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## STATE REGULATION

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The U.S. and the individual states have never reached any general accommodation as to how power over financial institutions should be divided between them. Rather, the division of authority between the federal government and the states is different in every sphere of financial regulation.

### Overview

1. As to the **commodity** derivatives markets, there is complete federal preemption with all power to the federal government and the states having no authority, except as regards the offering of interests in commodity pools, which are securities subject to regulation under federal and state securities laws.

2. **Energy** markets are primarily a matter of federal regulation and it is an area where several states are pressing for more aggressive federal action.

3. In **insurance**, by contrast, the federal government has virtually no authority and all power belongs to the states.

4. In **banking**, there is a dual system of regulation, where national banks are legally exempted from most inconsistent state regulation, but state-chartered banks are subject to dual regulation either as members or non-members of the Federal Reserve System.

5. In the **securities** markets, except in certain limited circumstances, the Securities and Exchange Commission (the “SEC”) and state Blue Sky administrators share regulatory authority over issuers, broker-dealers and investment advisers, and even where there’s federal preemption on the registration side, the states generally retain antifraud enforcement authority.

The first part of this outline provides some more specific description of the division of regulation between the federal government and the states as to different areas of regulation. The second part of this outline asks a number of questions that are raised by these differences.

### Commodities Exchange Act

Prior to the 1974 amendments to the Commodity Exchange Act (the “CEA”), the regulation of commodities markets was shared by the Commodity Exchange Authority, the SEC, and various state regulatory agencies. But amid concerns that futures traders could be subjected to conflicting agency rulings, Congress in 1974 amended the CEA (i) centralizing the regulation of futures markets in a newly created, independent federal agency, the Commodity Futures Trading Commission (“CFTC”), (ii) endowing the CFTC with “exclusive jurisdiction” over such markets, and (iii) preempting other state and federal regulatory authorities.

The fundamental design of the legislation was to avoid a duplicative or contradictory regulatory structure by creating one federal agency with the expertise to regulate the

commodities industry. The legislative history reveals that Congress intended the CFTC to be the sole regulatory authority for the futures industry and that its authority would preempt all other regulators at every level of government, both state and federal. These twin principles of exclusivity and preemption have been confirmed by the courts, which have consistently ruled that the CFTC's exclusive jurisdiction supersedes the jurisdiction over all state and federal agencies. See e.g., International Trading Ltd. v. Bell, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,495 at 21,996 (Ark. Oct 3, 1977) (holding that “[w]here . . . Congress has made it clear that authority conferred by it is exclusive in a given area the states cannot exercise concomitant or supplementary regulatory authority over the identical activity.”). Moreover, the CEA as amended by the Commodity Futures Modernization Act of 2000, expressly preempts the application of state and local laws regulating gaming and “bucket shops” to qualifying OTC derivatives, hybrid instruments, Treasury Amendment products and transactions on electronic trading facilities excluded or exempt under the CEA. Preemption, however, does not apply to state antifraud prohibitions of general applicability, and states have retained registration and antifraud authority under their Blue Sky laws over the offering of securities by commodity pools.

## **Energy**

Energy trading is regulated at the federal level by the Federal Energy Regulatory Commission (“FERC”), which regulates interstate transmission of electricity, natural gas, and oil, and the CFTC, which regulates commodity futures and options markets, including those markets involving the trading of energy futures and options. As both agencies have exclusive jurisdictional authority over their subject areas (in the case of the CFTC that exclusive jurisdiction is statutory), and furthermore interpret that authority as applicable to trading activities occurring in the over-the-counter and physical cash markets, states are largely precluded from regulating energy trading that is subject to either FERC or CFTC regulation. As a result of the Western power crisis and the collapse of Enron in the early part of the decade, both of which involved allegations of abusive trading practices by energy traders on largely unregulated electronic trading platforms (including Enron's “Enron Online”), state authorities, especially those in the Western United States, have expressed concerns that energy trading is not subject to adequate federal oversight and have lobbied for strengthened regulatory oversight of these markets by the CFTC.

