 Act for offerings up to \$5 million within a 12-month period. Securities issued in a Regulation A offering are freely tradable. In addition, an issuer may also “test the waters” to determine whether its offering will receive any interest from the investing public before incurring the full cost of undertaking an offering. Despite these benefits, participants noted that the Regulation A exemption appears to be underused. Commission staff discussed possible revisions of Regulation A for purposes of making the exemption more attractive to small businesses while maintaining investor protection; for example, possibly eliminating the “bad boy” provisions of Rule 262.<sup>11</sup> Another possibility included the elimination of Models A and B in Regulation A, and the exclusive use of the disclosure requirements in Part I of Form SB-2. The Commission staff also suggested increasing the offering level to \$20 million from \$5 million and requiring two years of certified financial statements. These offerings would not be subject to continuing reporting requirements.

The group discussed the need for a unified approach at the state and federal levels. One example cited was the different treatment of financial statements. Regulation A allows an issuer to include unaudited financial statements for the past two years in its offering circular; many states generally require three years of audited financial statements.

### 4. Form D

Regulation D provides limited offering exemptions from securities registration requirements at the federal and state levels. Issuers are required to file a Form D with the Commission within 15 days after the first sale in a Regulation D offering.<sup>12</sup> Issuers must also file the Form D in states that have adopted a form of the Uniform Limited Offering Exemption (“ULOE”) requiring a Form D filing.<sup>13</sup> Currently, paper copies of the Form D are filed with the Commission and some of the states. Given technological advances, participants indicated an interest in eliminating paper filings and replacing them with electronic submissions through the Commission’s EDGAR system.

Participants discussed the progress of a working group of Commission staff and NASAA members formed to explore methods of simplifying Form D and permitting it to be filed electronically. NASAA members pointed out that a consent to service of process provision similar to the Form ADV and BD should be included in the revised form. Participants also expressed concern that the prohibitions on general solicitation not be compromised due to the wide availability of filings through EDGAR.

The Commission staff noted a concern that the last working draft of the Uniform Securities Act of 2002 contained language indicating that states could only enforce Form D notice filing requirements that were in effect on September 1, 1996. It was noted that the draft provision appeared to be in conflict with the “substantially

similar” language of Section 18(b)(4)(D). Participants indicated a willingness to discuss these concerns with the Uniform Securities Act drafting committee.

## 5. Blank Check Companies

Under Commission Rule 419, a “blank check” company is defined as a development stage company with no specific business plan or purpose, or a company that indicates it plans to merge or acquire an unidentified company or companies. The Commission has adopted several rules to deter fraud in connection with offerings by blank check companies.<sup>14</sup> For example, blank check companies must deposit all proceeds into an escrow account until certain requirements are met, including the filing of a post-effective amendment once a business acquisition or assets for the blank check company have been located.<sup>15</sup>

Commission staff discussed a recent trend in registration filings by companies whose business plan is predicated on the outcome of a feasibility study. The feasibility studies are used to investigate the need or marketability of a particular service or product. Generally, these companies have no assets or experience in the particular business being considered. Commission staff indicated that the application of Rule 419 was being addressed in the comment process.

Participants discussed possible rule revisions aimed at improving the timeliness of certain disclosures made by blank check companies. Currently, blank check companies that have made a significant acquisition may take up to 75 days to file financial information on Form 8-K. Commission staff discussed the possibility of requiring blank check companies to file the Form 8-K within 15 days after making a significant acquisition.

Form S-8 is a registration statement used to offer securities to employees under an employee benefit plan. The registration statement becomes effective immediately upon its filing with the Commission. Blank check companies may use Form S-8. Participants discussed the possible abuses associated with these offerings, given that blank check companies generally have no operations and few if any employees. Commission staff indicated an interest in making the Form S-8 unavailable to blank check companies.

## 6. Operations and Processing

Commission staff noted an overall reduction in the number of registered securities offerings (both initial public offerings (“IPOs”) and secondary offerings). Because of this reduction, staff resources are being directed at reviewing the periodic filings of Fortune 500 companies. Small business offerings recently have accounted for two-thirds of all IPOs. Three issues relating to small business offerings were noted: (1) the validity of feasibility studies conducted by blank check companies; (2) the requirement to disclose in a pre-effective amendment that selling shareholders will sell at a fixed price where no public market exists and thereafter at prevailing market prices once the security has been listed; and (3) the implications under state law when issuers offer unauthorized shares.

