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State Securities Enforcement

Andrew K. Jennings

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State Securities Enforcement

Andrew K. Jennings[*]

Each year, state securities regulators bring over twice the enforcement actions brought by the Securities and Exchange Commission, yet their work is largely missing from the literature. This Article provides an institutional account of state securities enforcement and identifies two key advantages—detection granularity and institutional decentralization—that states enjoy over their federal counterparts in policing localized frauds involving individual, often small-dollar, victims. Although states share enforcement jurisdiction with the SEC and DOJ, their enforcement activity reflects their institutional advantages and constraints and thus largely does not overlap with that of federal authorities. Instead, states serve as the nation's residual securities enforcers, policing local misconduct that federal authorities or private plaintiffs largely do not. The states' work as residual securities enforcers should thus guide state and federal authorities as they cooperate and complement each other's enforcement missions. And given the need for local investor protection, proposals around national securities policy should bolster that work or, at the least, mitigate negative impacts on it.

CONTENTS

INTRODUCTION 68
I. WHAT IS STATE SECURITIES ENFORCEMENT? 74
A. Comparing State and Federal Securities Enforcement 75

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B. Enforcement Categories ... 79
II. WHO ARE STATE SECURITIES ENFORCERS? ... 82
A. Institutional Structures ... 84
B. Resources ... 89
C. Priority Setting ... 91
D. Fraud Prevalence and Public Salience ... 94
E. Legislation, Policy, and Autonomy ... 99
III. WHAT DO STATE SECURITIES ENFORCERS DO? ... 101
A. Investigation Sourcing ... 103
B. Investigations and Enforcement Actions ... 108
C. Criminal Prosecution ... 114
D. Coordination and Cooperation ... 119
E. Multistate Coalitions ... 122
IV. STATE SECURITIES ENFORCEMENT AS RESIDUAL SECURITIES ENFORCEMENT ... 127
CONCLUSION ... 132
APPENDIX ... 134

INTRODUCTION

In every American town, where there are investors ready to invest, there are fraudsters ready to steal. Although those fraudsters could face investor lawsuits or enforcement from the U.S. Securities and Exchange Commission (SEC) or federal prosecutors, in practice state authorities often are victims' (or would-be victims') only line of defense. This Article uses data collected via public-information requests and semi-structured interviews to provide an institutional account of how states exercise their securities-enforcement jurisdiction, including how they source and conduct investigations; set priorities within resource constraints; and coordinate with other state regulators, federal authorities, self-regulatory organizations, and local law enforcement and prosecutors. This account frames states as residual enforcers in the national securities-enforcement system,

meaning that they take cases that federal authorities and private plaintiffs cannot or will not bring.[1]

The National Securities Markets Improvement Act of 1996 (NSMIA) preempted broad swaths of state securities-offering regulation.[2] Its passage marked a summit moment in the federal government's rise as the nation's near-exclusive ex ante securities regulator.[3] NSMIA expressly preserved, however, states' authority to enforce the antifraud provisions of their securities statutes, leaving them and the federal government with largely concurrent jurisdictions over ex post enforcement.[4] For instance, most states have fraud prohibitions that track the SEC's Rule 10b-5, meaning that conduct that creates federal liability under the rule also gives rise to state liability.[5]

Whether ex ante state regulation should be preempted is well covered in the literature.[6] That states' ex post enforcement authority has gone mostly undisturbed after the passage of NSMIA, however, has received less consideration.[7] This seems unusual

1. *See* Zachary D. Clopton, *Redundant Public-Private Enforcement*, 69 VAND. L. REV. 285, 290 (2016) ("[R]edundant authority across diverse agents may respond to errors, resource constraints, information problems, or agency costs at the level of case selection.").

2. *See* National Securities Markets Improvement Act of 1996 § 102, Pub. L. No. 104-290, 110 Stat. 3417.

3. See Roberta S. Karmel, *Reconciling Federal and State Interests in Securities Regulation in the United States and Europe*, 28 BROOK. J. INT'L L. 495 (2003) for a history of the development of federal securities-regulation dominance. Federal ex ante regulatory dominance is greatest in the context of offerings and is more broadly shared in other contexts, particularly in broker-dealer regulation. *See generally* Yerv Melkonyan, Note, *Regulation Best Interest and the State-Agency Conflict*, 120 COLUM. L. REV. 1591 (2020) (conducting a preemption and economic-federalism analysis of state and federal regulation of broker-dealer conduct).

4. States have a claim to even broader antifraud jurisdiction than their federal counterparts, as state antifraud statutes typically lack a scienter requirement. *See infra* note 28 and accompanying text.

5. 17 C.F.R. § 240.10b-5.

6. *See* Renee M. Jones, *Dynamic Federalism: Competition, Cooperation and Securities Enforcement,* 11 CONN. INS. L.J. 107 (2005); Rutherford B. Campbell, Jr., *The Insidious Remnants of State Rules Respecting Capital Formation*, 78 WASH. U. L.Q. 407 (2003); Manning Gilbert Warren III, *Reflections on Dual Regulations of Securities: A Case for Reallocation of Regulatory Responsibilities*, 78 WASH U. L.Q. 497 (2000); Michael A. Perino, *Fraud and Federalism: Preempting Private State Securities Fraud Causes of Action*, 50 STAN. L. REV. 273 (1998); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359 (1998).

7. *But see* Amanda M. Rose & Larry J. LeBlanc, *Policing Public Companies: An Empirical Examination of the Enforcement Landscape and the Role Played by State Securities Regulators*, 65 FLA. L. REV. 395 (2013); Amanda M. Rose, *State Enforcement of National Policy: A Contextual Approach (with Evidence from the Securities Realm)*, 97 MINN. L. REV. 1343 (2013); Carlos Berdejó, *Small Investments, Big Losses: The States' Role in Protecting Local Investors from Securities Fraud*, 92 WASH.

because compared to their federal counterparts, states bring more securities-enforcement actions. Between 2012 and 2018, for example, the SEC brought on average 774 administrative and civil actions a year,[8] and from 2013 to 2017, the U.S. Department of Justice (DOJ) secured on average 234 criminal convictions a year against individuals for securities violations (e.g., insider trading or offering fraud).[9] During the same period, state regulators brought on average 1,826 administrative and civil actions annually, 139% more than the SEC.[10] Although data on state-law securities prosecutions are incomplete, from 2013 to 2017, states brought on average at least 256 criminal cases a year, slightly more than DOJ's average.[11]

Aggregate enforcement statistics do not tell the full story. After all, things like books-and-records violations at a broker-dealer or delinquent filings by a public issuer require fewer resources to address than an investigation into a complex accounting fraud.[12] These aggregates thus raise several questions: Given their largely concurrent enforcement jurisdictions, do state and federal authorities overlap or duplicate each other's efforts? Or, is there instead a division of labor between them in which each tackles distinct cases, making their efforts complementary? The answer, in short, is that state and federal authorities tend not to overlap in their enforcement activity despite overlapping in their enforcement jurisdiction, suggesting that they complement each other as public securities enforcers. This answer points to securities fraud as sometimes taking the form of financial street crime. It helps spotlight states' advantages within a national system of enforcement that includes federal authorities (including self-

L. REV. 567 (2017) (analyzing state securities enforcement with a focus on victim restitution); Wendy Gerwick Couture, *Principles for State Prosecution of Securities Crime in a Dual-Regulatory, Multi-Enforcer Regime*, 22 U. PA. J. BUS. L. 30 (2019) (examining and recommending principles for the exercise of states' criminal securities jurisdiction).