## **Insurance**

The Supreme Court held in U.S. v. South-Eastern Underwriters Ass'n, 322 U.S. 533 553 (1944), that insurance transactions which transcend state lines constitute “commerce” for the purposes of the Interstate Commerce Clause. In response to this decision, Congress, seeking to protect “the continued regulation and taxation by the several States of the business of insurance” from the threat of preemption, passed the McCarran-Ferguson Act of 1945, 15 U.S.C. § 1011 *et seq.* McCarran-Ferguson provides a general exemption from federal preemption for “any law enacted by any state for the purpose of regulating the business of insurance,” and a provision exempting state-regulated insurance firms from federal antitrust laws. Thus, there is currently no federal regulatory scheme for insurance and no way in which an insurance company can be nationally registered or regulated. Nonetheless, insurance products which are also securities, such as variable annuities and variable life insurance, are regulated under the federal and state securities laws.

## **Banking**

State chartered banks have existed since soon after America became independent. The State of New York has been granting state charters to banks for hundreds of years; the Bank of New York gained the first charter granted by the State in 1791.

The National Bank Act was passed in 1864 and authorized the creation of federally chartered banks. The national charter and the various state charters each authorizes its users to engage in separately defined banking activities. Many States have “wild card” provisions permitting State banks to exercise any power permitted to national banks. In general, national charters offer banks the ability to engage in permitted activities across State lines without regard to contradictory State laws. State charters may offer banks the ability to engage in a larger variety of activities than do national charters.

Thus, U.S. offers a dual system of regulation whereby a *de novo* bank may choose whether to operate pursuant to a national or state charter. A bank choosing a state charter must also choose whether or not to become a member bank of the Federal Reserve System. If it chooses membership, that bank will also be regulated on the federal level by the Federal Reserve; if not, the bank will be federally regulated by the Federal Deposit Insurance Corporation.

All national banks are required to be members of the Federal Reserve System, so while those banks are primarily regulated by the Office of the Comptroller of the Currency, the Federal Reserve also regulates them as a secondary player. The Federal Reserve regulates all bank holding companies, which are entities incorporated under and subject to state law.

In recent years, many larger formerly state-regulated banks have “flipped” their charters to national charters in order to take advantage of aggressively interpreted federal preemption of State laws regarding licensing, lending and bank fees. Preemption has become the largest issue for banks to consider in determining what charter to choose.

## **Broker-Dealers**

Historically, the states and the federal government shared regulatory authority over broker-dealers. In the early 1990s, there were adopted a raft of diverse state regulations governing broker-dealers, particularly in the area of broker-dealer record keeping. This in turn led to significant industry push back that it was simply not practical for national organizations to keep track of and to comply with so many sets of laws governing the same topics, and eventually to legislation. The National Securities Markets Improvement Act of 1996 (“NSMIA”), which amended Section 15(h)(1) of the Securities Exchange Act of 1934 (the “Exchange Act”), preempted state “Blue Sky” laws applicable to broker-dealers as regards capital, custody, margin, financial responsibility, record making and keeping, bonding, and financial and operational reporting requirements to the extent that those laws differ from, or are in addition to, the requirements under the Exchange Act (which would include SEC rules, as well as those promulgated by the Financial Industry Regulatory Authority, Inc. (“FINRA”) or securities exchanges for member firms).

While this federal preemption made the regulatory process somewhat simpler for broker-dealers seeking registration under the Blue Sky laws of the 50 states, Washington, D.C., Puerto Rico and the Virgin Islands (collectively referred to herein as “states”), and despite NASAA’s long-standing role as a vocal proponent for uniformity among the states, a number of state laws, rules and/or policy statements continue to create obstacles for broker-dealers attempting to conduct a national business by reason of local idiosyncrasies. For example, while state registration requirements for broker-dealers have a tendency to change on a regular basis, as reflected in a chart of state broker-dealer requirements available on NASAA’s website, the initial broker-dealer registration process with many states still requires the preparation and paper submission of a number of special state forms and materials, in addition to the materials submitted electronically to FINRA’s CRD system or otherwise submitted to FINRA in connection with the initial membership application process.