As of October 1, 1998, issuers filing 1933 Act registration statements were required to comply with the Commission’s plain English requirements when drafting the front part of prospectuses included in registration statements, *i.e.*, the cover page and summary and risk factors sections.<sup>16</sup> It was noted that the Division of Corporation

Finance continues to review filings for compliance with the plain English requirements.

A representative from the Division's Office of the Chief Accountant discussed several accounting issues involving Financial Accounting Standards Board ("FASB") Statement Nos. 141 and 142. Under FASB Statement No. 141, all business combinations are to be accounted for using the purchase method. Under FASB Statement No. 142, intangible assets, such as goodwill, that are acquired individually or with a group of other assets (but not acquired in a business combination) should be accounted for in financial statements upon their acquisition. Disclosure releases FR-60 and FR-61 regarding critical accounting policies and enhanced MD&A were also discussed. The three basic goals underlying the releases are: (1) enhanced liquidity disclosure; (2) better transparency with respect to a company's financial instruments; and (3) enhanced disclosure for "related party" transactions.

Division staff briefed the group on two recent Commission releases intended to modernize and improve the corporate disclosure system. The first release accelerates the periodic report filing dates for domestic issuers and requires disclosure concerning website access to such reports.<sup>17</sup> Generally, quarterly reports on Form 10-Q would be due within 30 days instead of the current 45 days. Annual reports on Form 10-K would be due within 60 days instead of 90 days. Small business issuers and foreign issuers would be excluded from the new accelerated reporting requirements.

The second release proposes to require domestic companies registered under Section 12 of the Exchange Act to disclose information about transactions in equity and derivative securities of their companies in a Form 8-K filing.<sup>18</sup> The rule proposal covers arrangements for the purchase and sale of equity securities of a company for the purpose of satisfying the defense conditions of Exchange Act Rule 10b5-1(c), and also covers loans made or guaranteed by a company or its affiliates.

## 7. Uniform Securities Act

A committee of the National Conference of Commissioners on Uniform State Laws is in the process of drafting a new version of the Uniform Securities Act. The new version would modernize and update the law to reflect many changes including, for example, NSMIA, technology advances, and the internationalization of securities offerings and trading. The group discussed the status of this redrafting effort.

## **B. Investment Management**

The investment management working group included representatives from the states and the Commission's Division of Investment Management ("IM") and Office of Compliance Inspections and Examinations ("OCIE").

### 1. Current Issues and Rulemaking

The IM representatives outlined the provisions of a recently proposed rule that would require investment advisers doing business exclusively over the Internet to register as investment advisers with the SEC.<sup>19</sup> The group discussed the proposed rule and related regulatory costs for advisers who conduct Internet-based advisory services. State representatives will provide comments on the proposed rule. The working

group discussed ways to improve coordination and information sharing between federal and state authorities in the rulemaking process.

IM representatives discussed the Commission's pending work to update Rule 206(4)-2 under the Investment Advisers Act of 1940, the rule governing advisers who have custody of a client's securities.<sup>20</sup> State representatives reported that once the Commission's rulemaking in this area is completed, the states will consider making similar modifications to state custody rules. An IM representative outlined possible changes to adviser books and records requirements applicable to registered investment advisers (Rule 204-2). IM representatives also outlined the current status of rulemaking initiatives to address principal transactions by advisers and possible exemptions from the Advisers Act for thrift institutions in response to the Gramm-Leach-Bliley Act.<sup>21</sup> The participants held a brief discussion of changes in the regulation of Canadian retirement accounts.<sup>22</sup>

A state representative summarized progress on the NASAA Model State Rules, including changes in the areas of performance fees, solicitor registration and books and records requirements. State representatives led a discussion on the need for additional educational programs for state-registered advisers and whether continuing education requirements should be established for all investment advisers. A state representative reported that NASAA has set up a new committee to help state-registered advisers develop stronger compliance programs. Compliance workshops and online assistance also will be available. The Division and NASAA discussed ways to work together on investment adviser education issues.