8. *See infra* APPENDIX, Table 1.

9. *See infra* APPENDIX, Table 2.

10. *See infra* APPENDIX, Table 1.

11. *See infra* APPENDIX, Table 2.

12. *But cf.* Urska Velikonja, *Reporting Agency Performance: Behind the SEC's Enforcement Statistics*, 101 CORNELL L. REV. 901, 933–47 (2016) (showing that metrics in the SEC's annual reports do not provide reliable views of enforcement levels because they inconsistently count follow-on actions, single actions against multiple defendants, and multiple actions against a single defendant).

regulatory organizations like the Financial Industry Regulatory Authority (FINRA)) and private plaintiffs. This finding suggests that state and federal authorities, given mutual resource constraints and distinct enforcement missions, do not over enforce by pursuing the same violations.

This Article proceeds in four parts, each drawing from public records collected from the states. It adds color to these records through interviews conducted with 61 current and former state securities enforcers covering 36 states, as well as 11 individuals who have worked adjacent to state enforcers as private attorneys, as federal enforcers, or in similar roles.[13]

Part I reviews the statutory scheme for concurrent state and federal enforcement jurisdiction over securities violations. It outlines broad areas of overlapping jurisdiction, while identifying differences between state and federal enforcement activity in terms of the targets they police. This Part organizes state enforcement actions into two categories: violations by registered issuers, broker-dealers, investment advisers, and their licensed representatives (registered violations), and violations by unregistered issuers and individuals (unregistered violations).[14] For both categories, states tend to bring actions that involve some form of theft, as opposed to compliance-based violations that would not be expected to have direct, identifiable victims.[15] This Part observes that state enforcement activity focuses on actions that impose direct harm on individual victims and would-be victims (as opposed to actions that impose diffuse harm on many parties, like material misstatements in public-company disclosures that harm large numbers of investors). State enforcement activity also focuses on harms to in-state residents, especially high-risk groups like the elderly, in contrast to SEC actions that generally address harms that cross state and national borders.[16]

13. Interviews were conducted by phone, primarily in January and February 2020, on a non-attribution basis. Calls were also held in summer 2019 as part of an earlier stage of this project. In some cases, there were multiple calls with the same interviewee. Some interviews were conducted jointly with two or more individuals from the same office. Because of the sensitive nature of these interviews, citations depart slightly from the Bluebook format.

14. *See infra* Section I.B.

15. *See id.*; *see also infra* APPENDIX, Tables 4 and 9.

16. *See infra* Section II.C.

Part I also examines securities violations in terms of the characteristics of victims and the substantive violations. That examination impresses that for each Enron, countless fraudulent oil-and-gas investment contracts are sold, and that for each Madoff, there are a hundred Ponzi schemes next door.[17] What this Article calls "local" frauds, in other words, are different in character and degree from high-profile or high-dollar cases that lead to publicized enforcement or significant private litigation and thus garner scholarly, policy, and press attention.[18] This Article, in contrast, focuses on the local frauds that predominate in state public enforcement: acts whose offenders and victims engage in discrete transactions, even if the offender has multiple victims or commits multiple acts against the same victim. Typical local violations include affinity-group, real-estate, and private-placement frauds whose victims might lose $5,000, $50,000, or $500,000. These are relatively small sums in the scale of the capital markets, but they are significant—potentially life altering—for individuals.[19] "National" public-enforcement cases, in contrast, would be expected to address aggregate conduct that harms markets or many investors at once, such as insider trading or material misstatements in public-company disclosures. They also include violations that are structurally similar to local frauds but that are more easily policed by a national enforcer because of their large scale, high investor losses, or interstate nature. An example would be an interstate Ponzi scheme with hundreds of victims and millions in losses.

To give context for the political and resources constraints that shape state enforcement activity, Part II outlines the diverse institutional structures behind state enforcement. A third of regulators, for instance, are led by elected officials, while only three

17. *See infra* APPENDIX, Table 3.

18. *See infra* Section I.A; *see also infra* APPENDIX, Tables 10–12; Jayne W. Barnard, *Securities Fraud, Recidivism, and Deterrence*, 113 PENN ST. L. REV. 189, 191 (2008) (discussing securities fraudsters who do not commit "the systemic, organizational frauds that command the attention of the popular press" but rather "engage in 'retail' securities fraud—sales made to investors on a one-on-one basis and schemes . . . designed to induce individual trades.").

19. *See infra* note 300 and accompanying table; *see also, e.g.*, Grand Jury Indictment, People v. Gollehon, Case No. 13CR0001, at *2 (City & Cnty. of Denver, Colo., Dist. Ct. 2013) (on file with author) (indicting a promoter of video-game-development securities alleged to have defrauded $885,930 from ninety-five individuals).

are (like the SEC) standalone securities agencies. Five are part of an attorney general's office,[20] while some are located within agencies that also carry out their states' insurance, banking, or consumer-finance regulatory functions.[21] Others are part of agencies that have distinctly non-financial regulatory responsibilities, including professional boxing and public utilities.[22] After presenting this typology, Part II reviews how state enforcers perceive of themselves and their roles, set priorities under resource constraints, educate the public and fellow in-state agencies, and participate in policy processes. These perceptions in turn support the notion that states function as residual securities enforcers and evidence the advantages they enjoy in that role.

Part III shows how state enforcers work, from the time they receive a complaint or referral, to the point that they reach settlement or bring an adversarial action. Civil violations of state securities laws are often also crimes. This Part explains how enforcers determine when prosecution is merited and how they work with federal, state, and local prosecutors on criminal cases. This Part also outlines what is perhaps the most significant part of the residual enforcer function: state regulators serve as hubs within securities-enforcement networks. This Part explains how as hubs, state regulators coordinate and cooperate with in-state agencies, sister state regulators, federal counterparts, FINRA, and private plaintiffs to channel cases to appropriate enforcers. A subset of that coordination are multistate coalitions formed to tackle systemic product and financial-industry issues.

Based on this institutional account, Part IV concludes that state and federal authorities generally do not overlap in their enforcement activity and indeed regularly refer cases among themselves that better match each other's advantages. Within the national enforcement system, state and federal securities enforcement are complementary, with these authorities following allocations reflective of each actor exploiting its advantages, adhering to its institutional constraints, and pursuing its perceived

20. *See infra* Section II.A; *infra* APPENDIX, Table 5.

21. *See infra* Section II.A; *infra* APPENDIX, Table 5.

22. *See* MICH. DEP'T OF LICENSING & REGUL. AFFS., CORPS., SECS. & COM. LICENSING BUREAU, https://www.michigan.gov/lara/0,4601,7-154-89334_61343---,00.html (last visited Oct. 16, 2021) (boxing licenses); VA. STATE CORP. COMM'N, https://www.scc.virginia.gov/ (last visited Oct. 16, 2021) (public utilities).

enforcement mission.[23] This Part also identifies two key advantages states enjoy over their federal counterparts in policing local frauds.

First, their detection abilities are more granular because they can foster state and local enforcement networks. That means that local police, adult protective services, and similar agencies—as the agencies most likely to first learn of potential violations—can channel leads to the state regulator. In effect, securities regulators have an indirect presence in each community in their states, a force multiplier that a national enforcer like the SEC lacks and would be hard-pressed to replicate.

