SUBJECT: Revising Securities Act enforcement provisions

COMMITTEE: Pensions and Investments — favorable, without amendment

VOTE: 4 ayes — Ritter, Grusendorf, Pena, Rose

0 nays

3 absent — Telford, McClendon, Martinez Fischer

WITNESSES: For — None

Against — None

On — Denise Crawford, State Securities Board

BACKGROUND: The Texas Securities Act (Art. 581, V.T.C.S.) governs the sale of securities under regulation of the State Securities Board (SSB). Art. 581-29 specifies penalties for violations of the act.

DIGEST: HB 2042 would make it a felony for a person to act as an investment advisor, directly or through a representative, without being registered or submitting a notice filing as required by the Securities Act. The penalty would be a fine of up to $5,000 or imprisonment for two to 10 years or both.

The state attorney general could seek equitable relief in district court for victims of securities fraud, and the court could grant any equitable relief it deemed appropriate. In an action involving fraudulent securities sales, the attorney general could seek disgorgement of any economic benefit gained by the defendant through the violation, including a bonus, fee, commission, option, proceeds, profit from or loss avoided through the sale of the security or any other tangible benefit.

HB 2042 would authorize the state securities commissioner to assist a securities regulator of another state or a foreign jurisdiction who requested help in an investigation relating to a securities matter. The commissioner could use any appropriate authority, including subpoena power, conferred by

the Securities Act. In determining whether to provide assistance, the commissioner could consider whether SSB employees and resources were available; whether complying with the request would violate or otherwise prejudice state policy; and whether the requesting state had agreed to provide reciprocal assistance within its authority.

The bill would specify that the term "security" or "securities" applies regardless of whether it evidenced by a written instrument.

The bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2003.

SUPPORTERS SAY:

HB 2042 would amend the Securities Act to conform with the states' Uniform Securities Act and with the federal Sarbanes-Oxley Act, the Public Company Accounting and Investor Protection Act of 2002. In doing so, it would strengthen the state's enforcement authority over investment securities. In the past year and a half, investors have witnessed sensational incidents of alleged and actual corporate malfeasance and violations of securities law. These events have caused much damage to financial markets and to the economy as a whole. Enron's demise has made Texans particularly aware of the effects of questionable accounting and investment practices.

The State of Texas — through the Employees Retirement System, Teacher Retirement System, University of Texas Investment Management Co., and Permanent School Fund — has lost millions of dollars in the value of its stocks and bonds, in part because of recent investment scams. WorldCom's malfeasance alone has cost the state $277 million. HB 2042 would help protect the state's investments and those of its citizens.

Currently, investment advisers who prey on unsuspecting investors do not face criminal liability for misleading clients. HB 2255, the sunset legislation for SSB enacted last session, removed "investment adviser" from the definition of a securities dealer and defined this term in a separate section. However, the bill did not amend the penalty provisions to apply to an investment adviser. HB 2042 would ensure punishment for investment advisers who render services without registering or without submitting a notice filing as required by the Securities Act. The bill would close a loophole

to conform with penalties for other securities professionals under the act. At a time when investor confidence is low, this would help preserve professional integrity among legitimate investment advisors.

The bill would authorize the attorney general to seek equitable relief through district court for victims of securities fraud and to seek disgorgement of any economic benefits from fraudulent securities sales. Violators would have to surrender their profits, proceeds, bonuses, fees, commissions, or other benefits to help make victims whole. This would give the state parallel authority to a similar provision in the federal Sarbanes-Oxley Act.

HB 2042 would allow the securities commissioner to aid regulators in other states who seek assistance with a Texas investigation, including reciprocal subpoena authority. Regulators need clear lines of cooperation and communication to track and sort multistate transactions. Although the SSB has cooperated with other states informally for years, this reciprocal arrangement, which would conform with the Uniform Securities Act, could save the state resources in investigations beyond Texas borders.

The bill would clarify the term "security" or "securities" and would apply it whether or not the term involved a written instrument. This portion of the bill would respond directly to a 2001 Texas Court of Criminal Appeals case, *Thomas v. State*, 65 S.W.3d 38, which found that the "definition of security in the Texas Securities Act requires a writing." The widespread use of technology makes this provision necessary. As more scam artists attempt to make fast dollars, the state should be able to pursue a fraudulent transaction whether it was made on paper or over the Internet. The law should recognize a security whether it is a certificate in writing or an electronic transaction.

As one of three bills this session designed to protect Texas investors against fraud, HB 2042 would be a significant first step toward addressing the concerns of Texas investors.

OPPONENTS SAY:

No apparent opposition.

NOTES:

The companion bill, SB 1060 by Ellis, passed the Senate by 29-0 on April 3 and was reported favorably, as substituted, by the House Pensions and Investments Committee on April 28, making it eligible to be considered in lieu of HB 2042. The Senate engrossed version also would allow the attorney general to recover from a disgorgement reasonable costs and expenses in an action brought under this legislation.