In particular, one state requirement which has been heavily criticized is the need for applicants to submit a so-called “come clean” affidavit or letter, detailing whether they conducted prior business with customers in a particular state. This practice may be problematic for firms already doing business and seeking to register in a new state, but which previously effected trades for one or more customers in that state, in many cases either inadvertently or in the mistaken belief that trades with certain types of institutional customers or with a *de minimis* number of customers qualified it for an exception or exemption from registration. If an applicant confesses that it has previously effected trades with customers in the state and can’t prove the availability of an exception or exemption from registration, the applicant frequently becomes the target of an administrative cease-and-desist order or similar agreement whereby, as a condition of obtaining state registration, it agrees not to violate the Blue Sky law in the future (typically without admitting or denying past violations), pay fines, investigative costs or other fees to the state, and/or offer rescission of prior trades to, or refund past commissions received from, its customers in that state. In certain cases these actions are taken despite the fact that the state administrator may have no record of past inquiries or complaints regarding the applicant, or even if the statute of limitations may have expired on any past violations. Industry and bar representatives have criticized this practice as serving as a disincentive to broker-dealers complying with state registration requirements, since applicants oftentimes decide that the cost of this “come clean” routine far exceeds any profits which might be earned from getting registered, and that the risk of actions against them by customers or state officials based on such prior registration violations is minimal.

It is also noted that state Blue Sky laws include disparate exceptions and exemptions from broker-dealer registration, and due to jurisdictional requirements, there may be instances where a broker-dealer must register in its home state or a state where it has a branch office, even though it has no customers there, yet it finds that it is excepted or exempt from registration in the states where its customers are located. While most state laws provide exceptions or exemptions for a firm with no place of business in a given state which conducts business exclusively with certain types of institutional customers, the types of institutional customers within the scope of these provisions vary widely. Further, only a minority of state laws provide exceptions or exemptions for broker-dealers with a minimal number of “retail” customers, and those provisions are non-uniform as well; some are based on the number of offers made during a given period (*e.g.*, not more than 15 offers during any period of 12 consecutive months, regardless of the

number of customers in the state), while others are based on the number of customers in the state during a given period.

## **Investment Advisers**

NSMIA also created a bifurcated approach to the registration of investment advisers on the federal and state levels, so that, as a general rule, only investment advisers managing at least \$25 million in assets *may* register with the SEC (absent an exemption, advisers managing at least \$30 million in assets *must* register with the SEC). If not subject to SEC registration and not otherwise covered by an exception or exemption by reason of federal or state law, an adviser is subject to state investment adviser registration requirements (all states, other than Wyoming, require advisers to register). This aspect of NSMIA, in contrast to the aspects dealing with broker-dealers, was primarily driven by the SEC's desire to not be responsible for the regulation of "smaller" advisers, which was straining the resources and budget of the SEC, but leaving that responsibility to the states.

While SEC-registered advisers are not subject to state registration requirements, they may be required to effect "notice filings" in those states in which they conduct business (basically consisting solely of the Form ADV filed with the SEC and a filing fee). States may also require registration of such advisers' associated persons qualifying as "investment adviser representatives" who have a "place of business" in a state, as those terms are defined in an SEC rule (essentially personnel who provide advisory services to, solicit, meet with or otherwise communicate primarily with retail customers). While states may not impose any substantive requirements on SEC-registered advisers, they may still investigate and bring enforcement actions for fraud or deceit against such advisers and their associated persons.

Non-SEC-registered advisers and their representatives are subject to full state registration requirements, absent an exception or exemption, as well as antifraud provisions. As in the case of state broker-dealer requirements, state laws and rules applicable to investment advisers include a number of inconsistent and non-uniform provisions regarding exceptions or exemptions from registration or notice filings, and registration requirements.