And second, state securities enforcement is decentralized, reducing the risk of regulatory myopia or capture. Not only are state regulators independent of each other, but almost all states have at least two levels of potential public enforcement in the form of the civil regulator as well as state and local criminal prosecutors. Any one enforcement agency can become myopic in focus, methods, or policy. This risk can be overcome, though, when in-state and state-to-state cooperation spur technical and policy innovation and contribute to enforcement trend spotting. This same effect can reduce the risk of regulatory capture.

These advantages impress that NSMIA's preservation of state enforcement jurisdiction was not a mere nod to federalism, but it instead was a reflection of the need for public enforcement on behalf of local securities-fraud victims who lack plausible recourse via federal or private enforcement. This Article's institutional account shows that state enforcers not only have advantages over the SEC and DOJ in policing local violations, but as residual enforcers they are often the only line of public defense against local violations.

I. WHAT IS STATE SECURITIES ENFORCEMENT?

The optimality of overlapping public and private securities enforcement is a longstanding question in the literature.[24] Several actors in that debate are heavily studied, including the SEC, private

23. *See* James J. Park, *Rules, Principles, and the Competition to Enforce the Securities Laws*, 100 CALIF. L. REV. 115 (2012) (supporting a multienforcer securities system given the comparative advantages of different enforcers).

24. See Amanda M. Rose, *The Multienforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PA. L. REV. 2173 (2010), for a thorough analysis of this question.

securities plaintiffs and their attorneys, the DOJ, and self-regulatory organizations like FINRA. This Article advances the literature with an institutional account of a group of actors that are understudied yet nevertheless integral to an understanding of securities enforcement in the United States: state securities regulators, along with their fellow in-state agencies like local police departments and prosecutors. In doing so, it identifies advantages these actors' enforcement efforts enjoy over their federal counterparts.

Those advantages have quietly influenced the structure of public securities enforcement in the United States. For instance, although state and federal enforcers share largely concurrent enforcement jurisdiction, in practice they roughly allocate enforcement between securities violations that are essentially local or regional (state) and essentially national or international (federal) in nature. That means that states predominately focus on violations—as when an investor buys fraudulent promissory notes directly from a promoter—that occur intrastate and that involve personal contact between offenders and victims. Federal enforcers, meanwhile, predominantly focus on violations that are interstate or international in nature or that implicate aggregated harms to markets or victims with an indirect relationship to the offender.

A. Comparing State and Federal Securities Enforcement

NSMIA preempts state ex ante regulation of many securities transactions, including those involving publicly listed companies and certain private placements, while it preserves states' "jurisdiction under [their own laws] . . . to investigate and bring enforcement actions with respect to fraud or deceit, or unlawful conduct by a broker or dealer, in connection with securities or securities transactions."[25] NSMIA's follow-up statute, the Securities Litigation Uniform Standards Act of 1998 (SLUSA), reaffirms that "State securities regulation is of continuing importance, together with Federal regulation of securities, to protect investors and promote

25. *See* National Securities Markets Improvement Act of 1996 § 102, Pub. L. No. 104-290, 110 Stat. 3417. It also maintains state authority to require notice filings of federally covered offerings, a reservation that both preserves filing-fee revenue and facilitates capital-markets surveillance. *See id.* (codified as amended at 15 U.S.C. § 77r(c)).

strong financial markets"[26] and carves out actions brought by state actors from restrictions it imposes on state-law securities claims.[27]

Together, NSMIA and SLUSA preserve roughly equal, and concurrent, enforcement jurisdiction between federal and state civil enforcers and prosecutors. Under Rule 10b-5, the SEC could, for example, bring an action against the promoter of a small-dollar promissory-note scam. For its part, a state regulator following Section 501 of the Uniform Securities Act, the state analog of Rule 10b-5, could bring an action against a public company for accounting misstatements that harm its in-state investors.[28] State regulators can even bring actions for some conduct for which the SEC cannot: Section 501 lacks Rule 10b-5's scienter requirement, thus allowing states to bring fraud actions for conduct that was merely negligent.[29] Some states go even further. Under the Texas Securities Act, for example, securities fraud includes unconscionably "gross or exorbitant" underwriting commissions, expanding the kinds of actions Texas can bring.[30]

Despite this concurrent jurisdiction, the SEC would not typically be expected to charge a promoter of a small-dollar fraud, nor would a state be expected to pursue a public company for misstatements in its SEC filings. There are exceptions, but a local/national enforcement allocation roughly holds.[31] The states bring nearly two-and-a-half times the number of administrative and civil enforcement actions brought by the SEC.[32] This comparison is apples-to-apples in some respects but apples-to-oranges in

26. Securities Litigation Uniform Standards Act of 1998 § 2, Pub. L. No. 105-353, 112 Stat. 3227.

27. 15 U.S.C. § 77p(d)(2).

28. UNIF. SEC. ACT § 501 (NAT'L CONF. OF COMM'RS ON UNIF. STATE L., amended 2005).

29. *Id.*

30. TEX. REV. CIV. STAT. ANN. art. 581-4, § F (West 2003).

31. Although this heuristic does not always hold, it is useful to think of state enforcement in terms of individual-victim frauds versus frauds on the market. *See* Rose, *supra* note 24, at 2206 (concluding that economics-of-federalism scholarship would support "assigning the federal government responsibility for deterring fraud in the national securities markets, while assigning state governments responsibility for deterring fraud targeted at their respective local capital markets"). *But see* People v. Exxon Mobil Corp., 65 Misc. 3d 1233(A), at *30 (N.Y. Sup. Ct. Dec. 10, 2019) (finding that the New York attorney general failed to establish that ExxonMobil made material misstatements regarding climate change).

32. *See supra* notes 8, 10 and accompanying text.

others. Compare apples to apples: in 2018, for example, states brought 245 actions against broker-dealers or their agents, whereas the SEC brought 169 broker-dealer actions.[33] These state and federal actions would generally deal with similar issues: unsuitable recommendations, compliance failures, books-and-records violations, and the like.[34] Then there is apples to oranges: in 2018, the SEC brought 121 actions for delinquent filings, 13 for foreign corrupt practices, 51 for insider trading, and 33 for market manipulation, violations that state regulators in many cases would lack capacity for or obvious jurisdiction over.

This chart sketches the rough allocation between the enforcement activity (but not necessarily the jurisdiction) of the SEC and state securities regulators:[35]

Subject Matter	SEC	States
Broker-Dealers (including registered representatives)	✓	✓ (in-state branches/licensees)
Investment Advisers (including associated persons)		
> $100m assets under management	✓	✗ (possible exceptions)
< $100m assets under management	✗ (possible exceptions)	✓
Offering-Related Fraud		
"Higher" Investor Losses	✓	✗ (with exceptions)
"Lower" Investor Losses	✗ (with exceptions)	✓

33. *Compare infra* APPENDIX, Table 10, *with* APPENDIX, Table 11. This comparison is a rough one. Included in both denominators are non-harm actions (e.g., books-and-records violations and delinquent filings) for which no investor monetary relief would be ordered. It is, nevertheless, consistent with the observations of interviewees that the cases brought by the SEC that involve investor harm tend to have higher loss levels.

