NEWS

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"FEDERAL PREEMPTION OF STATE BLUE SKY LAWS"

PANEL PRESENTATION

BY

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I am pleased to participate in this discussion on federal preemption of state blue sky laws. As we all know, this topic is receiving increasing attention. Congress, the Administration, and others are reviewing the regulation of financial institutions in order to eliminate overlaps, duplication, and conflicting laws. Basic existing approaches, including our dual system of federal and state regulation, are are being questioned.

Preemption naturally strikes a sensitive nerve for state regulators. It calls into question the need for certain functions that your organizations perform. Thus, many state regulators may instinctively oppose any federal preemption. Those who oppose preemption, may take confort in the fact that Congress intentionally established a two-tiered regulatory system in which the federal government would set broad minimum standards, while allowing more stringent state requirements.

This is clear in the first federal statute, the Securities Act of 1933, which provides that, "Nothing in this title shall affect the jurisdiction of the securities commission...of any state...over any security or any person." Other securities laws contain similar provisions.

Congress confronted the issue of dual regulation most recently in its consideration of the Small Business Investment Incentive Act of 1980. The intent of that statute

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The views expressed herein are those of the speaker and do not necessarily reflect the views of the Commission.

was to bring about improvements in the present regulatory system which was described as being "exhorbitantly expensive, maddeningly inefficient, and utterly frustrating." Congress explicitly declared a general policy of achieving "maximum uniformity in Federal and State regulatory standards." The method chosen to achieve this goal was cooperation between the Commission and the state regulators and among state regulators themselves. To make this point clear, a provision was included stating that "Nothing in this Act shall be construed as authorizing preemption of State law." Perhaps state regulators can take further comfort from the Reagan Administration's general policy of putting less reliance on centralized national regulation and returning more authority and responsibility to the states.

I do not believe that there is a serious risk of legislation being enacted in the near future to preempt state blue sky laws. Certainly, it will not occur in the next year or two; but that is only part of the story.

There is an increasing number of individuals and organizations openly critical of the existing system. Proposals are being made that would result in outright or de facto preemption. In this regard, last week's joint hearings on uniformity and coordination of state and federal securities laws and regulations held by the Commission and the North American Securities Administrators Association ("NASAA") was very informative. Those hearings and the written submissions in response to our request for comments contained some of the most

open and direct statements I have heard or read on the subject of uniformity and preemption.

For example, the most outspoken organization asserted that the dual system has a "negative impact on the securities industry [that] far outweighs the benefits to investors." It continued, "Coordination between federal and state agencies... is not enough....Dramatic changes in the entire system and long range thinking about the role of state governments in the process is called for...." The statement concluded that, "Legislation must be promoted that will make regulation of the raising of capital uniform and nationwide." Recommendations from others include certain exemptions from blue sky review under specified conditions, "a temporary national commission with authority to implement...changes in state securities laws," and consideration of a system under which actions by multistate bodies such as NASAA would be binding on members.

Those of us who believe that state securities regulation is important, as I do, must recognize that it is on trial in an era of nationwide securities markets and developing international markets when efficiency and simplicity are paramount priorities and government regulation at all levels is being severely criticized. We must also admit that although there are significant benefits, the dual system for regulating securities activities lacks simplicity and contains inefficiencies and conflicts which must be resolved.

Correcting these problems is not a simple task because of different regulatory philosophies and interests. However,

there have been some successes, such as the FOCUS reports, the Centralized Registration Depository system, and major revisions to Guide 5 concerning the "Preparation of Registration Statements Relating to Interests in Real Estate Limited Partnerships." Progress is also being made in developing more uniform offering exemptions from registration through Regulation D and provisions adopted by a number of states. We are working toward coordinating our interpretations, and Form BD for the registration of broker-dealers is presently out for comment. With the cooperation of all, I am sure that additional progress can be made. But it is a slow and often discouraging process. Moreover, success is not assured.