## 2. Examination and Enforcement Issues

An OCIE representative reported on the SEC's annual examination program for advisers in Wyoming, the only state that has no state adviser regulation. The OCIE representative also noted that most states receive the SEC's examination information and provided some updated information on federal/state information arrangements. There was a brief discussion of the types of problems uncovered in the SEC's examination program. The OCIE representative reported that advisers generally have adopted and implemented procedures to comply with their Privacy Act obligations under Title V of the Gramm-Leach-Bliley Act.<sup>23</sup>

The group discussed trends in SEC enforcement actions involving investment advisers. An IM representative reported that false and misleading advertising is a major problem area and that violations have resulted in enforcement actions against investment advisers. Recently, the SEC brought cases against advisers who used false statistics to describe their performance records,<sup>24</sup> their client population,<sup>25</sup> and the ratings they received from independent third-party rating services.<sup>26</sup> Problems also have arisen with investment advisers who switch between federal and state registration.<sup>27</sup> This may complicate bringing legal charges in particular jurisdictions. There was a brief discussion of how to address jurisdictional conflicts that impact enforcement actions and adviser registration status.

## 3. Electronic Filing, IARD and Investment Adviser Public Disclosure

An IM representative reported that electronic filing on the Investment Adviser Registration Depository ("IARD") is going smoothly. As of March 31, 2002, 7556 investment advisers had registered with the SEC on IARD. During IARD's first year

of operation, over 6400 annual amendments were filed, approximately 11,000 other-than-annual amendments were filed, and over 290 full Form ADV-Ws were filed.

The Investment Adviser Public Disclosure ("IAPD") system is now operational and operating without significant problems. During the first quarter of 2002, IAPD had over 4000 visitors each week. Currently between two and three thousand people visit IARD each week.

An IM representative reported that amendments to Part 2 of Form ADV are still being considered. There was a brief discussion about state and SEC coordination on final proposed changes to Part 2.

### **C. Market Regulation**

State representatives and staff of the Commission's Division of Market Regulation and Office of Compliance Inspections and Examinations ("OCIE") discussed the following matters:

#### **1. Business Continuity Planning for Broker-Dealers**

The participants discussed business continuity planning for broker-dealers in light of the lessons learned from the events of September 11, 2001, including the challenges presented to communications, execution and clearance and settlement systems. The impacts of geographical constraints on trading facilities also were considered. The group also discussed possible self-regulatory organization actions meant to facilitate continuity of all aspects of securities trading in the event of similar occurrences.

#### **2. Shorter Settlement Cycles and Immobilization of Stock Certificates**

In 1993 the Commission issued a rule that required the securities industry to reduce the settlement time for securities transactions from five days to three days (T+3). The rule is meant to reduce settlement risk and increase efficiency. The participants discussed how these goals might further be served by a settlement requirement of T+1. The group considered various proposals meant to minimize the cost of implementing the necessary systems and operational improvements. These include new rules to discourage the issuance and use of physical certificates and encourage the issuance of securities in book-entry form only, and rules to prohibit broker-dealers from taking a sell order unless the shares are on deposit with the broker-dealer or a bank, or in the book-entry direct registration system operated by the Depository Trust Company. The participants also considered how such measures might relate to restrictions imposed by certain state laws and exchange listing standards.

#### **3. Possible Changes to NASD Rules Relating to Tape Recording of Communications**

The participants conferred regarding a proposal filed with the Commission by the NASD to amend its taping rule, NASD Rule 3010(b)(2), and NASD Interpretive Memorandum 8310-2.<sup>28</sup> The NASD proposal would, in part, permit firms that otherwise must tape record and review all telephone conversations between registered persons and existing or potential customers to avoid doing so by adjusting staffing levels, and by not counting certain short-term employees of disciplined firms toward the threshold levels that trigger the requirement. The proposal also would extend the duration of the taping requirements and permit, upon request, public disclosure of whether a

particular firm is subject to the taping rule. The members of the group discussed their experiences with the evaluation of such taping systems in compliance examinations, the general utility of the rule, and the potential impact of the proposed changes.

