# Testimony of Rick Fleming

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**North American Securities Administrators Association, Inc.**

**Before the**

**Senate Committee on Banking, Housing and Urban Affairs**

**Securities, Insurance, and Investment Subcommittee**

**"The JOBS Act at a Year and a Half: Assessing Progress and Unmet Opportunities"**

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## Introduction

Good morning Chairman Tester, Ranking Member Johanns, and members of the Subcommittee. I am Rick Fleming, Deputy General Counsel for the North American Securities Administrators Association, Inc. ("NASAA"),[1] the association of state and provincial securities regulators. One of my roles at NASAA is to coordinate the activities of the NASAA Corporation Finance Section Committee. Prior to joining NASAA in 2011, I served as General Counsel for the Office of the Kansas Securities Commissioner. In that role, I frequently represented the state in disciplinary and enforcement cases, including criminal prosecutions and related appeals.

I am honored to testify before this Subcommittee about the Jumpstart Our Business Startups Act, or JOBS Act, a year and a half after its enactment.

Securities regulation is a complementary regime of both state and federal securities laws. NASAA has had a long history of working closely with the Securities and Exchange Commission (SEC) to affect greater uniformity in Federal-State securities matters, including meeting annually as required by section 19(d) of the Securities Act of 1933. The states also work closely together to uncover and prosecute securities law violators.

State securities regulators have protected Main Street investors for the past 100 years, longer than any other securities regulator. They are responsible for enforcing state securities laws by pursuing cases of suspected investment fraud, conducting investigations of unlawful conduct, licensing firms and investment professionals, registering certain securities offerings, examining broker-dealers and investment advisers, and providing investor education programs and materials to your constituents.

States are also the undisputed leaders in criminal prosecutions of securities violators. In 2012 alone, state securities regulators conducted nearly 6,000 investigations, leading to nearly 2,500 enforcement actions, including 339 criminal actions. Moreover, in 2012, 4,300 licenses of brokers and investment advisers were withdrawn, denied, revoked, suspended, or conditioned due to state action, up 27 percent from the previous year.

State securities regulators continue to focus on protecting retail investors, especially those who lack the expertise, experience, and resources to protect their own interests. In addition to serving as the "cops on the beat" and the first line of defense against fraud for "mom and pop" investors, state securities regulators serve as the primary regulators of most small size offerings. As such, state securities regulators regularly work with and assist small and local businesses seeking investment capital.

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

NASAA shares Congress' desire to improve the United States economy by, in part, spurring private investment in small business. However, we believe this goal is best achieved through restoring investor confidence, and it is our hope that the JOBS Act will be implemented with a balanced approach that reflects smarter regulation.

My testimony today will provide an overview of the current status of NASAA's work in designing a new multi-state review process for offerings conducted under Title IV of the JOBS Act, including a one-stop, filing process for "Regulation A+". I will also present NASAA's views on Title II of the JOBS Act, which lifted the long-standing ban on general solicitation, and summarize the most important of our recommendations to the SEC in association with the rulemakings under this title. Finally, my testimony will consider Title III's crowdfunding provisions and NASAA's views of the SEC's proposed rules. Although preempted from regulating crowdfunding offerings, the states have been committed to working with the SEC and the Financial Industry Regulatory Authority (FINRA) to develop a responsible regulatory framework for implementation of the Act.

My testimony will conclude with a discussion of sensible efforts to improve the ability of small businesses to obtain capital, along with a brief discussion of further deregulatory legislation in the House that is referred to as "JOBS Act 2.0." NASAA's view is that the JOBS Act imposed changes to the securities laws that were neither simple nor straightforward, and which required the SEC to grapple with very complex issues in its rulemaking. We would encourage Congress to observe and evaluate the full impact of the JOBS Act before proposing further legislation purportedly designed to spur economic growth.

## Title IV: Regulation A+

When a company wants to raise capital by selling securities, the company must first register those securities with the government unless the securities are sold in a way that qualifies for an exemption from the registration process. Title IV of the JOBS Act requires the SEC to adopt a rule to provide an exemption for certain offerings up to $50 million.

Because of its similarity to the current exemption under Regulation A, which is capped at only $5 million, this new exemption is commonly referred to as Regulation A+. These offerings will be exempt from SEC registration under the new Section 3(b)(2) of the Securities Act of 1933, but they will be subject to registration at the state level unless the securities are listed on a national securities exchange or sold to a qualified purchaser as defined by the SEC.