34. Indeed, it is not surprising that Congress's establishment of a dual ex ante registration system for the broker-dealer industry would, contra this Article's general claim, result in overlapping enforcement between national actors like the SEC and FINRA, on one hand, and states on the other.

35. This chart refers to expected actual enforcement activity, rather than actual enforcement jurisdiction that either the SEC or states have.

Public-Issuer Reporting and Disclosure	✓	✗ (possible exceptions)
Foreign Corrupt Practices Act	✓	✗
Insider Trading	✓	✗ (possible exceptions)
Market Manipulation	✓	✗ (with exceptions)
Self-Regulatory Organizations (SRO)/ National Exchanges/Transfer Agents	✓	✗

Another comparison can be made using regulators' investigation-to-complaint ratios. In 2018, for example, state regulators received 5,414 tips and complaints and conducted 5,320 investigations—many, but not all, of which would have been opened based on complaints—a 965:1,000 investigation-to-complaint ratio.[36] That same year, the SEC received 19,000 tips and complaints and opened 869 investigations—again, some, but not all, were sourced from complaints—a 46:1,000 ratio.[37] These ratios suggest that complaints or tips to state regulators are more likely to trigger an investigation than would a complaint or tip to the SEC.

This comparison does not necessarily imply that the states are more responsive than the SEC. The SEC's lower ratio might, for instance, indicate that it receives multiple tips for the same issue, that it receives frivolous tips, or that it refers complaints to other agencies like state regulators. The states' ratio, on the other hand, might suggest that they receive a higher proportion of unique complaints, perhaps directly from victims. These distinctions are consistent with how current and former enforcers interviewed for this Article described their typical cases: individuals complain of $5,000, $50,000, or $500,000 losses from investments that investigation shows to have been affinity, Ponzi, or similar frauds.[38] These loss amounts generally fall below a threshold that the SEC or

36. *See infra* APPENDIX, Table 11.

37. U.S. SEC. & EXCH. COMM'N, *FY 2020 Budget Request by Program*, *in* FISCAL YEAR 2020 CONGRESSIONAL BUDGET JUSTIFICATION ANNUAL PERFORMANCE PLAN 21, 25 (2020).

38. Interviewee #6 (describing typical losses); Interviewee #29 (same); *see also infra* APPENDIX, Table 3.

a U.S. attorney's office would have a capacity or interest to act upon.[39] Although those sums are small in the scale of the capital markets, they can be personally devastating for individual victims, often representing all or a substantial portion of a victim's investable assets.[40] Some investors, for instance, lose their homes.[41] And where there is one small-dollar victim, there are often more. Complaints can spark investigations that uncover dozens, even hundreds, of other victims.[42] For instance, victims of affinity frauds can be found clustered in the complainant's religious, ethnic, or professional community.[43]

B. Enforcement Categories

Cases fall into two categories: violations by registered issuers, broker-dealers, investment advisers, and their licensed representatives (registered violations); and violations by unregistered issuers and individuals (unregistered violations).

Of the two, interviewees considered unregistered violations to be the bulk of their caseloads,[44] a view that first appears inconsistent with aggregate state enforcement data. From 2012 to 2018, roughly 31% of enforcement respondents were unregistered firms or individuals, whereas about 61% were broker-dealers, investment advisers, or their

39. *See* Interviewee #30 (observing that state regulators "do the exams, they're in front of people, and their threshold for being able to say we want to make a case is lower than the SEC").

40. *See* Interviewee #48 ("In terms of victim impacts, the dollar losses are a little bit lower than what one might expect looking at big SEC cases, or a big class action, but the victim impact . . . is higher as a result because it's frequently all of their investable assets."). Interviewee #42 described the enormous harm some victims experience: "You see marriages break up. You see people who become depressed. We have had victims who've taken their lives because they're so devastated. Thank God it doesn't happen very often. There's a lot of shame. Sometimes people do everything right and still get taken advantage of."

41. *Cf.* Interviewee #4 (reporting that awards from the state's securities restitution fund allowed some defrauded investors to stay in their homes).

42. *Cf.* Interviewee #26 (discussing a criminal securities prosecution involving several hundred victims); Interviewee #57 ("At times we will ask for lists of all other investors in the state so we can interview as many as possible.").

43. *See* Interviewee #26 (discussing affinity fraud in the state); Interviewee #28 (same); Interviewee #29 (same); Interviewee #36 (same).

44. Interviewee #32 ("About 75% of the things we see are unregistered and 25% registered."); Interviewee #40 ("Many things that we see are unregistered activity."); Interviewee #48 ("[T]he majority of what I've seen during my . . . tenure is what I would qualify as unregistered violations.").

representatives.[45] That inconsistency is partly explained, however, by the qualitative differences between registered and unregistered violations: although registered cases exceed unregistered cases in count, unregistered enforcement requires more time and greater investigative resources. In 2017, for example, Florida brought 105 actions for books-and-records violations, versus 69 for unregistered activity.[46] Books-and-records violations would tend to be uncovered through routine examinations of broker-dealer branches and investment advisers and would be evident through straight-ahead document review or on-site interviews. The latter category, although fewer in number, would require greater time and resources to investigate, thus taking up the bulk of regulators' enforcement capacity. Florida's sixty-nine unregistered violations, for example, would require intaking complaints; obtaining and reviewing documents from victims, targets, and third parties; and interviewing persons with relevant knowledge.[47] In some states, investigations of unregistered activity would include executing search warrants and empaneling grand juries.[48]

The conduct underlying unregistered violations might also be more salient for enforcers. Interviewees reported that there is relatively little theft-like misconduct in the registered space, as opposed to technical, compliance-based violations. In the unregistered space, however, theft is the focus, versus naïve violations, such as entrepreneurs who unlawfully offer securities for otherwise legitimate businesses.[49] That is not to say that state

45. *See infra* APPENDIX, Table 10. Broker-dealers are regulated under both the Securities Exchange Act of 1934 and state securities statutes. *See* 15 U.S.C. § 78*o* (registration of broker-dealers); UNIF. SEC. ACT art. 4 (NAT'L CONF. OF COMM'RS ON UNIF. STATE L., amended 2005) (registration of broker-dealers and their agents); *supra* note 34 (discussing the overlapping enforcement effects of dual registration of broker-dealers). In general, investment advisers with under $100 million in assets under management are regulated exclusively by state regulators, whereas investment advisers over that threshold are regulated exclusively by the SEC. 15 U.S.C. § 80b-3a(a)–(b).

46. *See infra* APPENDIX, Table 9.

47. *See* Interviewee #29 (discussing intake procedures); Interviewee #34 (discussing document review and interview procedures for unregistered investigations and noting the comparative efficiency of examination-based investigations).

48. *Cf.* Interviewee #4 ("Unregistered activity is more criminally charged than registered activity; we usually handle that administratively.").