#### 4. Possible Revisions to Form BD

Under the Securities Exchange Act, broker-dealers apply for registration with the Commission by filing Form BD, the uniform application for broker-dealer registration. The state securities regulators also use this form. The form requires the applicant or registrant to provide certain information concerning its business and personnel in order to allow regulators to determine whether the applicant meets the statutory requirements to engage in the securities business. The conferees reviewed potential changes to Form BD in response to legislative developments, including the Gramm-Leach-Bliley Act of 1999 and the Commodity Futures Modernization Act of 2000. Other potential amendments to the form that were discussed included: (1) requiring owners of non-voting stock to disclose their identity; (2) requiring the disclosure of unregistered satellite offices and expanding the disclosure requirements for the same; and (3) requiring the disclosure of the SEC number of a registered entity if the entity does not have a Central Registration Depository number.

#### 5. Regulatory Regime for Certain Brokers

Commission staff and NASAA representatives discussed initiatives to develop a streamlined regulatory regime for persons who are classified as brokers because they earn transaction-based compensation to facilitate capital raising securities transactions, but who do not provide secondary market services or other services that traditional broker-dealers provide to investors. Different approaches to address this issue, such as possible acceleration of the current registration process, and the nature of substantive regulations that should apply to these brokers, were discussed.

#### 6. Examination Issues

State and federal regulators also discussed various examination-related issues of mutual interest, including: examination priorities, examination summits and coordination, branch office examinations, complaint trends, and anti-money laundering compliance.

### **D. Enforcement**

The enforcement working group addressed a range of topics during its session. Over 50 enforcement officials, including representatives from a significant number of states, and Canadian provinces, the SEC's Division of Enforcement and each of the 11 SEC regional/district offices, attended the meeting. Also attending were senior enforcement staff from NASD-Regulation, Nasdaq, the NYSE, the U.S. Department of Justice (DOJ), the Federal Trade Commission (FTC), and the Commodity Futures Trading Commission (CFTC). The session was co-moderated by the SEC's Director of Regional Operations and the head of NASAA's Enforcement Section.

#### 1. SEC Trends and Priorities

The Director of the Division of Enforcement opened with a discussion of several of the SEC's current areas of enforcement concern, beginning with the continuing

increase in financial and accounting fraud uncovered in the context of financial reporting failures and large restatements of earnings. This area has clearly become the top enforcement priority for the Commission. Several major enforcement actions filed by the SEC that involved these issues were described.

The senior SEC enforcement staff also discussed several of the Chairman's enforcement "themes," including real time enforcement, credit for cooperation and harsher sanctions for recidivists and for those who try to obstruct the SEC's investigations.

In light of the significant number of complaints being received from the SEC's Enforcement Complaint Center on the Commission's website, the SEC's Enforcement Director indicated that the Enforcement Division would be looking to make more referrals to the state securities commissions and to securities industry self-regulatory organizations. The representatives of the various regulators in attendance discussed how these referrals could be most effectively allocated and which ones they were interested in receiving.

The impact of the recent market downturn and market volatility on the mix of frauds confronting the SEC was mentioned. Of particular note are the changes now being seen in the sales tactics of the people committing securities fraud. Instead of pushing the prospects of the latest Internet or high tech company, some malefactors are currently playing on investors' concerns with the unsettled state of the established equity markets and with rapidly dropping interest rates on the more legitimate fixed income instruments. The focus of the sales pitch is on the stable, safe and high quality of the investments being sold. Unfortunately, the actual investments are anything but safe and frequently involve very risky and speculative ventures. The elderly are often the targets of these frauds.

The Regional Director of the SEC's Northeast Regional Office provided an update on the NERO's operations since September 11, 2001.

The SEC enforcement staff emphasized the continuing importance of developing better relationships with local and federal criminal prosecutors. In a growing number of instances, available civil remedies do not stop some of the people behind today's frauds. Criminal prosecution and resulting jail time does. The SEC's Enforcement Director observed that the SEC has worked, over the past few years, with a substantial number of U.S. Attorney's offices nationwide on criminal securities cases. The development of good relationships among the SEC and both federal and local criminal prosecutors is a major priority of the Commission's current Chairman.

In closing, the SEC senior enforcement staff, including the field office heads, emphasized the importance of continuing to coordinate and leverage the resources and remedial powers of the respective agencies represented at the meeting.