As regards exceptions and exemptions from registration or notice filings, due to a quirk in the federal law, while Section 222(d) of the Investment Advisers Act of 1940 includes a "national *de minimis* standard" preempting state registration requirements for non-SEC-registered advisers if they have no place of business and fewer than 6 clients in a given state during any 12 consecutive months, that provision doesn't apply to SEC-registered advisers. Accordingly, while most state laws contain comparable *de minimis* exceptions or exemptions from notice filings, not all do, and an SEC registrant with no place of business and only one client in a given state may be required to effect a notice filing in that state. Further, while most state laws include exceptions or exemptions from registration or notice filings for advisers with only institutional clients in the state, the types of institutions covered by these provisions vary, so that, for example, an employee pension plan would have to have total assets in excess of \$5 million to qualify as an institutional investor in one state, but would need over \$10 million in assets to qualify in another state.

As regards advisers subject to state registration requirements, it should be noted that Section 222(b) and (c) of the Investment Advisers Act of 1940, as amended by NSMIA, preempt state books and records, net capital and bonding requirements which are in addition to or more stringent than those imposed by the state where such an adviser has its principal place of business, if it is registered or licensed in that state and is in compliance with those requirements. Otherwise, these advisers are subject to a variety of filing and other requirements, in certain cases premised on state antifraud statutory provisions.

## Securities Offerings

### 1. Covered Securities

As a means of ensuring national uniformity, NSMIA preempted all state registration requirements (as well as special state disclosure requirements) with regard to certain “covered securities,” as designated in Section 18 of the Securities Act of 1933 (the “Securities Act”), as amended by NSMIA. As further refined by SEC Rule 146(b) under the Securities Act, “covered securities” include (1) securities listed on, or equal or senior to securities listed on, the New York, American, or NASDAQ Global Market Exchanges, Tier 1 of the NYSE Arca, Inc. (former Pacific Stock Exchange), Tier 1 of the Philadelphia Stock Exchange, the Chicago Board Options Exchange, options listed on the International Securities Exchange, or the NASDAQ Capital Market; (2) securities issued by any investment company registered under the Investment Company Act of 1940; (3) securities sold in exempt private offerings complying with Rule 506 of SEC Regulation D under the Securities Act; (4) securities of companies filing reports under Section 13 or 15(d) of the Exchange Act, when sold in exempt transactions under Securities Act §§ 4(1) or 4(3) (*i.e.*, secondary market transactions); (5) securities sold in exempt brokers’ transactions under Securities Act § 4(4); and (6) certain of the securities exempted by Securities Act § 3(a). However, states were authorized to impose “notice filings” for all covered securities offerings, with the exception of those described in category (1) above, such notice filings consisting solely of whatever materials have been filed with the SEC, a consent to service of process, a filing fee, and a periodic sales report.

It is believed that many, if not most, states were not adverse to the NSMIA preemption, particularly considering that: (1) except in the case of investment companies, prior to NSMIA, most covered securities were covered by self-executing exemptions, or by exemptions requiring minimal notice-type filings, under Blue Sky laws, albeit with discrepancies from their federal counterparts; and (2) in the case of investment companies, which were generally subject to state registration filings (but with little or no substantive review at the state level), state filing fees (a significant source of revenue) have been preserved through the NSMIA-authorized notice filings. As evidence of states’ acceptance of NSMIA preemption, it is noted that, at present, most states have imposed notice filing requirements solely for investment companies and for private offerings effected in accordance with Rule 506 of SEC Regulation D, but not for the other types of “covered securities.”

However, NASAA representatives have been fairly vocal in criticizing federal preemption with regard to private offerings effected in accordance with Rule 506 of SEC Regulation D. Prior to NSMIA, most states exempted Rule 506 offerings, but typically subject to: (1) a prohibition on paying commissions to persons other than registered broker-dealers or

agents in the state; (2) “bad boy disqualifications” if the issuer, its principals or any placement agent selling the securities were the subject of certain civil, criminal or administrative proceedings; (3) the issuer making a filing with the state prior to and/or subsequent to any offer or sale in the state, including an SEC Form D, a consent to service of process, a filing fee, and copies of the issuer’s offering materials (which often had to include a special state legend); and (4) special representations by any non-accredited investors in the state.

