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July 21, 2003

The Honorable Michael Oxley
Chairman
Financial Services Committee
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Barney Frank
Ranking Member
Financial Services Committee
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Oxley and Ranking Member Frank:

We are writing to express our strong opposition to Section 8(b) language in H.R. 2179 that would drastically reduce the ability of states to protect investors. The bill, as it emerged from subcommittee mark-up, asks investors to make an unacceptable trade-off – reduced state enforcement authority as the price for enhanced SEC civil enforcement authority. While we generally support the bill's other provisions, investors stand to lose far more from the state preemption provision than they stand to gain from enhanced SEC civil authority. For this reason, we urge that you not pass H.R. 2179 unless the preemption provision is taken out.

The amendment does far more than simply reinforce SEC authority to set national rules for national markets. For example, there is nothing in the language of the bill that limits its preemptive reach to state conduct remedies that are national in scope. State regulators would be preempted, not just by the SEC, but also by industry self-regulatory organizations. The areas in which states would be preempted are extremely broad – including disclosure, conflict of interest, and record-making requirements – all areas not covered by the NSMIA language from which this is derived. Because these are tools regularly relied on by states in crafting conduct remedies, all sorts of routine enforcement actions used by states to address abusive practices could be open to challenge by the brokerage firms. As a result, state regulators would be free to investigate fraud, but they could do little to end abusive practices beyond imposing a fine or revoking a license.

Proponents of the amendment contend that these concerns are unwarranted, since the SEC would have the power to define through rules areas where states would not be preempted. Leaving aside the appropriateness of requiring states to get SEC permission to enforce their own

laws to protect their own citizens, this is hardly reassuring. The SEC was badly embarrassed by New York Attorney General Eliot Spitzer's investigation into tainted stock research at Merrill Lynch, which exposed the SEC's inaction on a long-simmering and widely acknowledged problem. Without that, and the threat of further such embarrassment, it is unlikely that either the SEC or the SROs would have participated in the global settlement, which has laid the groundwork for important reforms. In short, the SEC has a strong incentive to prevent states from exposing similar federal regulatory failings in the future and could use its rulemaking authority under this amendment to deny them that ability. If the states' hands are tied, the SEC itself is likely to sink back into the complacency that has all too often characterized its response to widespread and ingrained, but abusive, industry practices. Small wonder that this amendment is enthusiastically supported by the Securities Industry Association.

No one has offered any evidence that Wall Street has been harmed by over-zealous state regulators imposing inappropriate restrictions on its activities. To the degree that the analyst settlement has been criticized – outside Wall Street, at least – it has been almost exclusively for not doing enough to separate research and investment banking and for not providing enough money in restitution to investors. The SEC and SROs may not have relished being forced under the glare of media attention to join the analyst investigation, but investors are better off today than they would have been had the states not prodded the federal authorities to act. Congress should not now step in to eliminate the "competitive pressure" that the threat of state action provides. If it does, investors will clearly be the losers.

In short, this provision's broad and unwarranted preemption of legitimate state authority is a serious threat to investors. We urge that you remove it from the bill. If the provision is removed, but only if it is removed, our organizations can enthusiastically support passage of the underlying SEC civil enforcement authority bill.

Respectfully submitted,

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