Given the inherently risky nature of these offerings, and the primacy of the states' role in policing small size offerings, NASAA believes state oversight is critically important for investor protection and responsible capital formation. However, we also recognize that in some instances this process can be costly and particularly burdensome upon small companies.

When a company applies for registration of securities at the state level, the company must ensure that the terms of the offering and the content of the disclosure document satisfy the legal requirements that apply to that particular type of offering. These legal requirements are found in state law but are usually derived from NASAA Statements of Policy that are approved by a majority of the NASAA members. A typical equity offering would be subject to a general set of rules, including things like limitations on underwriting expenses and a requirement to specify the anticipated use of proceeds.[2] More specialized securities, such as church bonds, oil and gas interests, and real estate investment trusts (REITs), are subject to specific rules for those types of offerings. All states conduct a "disclosure" review to ensure that all material risks are disclosed to investors, and some states conduct a further "merit" review of the offering to prevent offerings that are inherently unfair to investors. If an application for registration does not satisfy all of the legal standards applicable to that type of offering, the state securities regulator will issue a deficiency letter and communicate with the company until the deficiencies are resolved.

On behalf of NASAA President and Ohio Securities Commissioner Andrea Seidt, I want to assure this subcommittee that one of NASAA's priorities is the creation of an efficient filing and review process for multi-state securities offerings, including but not limited to, Regulation A+. In fact, in her inaugural speech to NASAA's membership earlier this month, President Seidt outlined her goal for this type of system as follows:

> The corporation finance world needs the equivalent of a CRD/IARD system for multi-state offerings. My vision is for there to be a one-stop, automated filing system for every type of corporation finance offering filed in multiple states. A system that has NASAA guidelines, forms, and core state requirements embedded in its design, a system in which all regulatory and industry users can track the filing status of an offering in all states in real time.[3]

For now, NASAA is focused particularly on Regulation A+ and is actively engaged in the design of a new multi-state review process for those offerings. As currently contemplated, one state would be designated the lead "disclosure" state and another would be designated the lead "merit" state, and those two states would coordinate the multi-state review of the offering to minimize the possibility of duplicative or inconsistent comments from multiple states. Of course, this means that the states would have to agree to a set of uniform standards that would apply to the particular type of offering. We are also working on a multi-state electronic filing platform that will allow one-stop filing with automatic distribution to all states, and we intend to build out that system to accommodate Regulation A+ filings.

In designing the system and developing a uniform set of standards, NASAA has consulted with a task force of the American Bar Association (ABA) to determine whether existing standards could be applied in the context of offerings under Regulation A+. The task force expressed concern about certain existing NASAA guidelines that are difficult for start-ups to satisfy, including the required amount of promoters' equity investment and the limitation on using investor funds to repay loans from officers of the company. In response to these concerns,

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[2] For a full list of NASAA Statements of Policy, see http://www.nasaa.org/regulatory-activity/statements-of-policy/.

[3] Andrea L. Seidt, President, North American Securities Administrators Association, Inc., 2013 Presidential Speech, NASAA 96th Annual Conference, Salt Lake City, Utah (Oct. 8, 2013), available at http://www.nasaa.org/26900/2013-presidential-address-andrea-seidt-ohio-securities-commissioner/.

a NASAA project group has proposed a review process that lowers some of our long-standing guidelines.

The proposed multi-state review program was submitted to NASAA members for "internal" comment, and the comment period expired on September 30, 2013. In addition, the members of NASAA engaged in a face-to-face discussion of this proposal at our annual meeting in Salt Lake City on October 6, 2013. From the comments and discussion, the NASAA membership appears willing to embrace this new review system.

*I am pleased to report that the NASAA Board of Directors met two days ago and approved the distribution of the proposal for public comment*.

NASAA is also communicating with the SEC in an effort to ensure that the requirements the Commission adopts for the federal exemption are consistent with the requirements we adopt for the state-level review of these offerings. As we continue to move forward in this process, we intend to keep Chairman Tester and the Subcommittee apprised of our progress.