By comparison, post-NSMIA, a state notice filing for a Rule 506 offering may consist solely of an SEC Form D, a consent to service of process, and a filing fee, and filings are typically required to be made within 15 days after the first sale in the state. States may not require the filing of offering materials, nor may they impose “bad boy” disqualifications (there are no such disqualifications presently applicable to Rule 506 offerings under Regulation D, although the SEC has proposed adding them in Release No. 33-8828 (Aug. 3, 2007)).

## **2. Registered Public Offerings**

As regards non-“covered securities,” absent some special state exemption, a registration or some other type of filing must be effected for public offerings in all states. Only Hawaii has a self-executing exemption for sales of SEC-registered securities, and New York requires registration or an exemption filing only for certain real estate syndication offerings; all states, however, have self-executing exemptions for sales of securities to certain types of institutional investors. Accordingly, the issuers and underwriters of public offerings of non-“covered securities” (*e.g.*, shares to be traded on the Nasdaq Bulletin Board, interests in direct participation programs such as commodity pools, or unlisted REITs) seeking to make sales to retail investors must undertake an expensive and time-consuming project of complying with the Blue Sky laws of all states in which the securities are to be sold.

In the case of SEC-registered offerings, most state laws provide for “registrations by coordination.” Under these provisions, if the state filing is made at roughly the same time the initial SEC filing is made, so long as a complete state filing is on hand for a stated minimum filing period (sometimes as little as 10 days), the offering will be deemed automatically effective upon giving the state notice of SEC effectiveness, notwithstanding that the state examiner hasn’t reviewed or completed review of the filing; thereafter the burden shifts to the state to stop-order the offering based on certain statutory grounds, which action generally must be taken within a certain period of time after effectiveness, subject to a hearing and appeal process.

In reality, however, many states ignore these statutory review periods, and applicants are requested or compelled to “waive concurrent effectiveness” upon threat of a stop order, thereby placing themselves at the discretion of the state examiner to complete review of the filing in a timely fashion. While the SEC will typically complete a full review of an initial public offering within 30 days, it is not unusual for certain states to take two months or more to complete their review of the same filing, and unless the issuer immediately agrees to comply with all comments raised; negotiations with a state examiner over the comments may easily add another month or more to the registration process.

A major distinguishing factor between state and SEC reviews of securities registrations is the use of so-called “merit review” standards by many states, whereby they consider whether an

offering is “fair, just and equitable,” applying both objective and subjective standards, as contrasted with the SEC’s “full disclosure” approach. NASAA has done an admirable job of developing guidelines, in the interest of promoting uniformity, for a wide variety of securities offerings (*e.g.*, for various types of direct participation programs, and for debt and preferred securities), as well as for corporate stock offerings (*e.g.*, guidelines which restrict an issuer’s options and warrants and “promotional shares,” and which require minimum promoters’ investment in a promotional or development stage company). Unfortunately, not all merit review states have adopted these guidelines as rules or formal policy statements, while others apply them on an informal, piecemeal basis without prior notice to applicants, and even those which have formally adopted these guidelines may impose different terms and conditions than otherwise required, as a matter of the state examiner’s discretion. Accordingly, applicants are frequently faced with major “surprises” based on these merit reviews, and the issuer may be forced to either make major changes to the structure of the offering to placate all states, or withdraw the offering from those states where the revisions are deemed overly burdensome or inappropriate.

The merit review process has been criticized over the years as adding substantial cost to the registration process, sometimes with little discernible benefit to investors, and there has always been a tension between that process and the Securities Act-based concept that full disclosure to investors is all that should be necessary. In this connection, it is noted that issuers are typically obligated to pay all state filing fees, as well as the legal fees and related expenses, of “Blue Skying” an offering, even though underwriters’ counsel typically handles these filings. Accordingly, all the costs of these state filings are ultimately borne by investors, as a charge against the proceeds to be received by the issuer. It is also noted that, when faced with the potential time and cost of complying with the requirements of certain merit review states, a number of issuers and underwriters will simply refuse to offer and sell the securities to retail investors in those states, and restrict the offering to institutional investors in reliance on applicable exemptions.