49. In one anecdote, an enforcer mentioned an entrepreneur who illegally issued a substantial number of real-estate-related securities, a common vehicle for local securities

regulators do not uncover serious violations by registered firms.[50] Interviewees noted that states examine state-registered investment advisers more often that the SEC examines federally-registered firms.[51] They do find violations there, particularly by small firms that fail to establish appropriate compliance programs.[52] National and regional firms are by no means spotless. In the Morgan Keegan case, for example, customers lost approximately $1.5 billion in bond funds that failed during the 2008 crisis.[53] A multistate investigation found that brokers at that firm engaged in material misstatements and omissions, unsuitable recommendations, and other customer-harming violations.[54] In one smoking-gun email produced to state

frauds. Interviewee #25. The regulator's investigation, however, found that the enterprise was legitimate, that the entrepreneur did not make material misstatements or omissions to investors, and that the entrepreneur had long since become compliant with the state's regulations. *Id.* Given the absence of theft and the entrepreneur's subsequent compliance, the regulator declined to bring charges. *Id.*

50. One interviewee expressed concern that some states overly focus on technical violations by firms and licensees—rather than more substantive violations that have directly harmed investors—because the former cases are easier to bring. Interviewee #30. There was limited suggestion in the interviews, however, that states eschew harder (but more substantive) cases in favor of easier (but more technical) ones. *See* Interviewee #42:

> If you looked at some of our cases in the late 90s, you'd see we issued hundreds per year; they were all cookie cutter. We didn't know if people selling over the phone were using their real names; we never got service. They may have changed names. One of my focuses is things happening in the state, where at least they met or know the person. Maybe it's over the Internet, but we're fairly certain of the name and we can serve them.

51. Between the 2013 and 2018 fiscal years, the SEC examined on average twelve percent of federally registered investments advisers per year. *See* U.S. SEC. & EXCH. COMM'N, *FY 2020 Annual Performance Plan, in* FISCAL YEAR 2020 CONGRESSIONAL BUDGET JUSTIFICATION ANNUAL PERFORMANCE PLAN 97, 99 (2020); *see also* Interviewee #60 (describing a schedule in which state-registered investment advisers are examined every three years, including random suitability reviews of client files). To the extent that FINRA's examination and enforcement efforts may be influenced by the industry it self-regulates, state regulators offer a check. *See generally* Benjamin P. Edwards, *The Dark Side of Self-Regulation*, 85 U. CIN. L. REV. 573 (2017) (examining the role of industry representatives in FINRA governance).

52. *See* Interviewee #2 (discussing issues with state-registered investment advisers).

53. Liz Skinner & Andrew Osterland, *Morgan Keegan on the Block After $210M Settlement?*, INVESTMENTNEWS (Sept. 20, 2011), https://www.investmentnews.com/morgan-keegan-on-the-block-after-210m-settlement-37101.

54. *See* Joint Notice of Intent to Revoke Registration and Impose Administrative Penalty at 50, Morgan Asset Mgmt., Inc., Ala. Sec. Comm'n SC-2010-0016 (Apr. 7, 2010) [hereinafter Joint Notice of Intent]. Other states also joined this settlement and their own enforcement orders contain roughly identical language to the Alabama/Kentucky/Mississippi/South Carolina order. *See, e.g.*, Consent Order, Morgan Asset Mgmt., Inc., Mo. Sec'y of State, Case No. AP-11-24 (Dec. 13, 2011).

investigators, a Morgan Keegan executive expressed concern about the firm's risky RMK bond fund and how it was marketed to unwitting investors.[55] As the next Parts will show, those kinds of concrete harms to identifiable investors motivate how state regulators spend their limited enforcement resources.

II. WHO ARE STATE SECURITIES ENFORCERS?

This Part analyzes the institutional, political, and resource constraints that state enforcers operate under. This analysis sheds light on the role they serve within their own communities and, indirectly, their function within the national securities-enforcement system.

A slogan among state enforcers is that they are "the local cops on the securities beat."[56] This slogan is both an assertion of the role of state enforcement as well as a description of what they do day-to-day.[57] Interviewees characterized their institutional missions as being focused on investor protection—particularly of in-state and at-risk investors (like the elderly)—and, to a lesser degree, capital formation. Enforcers pursue these missions through three core functions: registration and licensing, audits and examinations, and enforcement. Although this Article focuses on enforcement, the investor-protection mission imbues registration and examinations as well, supporting their prophylactic functions by implicit enforcement threats, including the denial or revocation of registrations, fines, or other sanctions. Given that federal policy has eroded states' ex ante regulatory authority, interviewees couched their capital-formation missions in terms of their investor-protection function; in policing against fraud, they promote capital

55. Joint Notice of Intent, *supra* note 54, at 32.

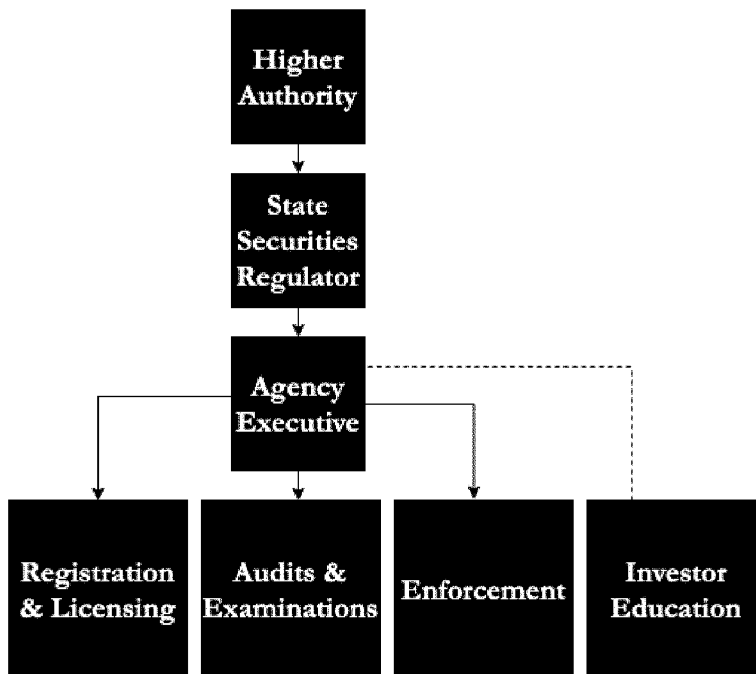
56. *The Role of State Securities Regulators in Protecting Investors: Hearing on Efforts to Enforce Securities Laws, Investment Advisor Registration and Licensing, State Investigations into Mutual Fund Industry Abuses, and Investor Education Programs Before the S. Comm. on Banking, Hous. & Urb. Affs.*, 108th Cong. 34 (2004) (statement of Ralph A. Lambiase, President, N. Am. Sec. Adm'rs Ass'n) ("We have been called the 'local cops on the securities beat,' and I believe that is an accurate characterization."); Interviewee #70 ("You've heard the term 'local cop on the beat,' but it's true. You get walk-in complaints. They want face time. It helps for public service: you're not writing some bureaucracy or concrete building in Washington. We're here. We can go do an exam. Records, we can get them more readily.").

57. A fourth function, education and outreach, supports the core functions. *See infra* Section II.D.

formation by bolstering investor confidence and channeling capital toward legitimate markets.[58]

Defining some key terms is in order. The institutional structures of state securities regulators vary wildly. The Texas State Securities Board, for example, is a standalone agency. The North Carolina Securities Division, in contrast, is a unit within the secretary of state's office. The institutional unit of analysis in this Article is the office that contains three core functions of securities regulation: registration and licensing, audits and examinations, and enforcement. Larger and better-funded regulators have dedicated investor-education functions as well. This Article refers to those core units as "regulators," or "divisions"; "agencies" means their parent agencies. A few standalone regulators, like the Texas State Securities Board, are themselves agencies. "Other agencies" or "in-state agencies" refer to the network of local and state agencies that state securities regulators potentially work with, including local and state police, prosecutors and attorneys general, adult protective services, and insurance and banking regulators. This generic structure can be seen in the following figure:

58. Registration and licensing protect the public by facilitating intrastate capital-market surveillance and vetting those seeking to enter local broker-dealer or investment-adviser industries. Examiners work to ensure compliance by broker-dealers and investment advisers with industry regulations. *See* Interviewee #45 ("[W]hat if the $200,000 invested in a scam went into a well-diversified portfolio? It's good for an investor, good for the markets. How many of these dollars that get ripped off in the unregistered space could have made it into the legitimate markets[?]").