## 2. State Trends and Priorities

The Chair of NASAA's Enforcement Section (the Securities Commissioner from Indiana) and certain other state securities commissioners described the major trends and priorities of state securities law enforcement. They emphasized the importance of the states acting on a coordinated, multi-state basis, where appropriate, to enhance their message that state regulation of the securities laws is a critical and necessary complement to federal regulation.

The states continue to uncover sales practice abuses in a number of broker-dealer firms that promote and sell low-priced securities. The state representatives reported similar problems with networks of "independent contractors." Frauds involving foreign currencies, promissory notes, CD brokers, prime bank notes, variable annuities, coin-operated telephone leaseback investments and viatical settlements were highlighted as continuing concerns of state securities commissions.

They also noted the growing use of unlicensed/unregistered individuals, particularly independent insurance agents, to lure people into buying these investments. According to the state regulators, an increasing number of these agents, drawn by the high commissions, are relying solely on marketing claims provided to them by the promoters of the scams that are either misleading or false. In fact, the states indicated that the presence of unregistered insurance agents in the sales of these types of scams had become a major problem for them. These agents use the relationships and trust developed in the context of insurance sales to get their foot in the door to sell high-risk investments to their clients.

As was the case with the SEC, the state securities commissioners are finding that senior citizens are popular targets of today's fraudulent promoters and that the sales pitches are also emphasizing the safety and high returns of the products being sold—again playing on investors' concerns with the current volatility of the equity markets.

The state representatives also listed affinity group fraud, where a scammer uses a common religion or ethnicity to gain the victims' trust, as a continuing problem for them.

### 3. NASD Regulation, Nasdaq and NYSE Trends and Priorities

Enforcement officials from three self-regulatory organizations, NASD Regulation, Nasdaq and the NYSE, described several areas of concern and discussed various initiatives aimed at alleviating those concerns. Many of their concerns overlapped those raised by the SEC and the state securities commissioners. The concerns included sales practice and trading abuses, online trading, microcap fraud, market integrity issues, market manipulation and other issues generated by advances in technology. They discussed the impact of the market downturn and market volatility on their respective enforcement programs. They all touched on the impact of the events of September 11, 2001 and the need for adequate contingency plans and back-up systems for the markets and their participants.

The NASD Regulation staff discussed a number of recent notices to NASD members, and certain specific enforcement cases brought by their organization. They also highlighted the increasing instances of registered representatives "selling away" from their firms, the apparent shift of investors away from the Internet and back to broker-dealers and the re-emergence of "boiler room" activities. Among the regulatory initiatives discussed were research analyst rules recently published for comment. The Nasdaq representative described enforcement initiatives regarding Nasdaq National Market System listings. The work of the unit in charge of enforcing the listing requirements of the Nasdaq market, and of monitoring various potential indicators of fraudulent activity in that market, was highlighted.

NYSE officials described several market surveillance and enforcement initiatives, including a number of specific cases brought by the exchange over the past year. They stressed their continuing focus in both the exchange's enforcement and inspection programs on the existence of adequate internal controls, operational capacity of online firms and supervisory procedures within member firms. They indicated that a growing percentage of their caseload involved failures to supervise. Unauthorized postings on the Internet by registered representatives of messages hyping particular stocks were highlighted as an emerging concern. They also mentioned the ongoing problems associated with the delayed allocation of trades to particular accounts, running the risk of distributing more profitable trades to preferred customers.

#### 4. Department of Justice ("DOJ") and U.S. Attorney's Offices Securities Fraud Programs

The DOJ representative touched on what the Department and various U.S. Attorney's Offices around the country look for in potential criminal cases referred to them by civil agencies and by the securities self-regulatory organizations. He also indicated that he believed the Justice Department would continue to place a high priority on securities fraud cases and other forms of white-collar crime. Included among the specific types of cases of interest to federal criminal prosecutors are financial reporting and accounting fraud cases. He also encouraged local and federal regulators to contact criminal prosecutors early in their investigations where there may be a need for criminal action as well as a civil or administrative proceeding.

All participants agreed that more regular meetings at both the national and local level between criminal and civil enforcement agencies would be helpful. Such meetings could facilitate the exchange of information, the development of joint or coordinated projects and the clarification of referral procedures.