It remains to be seen whether Regulation A+ will be used with any greater frequency than the existing Regulation A, especially considering the new alternative of crowdfunding and the use of general advertising under Rule 506.[4] For NASAA's part, however, state securities regulators are committed to helping Regulation A+ achieve its fullest potential. NASAA realizes that the increase in the cap from $5 million to $50 million will mean that the offerings are more broadly disbursed and that uniformity and efficiency are critical. NASAA also understands that investor protections must be maintained so that investors have confidence to enter this new marketplace. By working with the ABA and other interested parties, NASAA is attempting to strike the best possible balance so that Regulation A+ will be an attractive option for both the small business that needs capital and the investor who is asked to provide it. If we are successful in striking such a balance, we believe that shrewd investors and securities professionals will soon see that state review of these offerings generally yields safer opportunities than are available in the "Wild West" of Rule 506, and small businesses will find that smart, efficient, twenty-first century regulation can be beneficial for their capital formation efforts.

## **Title II: General Solicitation**

Even though securities sold in compliance with Rule 506 are "covered securities," which results in preemption of state-level registration requirements, the states retain antifraud jurisdiction and, for all practical purposes, are responsible for policing this market. As the regulators closest to small investors throughout the United States, state securities regulators frequently receive complaints from those who are victimized in offerings conducted under Rule

[4] Title IV of the JOBS Act called for a GAO study to determine the reasons that Regulation A is underutilized. The study concluded that a variety of factors have influenced the use of Regulation A, including the time and cost of the SEC review process and the attractiveness of other available exemptions. To be sure, state regulation was identified as one of the factors that led issuers to avoid Regulation A, but it was not the only factor and its importance could be greatly diminished if the states adopt uniform review standards and an efficient multi-state review system.

506, and private placements are commonly listed on NASAA's annual list of top investor traps.[5] In 2011 and 2012, NASAA members recorded 340 enforcement actions involving Rule 506 offerings,[6] making Rule 506 offerings the most common product or scheme leading to enforcement actions by state securities regulators during that period. As a result, the states have a very large stake in the SEC's rulemaking in this area.

In addition to protecting Main Street investors through enforcement actions, state regulators educate Main Street businesses about alternatives for raising capital under state and federal law, including Rule 506. States want to see those businesses succeed in their capital raising efforts so they can thrive and create jobs in our local communities. No NASAA member is interested in creating excessive or inefficient rules, but states have learned that efforts to spur successful capital formation must reflect a balanced regulatory approach that minimizes unnecessary costs and burdens on small businesses while protecting investors from fraud and abuse. Without adequate investor protections to safeguard the integrity of the private placement marketplace, investors may flee from the market, depriving small businesses of an important source of capital.

The recent lifting of the ban on general solicitation in Rule 506 will have an enormous impact on the securities markets in the United States. While some of this impact will be positive, NASAA members can anticipate that a greater number of investors will be defrauded, sold unsuitable investment products, or otherwise victimized in offerings conducted under Rule 506. NASAA believes that it is imperative for the SEC to adopt reasonable rules to protect investors in this market and that improvements to Rule 506 will facilitate the investor trust that is necessary to promote the capital formation goals embodied in the JOBS Act.

NASAA believes that modest changes can be made to Rule 506 and Form D that will enhance the ability of the Commission and NASAA members to protect investors while minimizing the burdens to the small businesses who utilize the rule to raise capital. These changes need to be adopted quickly, before unmonitored general solicitations begin to erode investor confidence in private placements and make it harder for businesses to find investors who are willing to enter this marketplace.

NASAA supported the adoption of the final rules prohibiting bad actors from using Rule 506 and requiring verification of accredited investor status. In general, we also support the proposed rules that would require the filing of Form D prior to advertising and make several improvements to the Form. However, we have suggested modest changes to the proposed rules that we believe will yield important protections for investors at the lowest possible cost to issuers, and we have pointed out places where we believe the proposed rules could be scaled back to save costs without unduly harming investors. It is our hope that our balanced approach

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[5] See *Laws Provide Con Artists with Personal Economic Growth Plan: NASAA Identifies Emerging and Persistent Investor Threats* (August 21, 2012), available at http://www.nasaa.org/14679/laws-provide-con-artists-with-personal-economic-growth-plan/.

[6] The enforcement statistics published by the SEC do not specifically identify the number of enforcement actions involving private placements. However, under the broader category of actions involving "Securities Offerings," which presumably includes private placement offerings, the Commission reports that it took a total of 213 enforcement actions in 2011 and 2012. See http://www.sec.gov/news/newsroom/images/enfstats.pdf.

will help the Commissioners reach consensus on these issues so that the final rules will be adopted as rapidly as possible.