A. Institutional Structures

Former New York Attorney General Eliot Spitzer was dubbed, or perhaps dubbed himself, the "Sheriff of Wall Street."[59] He occupied a uniquely positioned sheriff's office that not only physically sits at the heart of the U.S. capital markets[60] but that also has the Martin Act, a capacious antifraud statute, at the center of its enforcement arsenal.[61] Given these advantages, the New York attorney general is perhaps the nation's most prominent state

59. Rebecca Leung, *The Sheriff of Wall Street*, CBS (May 23, 2003), https://www.cbsnews.com/news/the-sheriff-of-wall-street/ ("Spitzer deputized himself the Sheriff of Wall Street."); *see generally* PETER ELKIND, ROUGH JUSTICE: THE RISE AND FALL OF ELIOT SPITZER (2010).

60. *Investor Protection Bureau*, N.Y. STATE ATT'Y GEN., https://ag.ny.gov/investor-protection/contact (last visited Oct. 18, 2021) (listing 28 Liberty Street, just steps away from the New York Stock Exchange on Wall Street, as the location of the Investor Protection Bureau).

61. N.Y. GEN. BUS. LAW § 352-C (Consol. 2014).

securities enforcer. It is, however, not a typical securities regulator, just as Eliot Spitzer was not a typical agency leader.[62] At the same time, New York's sister regulators are institutionally heterogenous, suggesting that there is not "typical" securities division.

Start with subject-matter jurisdiction. State agencies responsible for securities regulation are exclusive or non-exclusive to securities. The exclusive regulators, like the SEC, are self-contained agencies whose sole jurisdiction is securities. Only three states—Alabama, Oklahoma, and Texas—have exclusive regulators.[63] The non-exclusive agencies include sixteen that house other financial regulators—like banking, insurance, or consumer finance—as well as the thirty-two that conduct nonfinancial regulation, such as public utilities, sports agents, or professional boxing.[64] The latter group includes five states—Delaware, Maryland, New Jersey, New York, and South Carolina—that locate securities regulation within an attorney general's office.[65] Regulators are not only heterogenous in their institutional structures but also in their leadership, with a clear divide between elected and appointed leaders. Seventeen have parent agencies with elected leaders, including attorneys general (4), secretaries of state (9), auditors (2), corporation commissioners (1), and an insurance commissioner (1).[66] Thirty-four have parent

62. In their statistical study of state securities actions against public companies from 2004 to 2006 (years when Spitzer served as attorney general), Amanda Rose and Larry LeBlanc treated New York as a distinct variable of their regression analysis. Rose & LeBlanc, *supra* note 7, at 420 nn.63 & 66.

63. *See infra* APPENDIX, Table 5. The Arkansas State Securities Department was an independent agency until July 2021. *See* ARK. CODE ANN. § 25-43-302(a)(26) (2021) (effective July 28, 2021) (transferring the State Securities Department to the newly formed Department of Commerce). A number of interviewees cited the Alabama Securities Commission as exemplary, including its ability to develop criminal cases, its use of technology in investigations, and its commitment of substantial resources to public education. *See, e.g.*, Interviewee #34 ("I hate to brag about Alabama, but [they have] a whole department for investor education and more people in that department than we have in our division here."). Part of the Alabama Securities Commission's success is likely related to its being a standalone agency with self-funding; the agency has also been led by director Joseph Borg, whose leadership is widely recognized in the field, for a quarter century. *See* Jean Eaglesham, *In Alabama, Beware the Borg*, WALL ST. J. (Jan. 24, 2011, 12:01 AM), wsj.com/articles/SB10001424052748704031004576098960147787954. The Texas State Securities Board, another standalone agency, also has one of the states' most robust state enforcement operations.

64. *See infra* APPENDIX, Table 5.

65. *Infra* APPENDIX, Table 5.

66. *Infra* APPENDIX, Table 5.

agencies whose leaders are gubernatorial appointees, whereas two (New Hampshire and Virginia) are chosen by legislatures. Five have parent agencies led by boards, four appointed and one popularly elected.[67]

A natural question arises around elected-versus-appointed leadership: What impact, if any, does it have on securities enforcement? Amanda Rose and Larry LeBlanc addressed this question in their study of state enforcement actions disclosed in public-company SEC filings for the 2004, 2005, and 2006 fiscal years.[68] They found elected leadership—especially Democratic elected leadership—to be associated with higher enforcement levels against public companies, particularly against out-of-state firms.[69] This result is consistent with a hypothesis that elected officials have political incentives to engage in enforcement entrepreneurism. New York and Massachusetts, for example, are led by elected officials and are seen by many as entrepreneurial enforcers; some interviewees joined in this view that certain states are active enforcers due to the political incentives of their elected leaders. Rose and LeBlanc offer support for that view.[70]

Interviewees, however, offered another view of how agency leadership interacts with state enforcement. Importantly, the Rose and LeBlanc study focused on the 102 state enforcement actions disclosed by public companies for fiscal years 2004, 2005, and 2006, an average of thirty-four state actions against public companies per year.[71] Although aggregate state enforcement data are not available for those years, using the recent nadir of state enforcement—1,744 actions in 2016—that public-company average would represent a relatively small share of cases, about two percent annually.[72] This

67. *See infra* APPENDIX, Table 5.

68. Rose & LeBlanc, *supra* note 7.

69. *Id.* at 425.

70. When presented with a hypothetical critic who viewed state regulators as using SEC enforcement actions to piggyback penalties, one interviewee acknowledged that this practice occurs but is rare. Interviewee #45. The interviewee gave an example in which the SEC took an enforcement action against a firm that would disqualify it from doing business within the state. The state might waive the disqualification in return for a fine, rather than conditioning the waiver on remediation. *Id.*

71. *See* Rose & LeBlanc, *supra* note 7, at 401. *But see infra* note 280 (discussing the multistate coordination underlying some of the occurrences in the Rose and LeBlanc study).

72. *See infra* APPENDIX, Table 1.

ratio suggests that actions against public companies, which would be the most likely to garner headlines for elected agency leaders, are not a priority for state enforcers. Indeed, interviewees reported that they generally experience little to no political influence or input into their day-to-day enforcement activities. More, those in states with politically right-leaning governments reported conducting basic street-level enforcement without impediment.[73]

Yet although they may not be a priority, states do bring cases that involve public companies, the financial industry, or even whole product lines. Interviewees familiar with the internal workings of states that are commonly believed to engage in enforcement entrepreneurism offered an explanation at odds with the view that enforcement against public companies is driven by elected officials. Instead, career staff source and develop investigations.[74] Although career staff keep senior executives informed, particularly on potentially newsworthy cases, they did not experience top-down direction on what types of cases they should pursue.[75] Another enforcer noted that although the securities division operates fairly autonomously within the parent agency, the elected leader does like to tout securities cases when speaking to community groups in part because they are "unusual" from a jurisdictional perspective.[76] One former enforcer in an entrepreneurial state stressed that the

73. *See, e.g.*, Interviewee #53:

> Philosophically, the office wants to encourage responsible business, wants them operating in the state and to encourage and support the business community. But they know part of that is having a watchdog that will go after bad guys. We're business friendly, conservative generally, the state and the politics, but politics don't really play into a lot of what we do here[.]