#### 5. FTC Enforcement Initiatives

The FTC representative focused his presentation on various consumer protection initiatives, including certain projects designed to better monitor the Internet for a range of consumer frauds. He encouraged the other regulators to consider participating in FTC Internet "surf days" and enforcement sweeps. He provided an update on the Consumer Sentinel database and the information accessible from it, and urged the agencies present to become users of the database.

#### 6. CFTC Enforcement Program

The Enforcement Division Director of the Commodity Futures Trading Commission ("CFTC") and his deputy made a presentation on the organization of the CFTC's Enforcement Division and on the principal priorities of that unit. Of particular interest were the initiatives of the enforcement staff directed at various foreign currency exchange or "FOREX" scams. They cited examples of past and potential cooperation with other agencies, sharing of information, conducting parallel investigations and filing complementary enforcement actions.

### **E. Investor Education and Assistance**

More than 27 individuals attended the investor education working group session, including representatives from 7 Canadian provinces, 14 U.S. states, the District of

Columbia, Puerto Rico, NASAA's Corporate Office, the SEC's Office of Investor Education and Assistance, and the SEC's Philadelphia District Office. The working group discussed the following items:

### 1. Facts on Saving and Investing Campaign

In the spring of 1998, NASAA and the SEC, in conjunction with the Council of Securities Regulators of the Americas (COSRA), launched the Facts on Saving and Investing Campaign. The campaign is an ongoing, grassroots effort to educate individuals about saving, investing, and avoiding financial fraud. Over the past several years, members of NASAA have taken the lead in developing and implementing new campaign initiatives.

The 2002 campaign was held during the month of April to give regulators in the U.S. and Canada maximum flexibility in planning events. During the working group session, members of NASAA described the programs they promoted during the 2002 campaign and shared ideas for new programs. Campaign highlights included an April 9, 2002 presidential announcement commending campaign participants and recognizing the importance of increasing the financial literacy of all Americans. In addition, on April 22, 2002, NASAA and the Securities Industry Association jointly released a new brochure entitled "Understanding Your Brokerage Account Statements." The brochure explains the information that typically appears on monthly or quarterly account statements, providing illustrative examples from typical brokerage statements.

The Canadian Securities Administrators (CSA) reported on the ways in which they had increased their involvement in the campaign this year. For example, the CSA developed a full-page advertisement for *Reader's Digest* magazine, issued a series of press releases that garnered extensive media coverage, and worked with the Canadian Broadcasting Corporation to produce a television segment for Street Cents, a non-commercial consumer advocacy program aimed at young teenagers. The CSA also collaborated with the Scouts Canada program to create—and develop the criteria for awarding—a "proficiency crest" (an award similar to a merit badge) in investing.

### 2. Investor Summit

The Director of the SEC's Office of Investor Education and Assistance discussed plans for the SEC's first-ever Investor Summit on May 10, 2002, in Washington, DC, including proposed topics and panelists. She explained that the summit was to be open to the public and audio-cast over the Internet from a link on the SEC's website, and that the summit represented an attempt to give investors nationwide an opportunity to weigh in on the broad policy issues that affect them, including ways to improve corporate disclosure. Panelists were to include Joseph P. Borg, the 2002 President of NASAA and Director of the Alabama Securities Commission.

### 3. Financial Literacy 2010

In the spring of 1998, NASAA, the NASD and the Investor Protection Trust (IPT) joined forces to launch Financial Literacy 2001, an unprecedented \$1 million campaign targeting 25,000 high school teachers across America. Recently renamed Financial Literacy 2010 to reflect an ongoing commitment to offer the program for teachers in the future, the program aims to encourage—and make it easier for—

teachers in every state to teach the basics of saving and investing. Working together, NASAA, the NASD, and the IPT have developed and updated a state-by-state customized classroom guide and have provided aggressive distribution and teacher training.

The Chair of NASAA's Investor Education Section (who also chairs the FL 2010 project group) briefed the working group on the status of FL 2010. She reported that the revised teachers' guide, which includes a new chapter aimed at high school economics teachers, has now been translated into Spanish. She further noted that the IPT's "train-the-trainers" program continues to thrive.