### i. Advance Filing of Form D

From the perspective of state securities regulators, the most important item in the proposed rules is the requirement to file a Form D prior to the use of general solicitation. As part of NASAA's investor education efforts, state regulators implore investors to "investigate before you invest," and encourage investors to contact the securities regulators in their states if they have questions about an offering. Frequently asked questions include whether the offering is registered or exempt, whether there have been any complaints against the issuer or placement agents, and whether the issuer, control persons, or placement agents have any regulatory history. With the Commission's recent lifting of the ban on general solicitation, states anticipate a substantial increase in the number of investors who will want this type of information as part of their due diligence. However, without a requirement that the Form D be filed prior to the use of general solicitation, there is no way for state securities regulators to respond to these basic questions.

In addition, the lack of a pre-solicitation filing makes it impossible for state enforcement personnel to easily determine whether an offering is being conducted in accordance with the securities laws. Under the current rules, Form D need not be filed until 15 days after the first *sale*, so an issuer can advertise for investors without filing the form. An investigator who sees an advertised offering will not be able to check the Commission's records to quickly determine whether the issuer is attempting to engage in a compliant Rule 506(c) offering or is merely advertising an unregistered, non-exempt public offering with no intention of complying with any legal requirements. Regulators may have no alternative except to contact issuers – with subpoenas, if necessary – to determine whether their offerings are being conducted in compliance with Rule 506(c). This will increase the number of investigative inquiries directed to legitimate issuers and lengthen the process for stopping illegitimate offerings. Ultimately, investors will be put at greater risk because it will be more difficult for regulators to prevent or stop investor losses.

The proposed rule would require the filing of the Form D at least 15 days before the issuer engages in general solicitation. For NASAA's purposes, it would be sufficient to simply require the filing at any time prior to the use of general advertising. The critical issue is that the Form D should be publicly accessible before an issuer begins to publicly solicit investors.

### ii. Consequences for failure to file

For far too long, the Commission has failed to address a glaring problem in Rule 506 offerings. As reported by the SEC Inspector General in 2009, "there are simply no tangible consequences when a company fails to file a Form D." [7] The proposing release cites only one

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[7] SEC Inspector General Report No. 459, "Regulation D Exemption Process" (March 31, 2009), at 10, available at http://www.sec-oig.gov/Reports/AuditsInspections/2009/459.pdf. When Rule 506 was originally adopted in 1982, it required compliance with Rules 501 through 503, including the timely filing of a Form D, in order to qualify for the exemption. 47 Fed. Reg. 11251, 11267 (Mar. 16, 1982). In 1989, Regulation D was amended to remove the

case in which the Commission has ever brought an action under Rule 507 to enjoin an issuer from future use of Regulation D.

The voluntary nature of Form D has significant repercussions for state regulators. Pursuant to Section 18 of the Securities Act of 1933, states are preempted from requiring registration of securities that are sold in compliance with Rule 506. However, state regulators routinely review Form D filings to ensure that the offerings actually qualify for an exemption under Rule 506 and look for "red flags" that may indicate a fraudulent offering. The absence of a Form D filing complicates state efforts to protect the investing public. In addition, a promoter who has no intention of complying with Rule 506 may attempt to assert it as a defense to a state-level enforcement action by filing a Form D long after the fact.

Apart from bad actors, it is likely that many legitimate issuers never file a Form D because they simply have no incentive to file one. As the proposing release illustrates, this makes it nearly impossible to accurately gauge the size of the private placement market.[8] From what we do know, the market rivals the size of public offerings, but policy-makers are left to guess at the implications of loosening the rules for private placements. The information captured in Form D, as enhanced in the proposing release, will provide important data that can be used to determine future economic impacts for businesses and investors. A lack of a true and complete understanding of the private placement market hampers states' ability to foster growth in that market and police bad actors.

For these reasons, it is imperative for the Commission to act quickly to establish meaningful consequences for issuers who fail to file a Form D. Because the filing is such a critical part of the exemption, and because it is such a simple condition to satisfy, NASAA believes that the loss of the exemption is a reasonable consequence for failure to file the form.