74. *See, e.g.*, Interviewee #38:

> [A]ny type of subpoena or enforcement action that might get significant attention outside the office would be run by top leadership, not necessarily the [senior-most leader], but the top executives under the [senior-most leader] would at least know what's happening. . . . If it's to [a major bank], you want leadership to know. It doesn't mean they're going to have an issue with it, but it's better for them to know.

75. There is some indication, including in the interviews, that former New York Attorney General Spitzer was actively involved in the development of his office's securities-related cases. Interviewee #38 (discussing Spitzer's personal role in enforcement actions); Interviewee #43 (same). To this day, Spitzer is the posterchild for vigorous, headline-grabbing state securities enforcement. That profile might mask his atypicality as an elected securities leader, although former Attorneys General Andrew Cuomo and Eric Schneiderman arguably continued in the role that Spitzer fashioned.

76. Interviewee #53.

personalities of enforcement chiefs, who are career officials, are the key driver of enforcement behavior.[77]

Two former elected leaders were interviewed. Both said that securities enforcement was not an issue in their election campaigns.[78] After election, one took a hands-off approach to securities enforcement; the incumbent division head remained on the job and reported to a deputy, who kept the elected leader informed on securities matters in addition to other areas under the leader's jurisdiction.[79] The other former elected leader became more interested in securities regulation after taking office, including successfully seeking new enforcement-enhancing legislation.[80] Even this leader, however, continued to focus on other areas within the agency's jurisdiction.[81]

These observations suggest an alternative account to one in which regulators, especially those with elected leaders, engage in enforcement entrepreneurism. In this account, elected leaders take a passive role in the early stages of significant cases and become involved only at a later, public-facing stage. Executive passivity does not mean, of course, that elected-versus-appointed leadership does not impact a state's enforcement activity. Elected leaders might not push proactively for high-profile investigations. But the potential political benefits to be gained from them could enable career staff to pursue those cases more frequently than if they worked in states whose agency leaders stood to gain little from high-profile cases.[82]

These reports distinguish from the literature exploring the impacts of internal and external politics on SEC enforcement,[83] suggesting that state enforcement may be less politicized in the sense that it is largely insulated from—or even ignored by—

77. *See* Interviewee #43 (discussing "one example where [a multistate investigation] was driven by the strength of an investigation and the personality of one regulator").

78. Interviewee #39; Interviewee #44.

79. Interviewee #39.

80. Interviewee #44.

81. *Id.*

82. *See* Andrew K. Jennings, *Follow-up Enforcement*, 70 DUKE L.J. 1569, 1583 nn.55–56 (2021) (discussing and collecting sources on incentives of career line enforcers).

83. *See, e.g.*, Urska Velikonja, *Politics in Securities Enforcement*, 50 GA. L. REV. 17, 19 (2015) ("[Although] politics is largely irrelevant at the individual case level, political influences do shape [the SEC's] enforcement choices at the aggregate level.").

political actors.[84] This reduced political influence, coupled with the long-term staff retention some regulators report enjoying, could drive more consistent, predictable enforcement behavior, an advantage to state enforcement and a benefit to in-state securities firms. Of course, the localized, theft-focused nature of state enforcement might also explain its relative lack of politicization. Because they take all comers who make complaints, states largely lack active discretion over their caseloads. If they had more room to exercise discretion, then those decisions might become more politically salient overall. The public harm and moral culpability associated with a local fraud is also clear: *A* stole from *B* in connection with a securities transaction, a fact that can be proven by overwhelming evidence. The appropriateness of enforcement might seem less clear, though, in cases that federal authorities might pursue in which targets are complex organizations, potential misconduct is amorphous, and the evidence is open to competing interpretations. States, in contrast, mostly do not pursue those harder-call cases but rather conduct more routine policing.

B. Resources

Enforcers noted limited resources as a key constraint on enforcement, which result in slowing case progress; making proactive surveillance and larger investigations resource prohibitive; and limiting investor-education and outreach efforts.[85] Those who

84. *But see* Park, *supra* note 23, at 157–59 (suggesting that political incentives may motivate or demotivate elected securities regulators' enforcement activities).

85. *See* Interviewee #21 ("I feel like in terms of enforcement, we're adequately resourced to respond to complaints that we get. If we had additional resources, we might do more proactive investigations where we haven't gotten a complaint.").

Interviewee #25:

> We're able to handle the cases that come in . . . . Where I think my hands are somewhat tied are the proactive cases, cases where you don't know if there's a case. Should you invest the time and resources to pursue a case if you're not sure one will be there in the end? That weighs on the decision whether to open an investigation or not.

Interviewee #36:

> [W]e're in a reactive state in our enforcement capacity. There are so many complaints and investigations to pursue. If we had more resources we could do more proactive work, going [undercover] to [investment-pitch] seminars, getting investigative leads, doing more cooperation with federal law enforcement. Now we have to make a referral, but we can't maintain any assistance to them. I think that's the biggest hindrance, resources.

expressed satisfaction with their resources tended to work at one of the few regulators permitted to retain fee revenues, versus relying on legislative appropriations.[86] The best proxy for resources is full-time-equivalent (FTE) staff, including analysts, investigators, attorneys, and other professionals.[87] Although it might be expected that the SEC is resource rich compared to its state counterparts, that is not always the case. In 2018, the SEC's Division of Enforcement had 1,385 FTEs, or about one per 236,245 U.S. residents.[88] By comparison, Florida had 113 enforcement FTEs in 2017 (or one per 188,496 Floridians), whereas Michigan had 23 in 2018 (or one per 434,609 Michiganders).[89] In 2019, California had 50 FTEs involved in enforcement activity (or one per 790,000 Californians).[90]

A number of interviewees cited comparatively low salaries for their staffs as an obstacle to their enforcement efforts. These enforcers attrite staff to other in-state agencies, federal agencies, or industry, and with them, institutional knowledge and investments in training.[91] Other enforcers touted the longevity of their teams as key strengths. By retaining employees, they are able to apply formal and informal policies and practices consistently. That point is important given that state regulators have less accumulated written guidance and policies compared to the SEC. Professional judgment and institutional knowledge are thus comparatively

Interviewee #34 ("[D]ue to our size and manpower issues, I think the one area that we fall down is investor education.").

86. *See, e.g.*, Interviewee #57 ("We're a non-appropriated agency, so we don't have the pressures of a budget and appropriation process, like some states and the federal agencies have to deal with.").

87. Budget records were requested from state securities regulators as part of this Article's data-collection process. To the extent that states had budgets specific to securities regulation—often, budgets were aggregated within a larger parent agency—financial expenditures for enforcement were not comparable between states. Interviewees used headcount as a proxy for "resources," however, because personnel levels are the key limiting factor on enforcement capacity.

88. U.S. SEC. & EXCH. COMM'N, *FY 2020 Budget Request by Program*, *in* FISCAL YEAR 2020 CONGRESSIONAL BUDGET JUSTIFICATION ANNUAL PERFORMANCE PLAN 21, 24 (2020).