Participants in the working group discussed their efforts to promote FL 2010 in their respective jurisdictions and the challenges involved. In the coming months, NASAA and the IPT plan to continue conducting teacher-training workshops nationwide to expose more teachers to the curriculum.

#### 4. Online Investor Protection

The Chair of NASAA's Investor Education Section briefly discussed recent developments in online investor protection following the December 1999 launch of the Investing Online Resource Center (IORC). Although the Securities Division of the Washington State Division of Financial Institutions originally created the IORC, NASAA adopted the IORC as one of its official projects in January 2001.

In August 2001, NASAA re-launched the IORC. The new site features an interactive simulation that guides the user through the process of setting up an account and trading online, educational materials, investor alerts, and online trading in the news. The site continues to offer a self-assessment tool to help investors determine whether to consider trading online. It also provides links to helpful resources, including state regulators, the NASD and the SEC. In the year ahead, NASAA plans to develop a version of the IORC that is tailored to the needs of Canadian investors.

The Director of the SEC's Office of Investor Education and Assistance briefed NASAA and the working group participants on its initiative to educate the public about bogus online investment opportunities. In January 2002, the SEC launched its first fake "scam" website—<http://www.McWhortle.com>—to warn investors about fraud *before* they lose their money. McWhortle Enterprises Inc. purports to be "an established and well-known manufacturer" with a revolutionary product it plans to produce with the money it raises through an IPO. But the company doesn't exist, and anyone who tries to "invest now" is greeted with an educational message that warns, "Watch out! If you responded to an investment idea like this, you could get scammed." The educational message provides detailed tips for avoiding online frauds and features links to helpful resources, including NASAA's website.

Within weeks of its launch, the site got more than 1.5 million hits, and the SEC received more than 500 emails, nearly all of which were positive. Securities regulators in several states have linked to the McWhortle website, and the site has been featured in numerous online bulletin boards and chat rooms. The SEC described two additional fake scam websites that have been successfully launched, and it discussed its plans to create other similar sites in the months ahead.

## 5. New Investor Education Programs

Participants in the working group session discussed recent investor education initiatives in their respective jurisdictions, including programs and workshops designed to reach underserved populations such as rural communities, minority groups, elementary and high school students, and the elderly. Several jurisdictions discussed their efforts to launch either public service or paid advertising campaigns to heighten the general public's awareness of the services that state securities regulators provide. These efforts have included radio announcements and movie theater "billboard" screening ads.

Many working group participants emphasized the need to avoid reinventing the wheel when exploring new ways to educate investors. To that end, the Chair of NASAA's Investor Education Section and a member of NASAA's Investor Education Coordination Project Group reported that NASAA's *Investor Education Resource Guide* had been completely updated and revised. The new Guide—a comprehensive list of educational publications, brochures, and other resources organized by both subject matter and jurisdiction—will be distributed to members of NASAA and posted on the members' section of NASAA's website. The Chair of NASAA's Investor Education Section also reported that NASAA's Investor Education Training Conference would occur from Thursday to Sunday, November 14 to 17, 2002, in Minneapolis, Minnesota.

The Chair of NASAA's Investor Education Section encouraged participants in the working group to consider public/private partnerships, noting that such alliances will become increasingly important as investor education initiatives move to the next level. Along that vein, several jurisdictions reported that they have partnered with active or retired members of the financial services industry to maximize resources. Others noted their success in partnering with consumer-focused organizations, such as AARP and the USDA's Cooperative Extension Service. In addition, several participants in the working group discussed the potential for working with faith-based organizations on a grass-roots level to improve financial literacy levels in their communities.

## 6. Investor Education Resources

Participants in the working group session discussed existing resources for investor education—including brochures, videotapes, pre-packaged seminars, posters, online resources, and materials that have been translated into Spanish and French—and identified gaps. Several jurisdictions also shared their experiences with identifying and obtaining monetary resources to fund their programs. While some jurisdictions receive funding from enforcement penalties or department surpluses, others must rely on grants, private sector sponsorship, or other sources.