### iii. Other changes to Rule 506

NASAA supports the addition of several data points to Form D. For example, we believe the disclosure of certain uses of proceeds will provide clear, material information that is necessary for investors to make informed decisions and will deter abusive practices in which promoters pay themselves with investor funds. We believe that additional information on Form D will be beneficial to investors, and it will capture data that will help policymakers evaluate the use of the exemption. In particular, the proposed closing amendment will provide important data about offerings that were unsuccessful and the types of issuers who have difficulty raising capital. This information can be used to determine whether the changes to Regulation D were

requirement of compliance with Rule 503 as a condition of the Rule 506 exemption. 54 Fed. Reg. 11369, 11373 (Mar. 20, 1989). The Commission's summary of the rule change stated, "While the filing of Form D has been retained, it will no longer be a condition to any exemption under Regulation D. New Rule 507 will disqualify any issuer found to have violated the Form D filing requirement from future use of Regulation D." SEC Release No. 6,825 (Mar. 14, 1989).

[8] A study by the SEC's chief economist in 2011 found that private offerings grew by nearly 50% from 2009 to 2010; from about $950 billion to about $1.4 trillion, and that private stock issuances surpassed debt issuances in 2010 and the first quarter of 2011. See Craig Lewis, "Unregistered Offerings and the Regulation D Exemption," November 2, 2011, available at http://www.sec.gov/info/smallbus/acsec/acsec103111presentation-regd.pdf.

effective in achieving the JOBS Act goals of economic growth and job creation or whether investors are reluctant to invest in these offerings.

In NASAA's view, it is not necessary for the Commission to require the long advertising legend as proposed in Rule 509. We agree that the issuer should be required to disclose the information that is contained in the proposed legend, but believe that it would be better for the Commission to require some indication that the issuer has read the material. This could be done by requiring the information to be contained in the subscription agreement or by requiring the investor to click through the information on the issuer's chosen internet platform. Then, instead of the lengthy legend as proposed, the Commission should require a very brief legend on all internet-based advertising. A brief legend containing a unique short phrase will readily identify the offering as one being conducted under Rule 506. The Commission could then monitor on-line advertising without requiring it to be filed as proposed in Rule 510T.

NASAA has long encouraged the Commission to revisit the monetary thresholds set forth in the "accredited investor" definition in Rule 501 to account for inflation that has occurred since the rule's adoption. According to the U.S. Bureau of Labor Statistics, $200,000 had the same buying power in 1982 as $484,719 has in 2013,[9] but the annual income threshold for accredited investors remains unchanged. Similarly, $1,000,000 had the same buying power in 1982 as $2,423,595.85 today,[10] yet the net worth threshold has only been changed during that time period to remove the value of a potential investor's primary residence from the calculation. NASAA also believes that the Commission should update the definition of accredited investor to ensure that it more accurately reflects investor sophistication. However, given the importance of the other rules that have been proposed in the current release, we urged the Commission to move forward with the other rule proposals and to address the accredited investor definition in a separate rulemaking.

## Title III: Crowdfunding

As the voice of state securities regulators, NASAA has a special interest in the rules governing crowdfunding issuers and intermediaries. State securities regulators work closely with small businesses in their capital formation efforts and want those businesses to be successful in raising money through crowdfunding or other methods so they can thrive and produce jobs. However, state securities regulators are keenly aware that capital formation requires confident investors who are adequately protected. Thus, NASAA believes that crowdfunding, to be successful, requires a balanced regulatory approach that minimizes unnecessary costs and burdens on small businesses while protecting their investors from fraud and abuse.

Given the length of the proposed rules that were issued by the SEC last Wednesday, October 23, 2013, NASAA has not yet formulated an official response to the proposing release. From our initial observations, it appears that the SEC has attempted to stay relatively close to the

[9] *See* http://www.bls.gov/data/inflation_calculator.htm as of September 18, 2013.
[10] *Id.*

statutory mandates, but we will be taking a closer look at the proposed rules and we expect the SEC to consult further with state regulators as required by Section 302(c) of the JOBS Act.

NASAA's largest concern about Title III of the JOBS Act is that it removed much of the states' authority over equity-based crowdfunding. Congress chose to preempt the states from regulating crowdfunding issuers, thus retaining only the states' antifraud, post-sale enforcement authority. Furthermore, although Section 305 of the JOBS Act preserves the authority of a crowdfunding intermediary's home state to conduct examinations of resident intermediaries, state rules cannot exceed the federal requirements. In effect, this puts state governments in the position of enforcing federal laws from which they may not deviate.