Another issue faced in connection with state filings (which has become more acute with the SEC’s recent expansion of the availability of S-3 registrations to additional issuers) is the manner in which states handle “shelf registrations,” whereby certain states require separate filings and fees for each series of securities sold, rather than permitting a single filing for all securities covered by the registration statement, a practice which can add substantial expense to an offering.

## **Enforcement**

In recent years, state securities officials have done a remarkable job in the enforcement arena, frequently beating the SEC to the punch, primarily under the aegis of Eliot Spitzer, when he served as New York’s Attorney General and thus as prime enforcer of New York’s Blue Sky law, popularly known as the “Martin Act.” For example, using the broad investigative authority of that statute and the threat of its somewhat harsh civil and criminal remedies, Spitzer was the first to uncover a variety of inappropriate activities by certain major broker-dealers’ research analysts, as well as “market timing” in certain mutual funds by hedge funds and other favored securities traders.

Other states, sometimes acting through cooperative “task forces” under the auspices of NASAA, and sometimes in concert with the SEC and FINRA, have aggressively pursued alleged violations of their Blue Sky laws, recently in the case of questionable securities offerings directed to senior investors, the use of dubious senior-specific certifications and professional designations by broker-dealer and investment adviser representatives, “free lunch” investment seminars promoting questionable securities, and spurious so-called “affinity offerings” to members of certain ethnic or religious groups.

Of course, critics have argued that a number of these state actions, particularly Spitzer’s, were brought against “easy targets,” such as major broker-dealers and mutual funds, which would rather quickly settle the allegations than fight them in open court, and that some cases seemed to have been brought more for the headline value to generate publicity for a securities administrator seeking higher political office (such as Spitzer, who rode his reputation as “Sheriff of Wall Street” into the New York State Governor’s office, only to be forced to resign in a well-publicized scandal a little over a year later). Questions have also been raised as to what was gained for investors in some of these enforcement actions, as opposed to injunctive relief obtained against, and fines or penalties paid into state coffers by, the defendants. It should also be noted that a particular state’s aggressiveness in pursuing securities fraud may be a function not only of the political ambitions of the securities administrator (and since many securities administrators are gubernatorial political appointees, a change in governors may result in a sea change of attitude as regards enforcing the Blue Sky law), organizational issues (some state securities administrators may not pursue enforcement matters directly, but rather must use local or state prosecutors, who may not be as familiar with the Blue Sky law, or may have other priorities), as well as budgetary concerns.

A few recent court decisions (in particular, the California Court of Appeals’ decisions in the Capital Research & Management Co. v. Brown and People v. Edward D. Jones & Co. cases) raise the issue of to what degree states may employ their reserved antifraud authority under NSMIA over offerings of “covered securities” within the meaning of Securities Act § 18. In these California cases, the California Attorney General brought enforcement actions against the investment adviser to, and/or a broker-dealer acting as principal distributor or selling shares for, certain mutual funds, premised on the failure of the funds’ prospectuses to disclose so-called “shelf-space agreements” with dealers selling the funds’ shares. While the defendants asserted as a defense that these disclosures weren’t required under SEC standards and that NSMIA therefore preempted the states from imposing their own disclosure requirements on mutual fund prospectuses, the courts ruled that there was no preemption in the case of an antifraud action against a fund’s investment adviser or broker-dealer premised on a disclosure violation, even though the state would be foreclosed from pursuing the fund itself on the same basis.

## Questions

The diversity of approaches to the division of authority between federal and state regulators in different areas of financial regulation may in some senses be viewed as a social sciences experiment. Can we look at the relative costs and benefits of how the different divisions of authority have worked in each area and determine that one of these approaches may be better, or that they all have value but can be individually improved.

Are the non-uniform and confusing state laws, rules, policies and practices governing registration of or notice filings for broker-dealers and investment advisers, and exceptions and exemptions from such requirements, worthwhile as a matter of investor protection, or are they largely displays of state sovereignty?

For example, is there significant evidence that Rule 506 offerings have been abused by issuers and that federal preemption for these offerings has thereby endangered investors? Did the states prevent any fraudulent activities in connection with Rule 506 offerings prior to NSMIA by requiring pre-offering filings of offering materials?