### **III. Conference Participants**

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Arthur Laby  
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Netta Williams  
Twanna Young

#### **Corporation Finance Working Group**

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##### **SEC**

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### **Investment Management Working Group**

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### **Market Regulation Working Group**

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Joshua Kans  
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Maria D'Alessandro Piccirilli  
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Frank Fitzgerald  
Alice Ann Gaultney  
Peter Jamison  
Michael Johnson  
Adam Levi  
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Joseph Meyer  
Charles Moore  
James Nelson  
Matthew Nestor  
Douglas Ommen  
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Stephen Perry  
James Ropp  
W. Mark Sendrow  
Gail Sheppick  
Bradley Skolnik  
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Juan Manuel Ugarte Chavez  
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David P. Nelson  
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Roger Sherman, NASDR  
Gary N. Sundick, Nasdaq

**Others**

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Stephen Gurwitz, Federal Trade Commission  
Eileen Harrington, Federal Trade Commission  
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**Investor Education and Assistance Working Group**

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***SEC***

Susan Ferris Wyderko  
Gerri Walsh

**Commenters**

Michael C. Herndon  
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## IV. Endnotes

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<sup>1</sup> Formerly Section 19(c) of the Act. The provision was renumbered by section 108 of the Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (July 30, 2002).

<sup>2</sup> Release No. 33-8072 (March 21, 2002) [66 FR 14746].

<sup>3</sup> Comment letters are available for public viewing in File No. S7-04-02 in the Commission's Public Reference Room at 450 5<sup>th</sup> St., N.W., Washington, D.C. 20549, and on its website at [www.sec.gov](http://www.sec.gov).

<sup>4</sup> Conference participants are listed in Part III of this report.

<sup>5</sup> H.R. Rep. No. 622, 104<sup>th</sup> Cong., 2d Sess. 31 (1996). See also S. Rep. No. 293, 104<sup>th</sup> Cong. 2d Sess. 15 (1996).

<sup>6</sup> Release No. 33-8041 (December 19, 2001) [66 FR 66839].

<sup>7</sup> 17 CFR 230.501.

<sup>8</sup> Such as securities exempted by Sections 3(a)(4), (10), and (11) of the 1933 Act.

<sup>9</sup> 15 U.S.C. 77r(b)(1)(A).

<sup>10</sup> Exchange Act Release No. 45451 (February 14, 2002) [67 FR 8326].

<sup>11</sup> 17 CFR 230.262.

<sup>12</sup> 17 CFR 230.503.

<sup>13</sup> The ULOE provides a uniform exemption from state registration for offerings complying with Regulation D.

<sup>14</sup> 17 CFR 230.419, 240.15g-8.

<sup>15</sup> 17 CFR 230.419(b)(2)(i), 230.419(e).

<sup>16</sup> See Release No. 33-7497 (January 28, 1998) [63 FR 6370].

<sup>17</sup> See Release No. 33-8089 (April 12, 2002) [67 FR 19895].

<sup>18</sup> See Release No. 33-8090 (April 12, 2002) [67 FR 19914].

<sup>19</sup> See Investment Adviser Act Release No. 2028 (April 12, 2002) [67 FR 19499].

<sup>20</sup> See (May 13, 2002) [67 FR 34227] for a list of Commission rulemaking initiatives.

<sup>21</sup> 15 U.S.C. 6801.

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<sup>22</sup> Investment Company Act Release No. 24491 (June 7, 2000) [65 FR 37671] (rules adopted that permit foreign securities to be sold to certain Canadian retirement accounts without registration under the federal securities laws).

<sup>23</sup> 15 U.S.C. 6801.

<sup>24</sup> *In the Matter of Merrimac Advisors Company and Fredrick J. French*, Investment Advisers Act Release Nos. 2009 (January 4, 2002) and 1977 (September 27, 2001).

<sup>25</sup> *In the Matter of Tiffany Capital Advisors, Inc. and Curtis Townsend*, Investment Advisers Act Release No. 1988 (October 3, 2001).

<sup>26</sup> *In the Matter of F.X.C. Investors Corp and Francis X. Curzio*, Investment Advisers Act Release No. 1991 (October 18, 2001).

<sup>27</sup> *In the Matter of Stan D. Kiefer & Associates and Stanley D. Keifer*, Investment Advisers Act Release No. 2023 (March 22, 2002).

<sup>28</sup> SR-NASD-2002-04.