NASAA firmly believes due to the localized nature of smaller offerings, the states should be the primary regulator of small business capital formation efforts, including crowdfunding offerings. Based on the small size of the offering, the small size of the issuer, and the relatively small investment amounts, it is clear that the states have a more direct interest in these offerings. The states are in a better position to communicate with both the issuer and the investor to ensure that this exemption is an effective means of small business capital formation. The states will be most familiar with the local economic factors that affect small business and have a strong interest in protecting the particular investors in these types of offerings. Further, requiring the SEC to regulate these small, localized securities offerings is not an effective use of the agency's limited resources.

During the debate surrounding the JOBS Act, NASAA asked Congress to leave the regulation of small investments in small companies to the states because the federal government has neither the inclination nor the resources to regulate effectively in this area. Before the JOBS Act was even introduced, three states allowed crowdfunding in intrastate offerings,[11] and during the debate on the Act, NASAA was working on a model exemption that would apply to multi-state offerings. The model rule envisioned a one-stop filing mechanism and the application of uniform review standards. However, those efforts were halted when Congress enacted a federal exemption for crowdfunding that preempted state authority.

Ironically, many crowdfunding advocates have grown frustrated with the pace of federal rulemaking that they are again seeking state-level crowdfunding exemptions. Earlier this year, bills were introduced in six states to allow intrastate offerings that involve equity crowdfunding.[12] We believe this underscores why Congress should let the states innovate and be creative in striking a reasonable balance between investor protection and capital formation for smaller offerings.

## New and Unmet Opportunities and JOBS Act 2.0

[11]Two states – Kansas and Georgia – adopted exemptions before the JOBS Act was even introduced. See the "Invest Kansas Exemption," Kan. Admin. Reg. 81-5-21 (adopted Aug. 12, 2011) and the nearly identical "Invest Georgia Exemption," Ga. Rule 590-4-2-.08 (adopted Dec. 2012). Idaho adopted an exemption by order on January 20, 2012, which imposes similar conditions upon crowdfunding as the Kansas and Georgia regulation.

[12] Maine L.D. 1512, Michigan H.B. 4996, New Jersey S. 3008, North Carolina H.B. 680, Washington H.B. 2023, Wisconsin A.B. 350.

Successful regulation requires balancing the legitimate interests of investors with the legitimate goals of business owners through tailored regulation, and pursuing policies that are fair to both. One of the fundamental problems that the JOBS Act failed to adequately address was investor retreat from the markets. Investor confidence in the U.S. securities markets remains low, as reflected by a recent Bankrate survey.[13] A Gallup survey in June 2002 found that 67 percent of Americans owned a 401(k) or otherwise invested in individual stocks, bonds, or mutual funds. Earlier this year, that number was down to 54 percent.[14] To have an impact on investor participation, and, by extension, job creation, Congress must focus on giving those 13 percent the confidence to re-enter the marketplace.[15]

One way to increase investor confidence is to carefully craft the rules implementing Titles II, III and IV of the JOBS Act so they do not have the undesired effect of decreasing investor confidence, thus subverting the overall intent of the Act. Further, if the rules lack clarity, they will lead to litigation between state regulators and issuers, and judges will ultimately be required to provide greater clarity. We also encourage the SEC to finalize its investor protection mandates under the Dodd–Frank Wall Street Reform and Consumer Protection Act.

Although NASAA has not yet come to firm conclusions about new, and unmet opportunities that would decrease investor cynicism and encourage capital formation, we are interested in a few proposals, discussed below, that would be worthy of further study and consideration by this Subcommittee.

First, NASAA believes that Congress should study the impact of high frequency trading and take steps to ameliorate any associated risk of harm to retail investors. According to Charles Schwab, high frequency traders flood the market with orders to evaluate the market, then cancel 90 percent or more of the orders and retain only the advantageous trades.[16] To curb these abuses, some European governments have proposed transaction taxes on all orders that are placed in the markets, but Mr. Schwab has suggested a narrower approach that would probably be less controversial and more effective – a penalty on excessive cancellations.[17]

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[13] When asked to pick the best way to invest money that would not be needed for the next ten years, investors picked cash, real estate, and even precious metals over the stock market. The findings of the Bankrate survey are available at http://www.bankrate.com/finance/consumer-index/financial-security-charts-0713.aspx.