Are investors really getting any additional protection from the state securities registration review process? Does “merit review” add that much over a “full disclosure” approach, or does it amount to states micro-managing offerings? Should states be concerned by the fact that, due to Blue Sky concerns, an offering may only be sold to institutional investors in a particular state, thereby depriving individual investors in that state of what may be a worthwhile investment opportunity?

Do the enforcement cases involving NSMIA “covered securities” portend the possibility of state administrators, or private litigants, bringing antifraud actions against a broker-dealer premised on state law, alleging material misrepresentations in, or material omissions from, a prospectus for an offering of “covered securities,” notwithstanding that the prospectus clearly satisfies SEC standards? For example, could an issuer’s failure to disclose that one of its directors or executive officers was convicted of a crime 10 years before an offering form the basis for a civil, criminal or administrative action against a broker-dealer for selling that issuer’s securities, even though SEC Regulation S-K only requires disclosure of convictions going back five years? Further, could a state court decide that a prospectus for an offering of New York Stock Exchange-listed securities was fraudulent because it didn’t contain certain financial statements, even though it included, or incorporated by reference, financials satisfying SEC Regulation S-X? Do these cases open up the possibility of confrontations between issuers and nervous underwriters over disclosure issues, as the latter seek to avoid possible liability under state laws?

Also, in light of other court decisions holding that NSMIA preemption doesn’t exist for offerings claiming “covered securities” status based on the private offering exemption under Rule 506 of SEC Regulation D, unless the offering actually satisfies the requirements of that Rule, could a state court ignore federal court rulings or SEC interpretations of Rule 506 and hold that the issuer didn’t satisfy the Rule as a matter of state law? For example, could a state court hold that a particular investor (*e.g.*, a limited liability company) wasn’t an “accredited investor” within the meaning of Rule 501(a) of Regulation D because it didn’t satisfy the literal requirements of that Rule, even though the SEC had issued a “no-action” letter to the contrary, thereby causing the issuer to sell to more than 35 non-accredited investors? Could a state court decide that the private placement memorandum used for the offering didn’t provide adequate disclosure to investors, even though it satisfied the applicable requirements under Rule 502(b) of Regulation D?

While it’s difficult to make a cost/benefits analysis of the value of state regulation, at least on the registration side, some states have been criticized for serving primarily as revenue

collectors, and filing fees imposed by some states appear to be disproportionate to the amount of effort expended by them in the review process and, in certain cases, to their populations. In addition, persons attempting to comply with these laws are often frustrated by staff shortages (frequently attributed to general state budgetary issues, since securities regulators' revenues are generally paid into states' treasuries, and are not specifically allocated to support the agency) or general bureaucratic malaise. In this regard, in an August 15, 2000 report by the U.S. General Accounting Office to Congressman Vito Fossella (R-NY), the GAO surveyed the securities agencies of the 50 states, the District of Columbia and Puerto Rico for their revenues and expenditures for fiscal years 1998 and 1999. The results from the 46 agencies which responded revealed that in fiscal year 1998, they took in \$483 million, yet expended only \$79 million, while in 1999, they took in \$547 million, yet expended only \$88 million. Further, in fiscal year 1999, only 1% of revenues were derived from violations and penalties; the balance was attributable to securities filing fees and broker-dealer and investment adviser registrations and licensing fees. In fiscal year 1999, only one state (California) reported spending more than it received in revenues, and only four other states (Colorado, New Jersey, Oregon, and Virginia) spent 50% or more of revenues received.

Does the dual system of bank regulation continue to make sense, or is it merely duplication of costs? Should bank regulation follow the *de facto* split of bank charters where the large, national and regional banks are supervised at the federal level, while the smaller banks and non-banks are supervised by the states? Or should supervision be allocated by activity?

Considering the national nature of most insurance companies' businesses, should they be given an option to obtain a federal charter and be regulated by a federal insurance regulator, instead of being subject to regulation by the individual state insurance regulators?