Our experience with Regulation D is an example of the difficulties. In the Investment Incentive Act of 1980, Congress sought to engender "the development of a uniform exemption from registration for small issuers which can be agreed upon among several States or between the States and the Federal Government." The development of Regulation D, which substantially amended federal rules regarding limited offering exemptions, represents the most significant cooperative effort thus far between the Commission and the states. There were extensive consultations among us aimed at achieving uniform securities regulation in an area where both state and federal governments have been actively involved.

Unfortunately, despite intensive good faith efforts, NASAA members have not endorsed limited offering exemptions in the same form as adopted by the Commission, and a number of

states have enacted exemptions that are at variance with each other and with Regulation D. The American Bar Association and other interested parties have argued with merit that these actions defeat the congressionally mandated goal of uniformity. Fortunately, due to the untiring efforts of Chairman Al Mackey and other members of NASAA's Small Business Committee, and Michael Halloran, Hugh Makens, and Ronald Fein of the American Bar Association's State Regulation of Securities Committee and others, further improvement can be expected.

Nevertheless, achievement of uniformity among 51 sovereign jurisdictions entails several very significant hurdles. First, NASAA and the Commission must reach agreement. Then all of the individual state regulators must accept that agreement. Respective state legislatures must be convinced to follow suit, and finally, amendments, interpretations and no action positions must be coordinated. Agreement on uniform regulation by an overwhelming majority of states cannot bind a small minority. That minority can substantially undermine the effectiveness of the entire effort.

Considering that individual states understandably do not wish to surrender their independence, complete uniformity is unlikely to be achieved through voluntary means. Of course, it can be argued that the benefits of uniformity do not outweigh the benefits to particular states of having different requirements. But if Congress determines that substantial uniformity in a particular area such as limited offering exemptions is in the national interest, and we fail in our cooperative efforts

to achieve that goal, the primary alternative available appears to be preemption.

In this regard, we should keep in mind the two doctrines cited by the Supreme Court's majority opinion in the MITE case which invalidated the Illinois Business Takeover Act. The first is that when there are conflicts between state and federal law which make compliance with both impossible, the Supremacy Clause of the U.S. Constitution mandates that the federal regulation prevail. Second, even in the absence of specific federal regulation, state law can and should be voided when it imposes a burden on interstate commerce which is excessive in relation to the putative state benefits, because the U.S. Constitution vests regulation of interstate commerce solely in the federal government.

Undoubtedly, the best way to avoid preemption is to redouble our efforts to achieve uniformity. The SEC must accept some of the responsibility for the present situation because until recent years the Commission did not make adequate efforts to coordinate its actions with the states. We can and must do more.

Our hearings last week and our meetings in Williamsburg later this month will be an important step in the development of more formally structured coordination than that which we have had in the past based on individual relationships and interests. I also hope that we can develop a mechanism that would be acceptable to the states whereby amendments to Regulation D, interpretive opinions and no-action positions developed in

consultation with NASAA and perhaps contained in joint SEC-NASAA releases would also apply to the states unless some affirmative state action is taken within a specified time period to halt effectiveness.

If we can implement such arrangements, or some better alternatives to achieve and maintain substantial uniformity, I believe that state securities administrators will continue to play a vital regulatory role indefinitely. This is important because the SEC is just not able to fulfill many funtions now performed by the states.

In recent years, new securities issues and trading volume have increased significantly, a vast range of novel and complex products has been introduced, and the recent recession has brought with it numerous fraudulent acts. Despite all of this, the SEC will employ fewer people in 1984 than it did in 1974. Clearly, the Commission does not have the resources to assure proper regulation of all participants in the burgeoning securities markets. There is so much to be done, particularly in the enforcement area, that the maintenance of vigorous and effective state regulators may well be more important today than ever before. Any significant federal preemption of state blue sky laws could be expected to reduce the resources and effectiveness of all efforts by state securities regulators. Absent a corresponding increase in federal resources, which I do not anticipate, such preemption would work to the detriment of investors. Accordingly, it is imperative that we intensify our efforts to achieve a level of uniformity and coordination that will forestall momentum to preempt state securities laws.