[14] See http://www.gallup.com/poll/147206/stock-market-investments-lowest-1999.aspx.

[15] The legislative history of the Securities Act of 1933 reveals that "smart" regulation can be successful in encouraging investors to reenter the capital markets. As one of the principal drafters of the Act noted, "[t]h great and buoyant faith in capitalism, in the competitive system, is largely deflated, and … it is not only a question of whether the system is just, but whether it works." L. Baker, Felix Frankfurter 146 (1969) (taken from a Frankfurter speech delivered at Smith College, Feb. 22, 1933). Smart and robust regulation embodied in the Securities Act of 1933 led to a substantial increase in new corporate offerings of over $2.5 billion in 1935 and over $4.3 billion in 1936 (from a low of $644 million in 1932 and $380 million in 1933). Goldschmidt, Registration under the Securities Act of 1933, 4 Law & Contemp. Probs. 19, 28 (1937); see also Bureau of the Census, Historical Statistics of the United States: Colonial Times to 1970 1006 (1975). As history reveals, smart regulation does not always equate to deregulation, and we encourage Congress to study the outcome of the JOBS Act in the coming year.

[16] Charles Schwab and Walt Bettinger, Why Individual Investors Are Fleeing Stocks, Wall Street Journal Editorial, July 10, 2013, available at http://online.wsj.com/news/articles/SB10001424127887323582904578484810838726222?mod=dist_smartbrief.

[17] Id.

Another innovative effort to combat high frequency trading has been undertaken by ParFX and EBS, two international currency trading platforms. They use a randomized pause so that the first order placed in the system queue is not necessarily the first to be executed.[18] According to Larry Tabb, founder of the TABB Group, "In the equities market, it's going to be pretty tough for an exchange to introduce randomization because the regulations have been interpreted to be very time-price specific."[19] Therefore, Congress might consider amending the laws to allow this type of reform in the United States equities marketplace.

Congress could also study the numerous electronic "glitches" that have plagued the markets with market shutdowns and price instability. Many have called for mandatory "kill switches" to stop trading when problems occur, but we believe more aggressive steps should be taken to ensure that our markets are protected. If such havoc can be wrought from innocent errors by companies who have every incentive to get things right, then we worry what could be done by someone with a malicious intent to harm the markets or the country.

State securities regulators support efforts to seek legislation that would authorize the SEC to collect "user fees" from federally registered investment advisers (an idea proposed in the Dodd-Frank mandated Section 914 study), and to use the revenue derived from these fees to fund more frequent examinations of such advisers. NASAA also supports legislation that would preserve an investor's right to access the court system if they have a dispute against their broker-dealer or investment adviser. As noted above, NASAA President Andrea Seidt has advocated for the equivalent of a CRD/IARD system (the centralized, web-based system for processing of federal and state licensing applications for broker-dealers and investment advisers) for multi-state securities offerings. In fact, NASAA has already taken the first major step in that direction by setting up the EFD, an electronic filing depository for Form D notice filings, which is set to launch in the coming year.

The House of Representatives has been circulating additional deregulatory proposals for a sequel to the JOBS Act referred to as "JOBS Act 2.0." NASAA would encourage this Subcommittee to reject further changes to the securities laws until at least after the full impact of the JOBS Act on investors and securities markets can be determined. Until that time, the potential costs and benefits of further expanding the JOBS Act is impossible to determine.

## Conclusion

NASAA has been working expeditiously and diligently to update applicable statements of policy and coordinate a new multi-state review program for Regulation A+ offerings. We have also been working to provide investor-friendly, yet sensible and realistic comments to the SEC as it finalizes the rules implementing Title II of the JOBS Act and Form D changes. We are optimistic that the new rules will lead to investor confidence and renewed participations in the

[18] Eric Onstad, Analysis: 'Slow Frequency' Technology Faces Tough Shift from FX to Stock Markets, Reuters, October 2, 2013, available at http://www.reuters.com/article/2013/10/02/us-hft-curbs-analysis-idUSBRE9910PJ20131002.

[19] Id.

markets.  NASAA and state securities regulators look forward to working with this Subcommittee on new and unmet opportunities to strengthen our securities markets.

Thank you again, Chairman Tester and Ranking Member Johanns, for the opportunity to appear before the Subcommittee today.  I would be pleased to answer any questions that you may have.