89. *See infra* Table 6.

90. Letter of Marlou de Luna, Cal. Dep't of Bus. Oversight, at *1 (July 25, 2019) (on file with author).

91. *See, e.g.*, Interviewee #23 ("[As far as] personnel, [the] nature of [the state's] government in particular is that there is a lot of turnover. The salaries are not good enough to be able to keep people.").

important for effective and consistent enforcement. One enforcer contrasted the longevity within the regulator with turnover at the SEC and opined that the regulator's comparatively high retention rate allowed it to operate independently, to avoid politicization of its enforcement mission, and to act consistently in policing the state's securities industry.[92]

C. Priority Setting

No enforcer reported actively setting priorities as an act of policymaking, as compared to the SEC or DOJ's ability to choose types of violations that they are particularly focused on pursuing, such as insider trading or foreign bribery. State enforcement activity is overwhelmingly driven by complaints, or to a lesser extent, the results of routine industry examinations and referrals from other agencies.

Enforcers expressed an obligation to focus on incoming complaints and to pursue meritorious cases.[93] Interviewees see themselves as the only line of public defense for many victims of securities fraud: relatively small thefts that simply will not or cannot be addressed by the SEC or a U.S. attorney's office.[94] This point is especially true for state-registered investment advisers under the $100 million assets-under-management threshold. Unlike broker-dealers—who are regulated by the SEC, FINRA, and state regulators—state-registered investment advisers are exclusively supervised by state regulators.[95] Enforcers expressed heightened awareness around that responsibility because, apart from the antifraud provisions of the federal securities laws, there is no other public oversight when it comes to those firms.

92. *See* Interviewee #18; Interviewee #40; Interviewee #56; Interviewee #57.

93. Interviewee #29:

> [W]e've gotten more involved with federal agencies like Homeland Security, the IRS, the FBI for a long time, and they'll refer cases to us. But as far as what comes in, we take all comers. We will take any complaints that come in or tips that we may get and we will investigate.

94. *See supra* notes 39–40.

95. *See, e.g.*, Interviewee #2 ("We're the only resource and recourse for everything from suitability to excessive fees, to generally the fiduciary standard that applies to investment advisers. We are the only regulatory authority for these [state-registered] investment advisers, so that's a pretty big responsibility and a big focus of our division.").

Agenda setting by incoming complaints, referrals, and examinations does not mean that state regulators follow a first-in-first-out approach. Matters are investigated and resourced on a priority basis: ongoing misconduct takes priority over completed misconduct, misconduct against elderly and vulnerable people over younger and less vulnerable people, and matters with cooperative victims over uncooperative victims.[96] Indeed, some victims react with denial, believing that their investments are legitimate and that it is the regulator's interference that creates the risk of loss; fraudulent promoters sometimes scapegoat the investigation itself as the cause for losses.[97] Enforcers sometimes redirect resources from investigations with uncooperative victims to ones with cooperative victims, which reflects the tight resources many regulators face. For instance, interviewees touted their ability to use cease-and-desist orders to stop ongoing frauds more quickly than the SEC can.[98] Investigations of prior, nonrecurring misconduct may take longer, however. That point was echoed by private attorneys who expressed frustration that long investigations prevent claimants from making collateral use of enforcement actions and sometimes prejudice claims by telegraphing to adjudicators that the regulator does not consider the claims to be urgent.[99]

96. *See, e.g.*, Interviewee #8:

> Do we have an ongoing fraud, and if we have an ongoing fraud, what is the number of victims and the dollar amount of victim loss? We may receive a complaint about a historical fraud with 10 victims that is no longer ongoing, whereas a complaint with ongoing fraud, like an affinity fraud with [hundreds] of investors, is going to take priority. It's a triage system.

97. *See, e.g.*, Interviewee #69:

> It's kind of frustrating . . . a lot of times these investors have no idea their money is gone. We're the ones who basically have to tell them this. The people we're going after, they tell these people that if it weren't for the [securities regulator], you'd have your money.

98. *See* Interviewee #31 ("[I]'ve found that we can use administrative authority very effectively to stop ongoing fraud. We have authority to issue ex parte emergency C&Ds. Violation of an emergency C&D order is punishable as a [crime].").

99. *See, e.g.*, Interviewee #13:

> We want to help the regulators, but we don't want to do so if it's going to hurt the client's case. That bleeds over to the states as well. You can alert the states, but if they don't take action or give a slap on the wrist for whatever reason, it looks bad for the customer's case.

States break with no-priorities all-comers practice, however, when it comes to protecting elderly investors. They see these investors as particularly vulnerable and, because they often have substantial assets, as attractive targets.[100] This belief is reflected in states' enforcement activity: in 2018, of the 1,786 actions they brought, 758, or 42%, involved elderly victims.[101] To address this concern, states have embraced the protection of senior citizens as a national priority. NASAA, for example, has issued a vulnerable-adults financial-exploitation model act, and 27 states and FINRA have adopted it to some degree.[102] The act mandates broker-dealers and investment advisers to report suspected financial exploitation of covered individuals to adult protective services or a state securities regulator.[103] NASAA has begun separately collecting data on senior-related enforcement activity, reporting that in 2018 state regulators received 410 complaints or tips, conducted 365 investigations, and took 141 enforcement actions related to 758 elderly victims.[104]

This example of national priority setting, however, both exemplifies the states' ability to identify and adapt to emerging risks in the capital markets and hints at the risks of doing so. Several interviewees viewed reports made under their new financial-exploitation acts as stressing existing resources.[105] Although financial-exploitation statutes represent an opportunity to detect, and even thwart, fraud, if states are unable to add resources needed to act on incoming information, it could have the pernicious effect of reducing capacity to investigate and pursue cases by imposing too

Interviewee #14 ("Whenever you have a written record of the customer's response and the customer is unsophisticated and doesn't understand the nuances, they say things that screw them up.").

100. *See, e.g.*, Interviewee #20 ("[I]n terms of priorities, the one we would have is a case involving seniors. . . . We prioritize that because [this state] is an older state and because elderly victims [are] vulnerable, susceptible to fraud. They also need the money to live."); Interviewee #23 ("[I]n every administration the interest is going to be trying to prevent fraud and theft by other names, especially with respect to senior citizens.).

101. *See* N. AM. SEC. ADM'RS ASS'N, NASAA 2019 ENFORCEMENT REPORT 4, 8 (2019).

102. *Id.* at 8.

103. NASAA MODEL LEGISLATION OR REGULATION TO PROTECT VULNERABLE ADULTS FROM FINANCIAL EXPLOITATION (2016).

104. N. AM. SEC. ADM'RS ASS'N, *supra* note 101, at 9.

105. *See, e.g.*, Interviewee #47 (discussing a high volume of senior-exploitation reports from investment advisers and broker-dealers and explaining that the division is "trying to understand how to handle, how to process them").

much new demand on already stretched resources. An advantage of the states' all-comers approach is avoiding the potential tunnel vision that the SEC and other agencies with enforcement discretion might be criticized for. The structural and resource constraints that lead state regulators to function on a largely all-comers basis limits proactive policing but advantages spotting new trends. Without adding compensating resources, however, prioritizing types of victims or misconduct risks undermining that advantage while exacerbating overall resource constraints.

D. Fraud Prevalence and Public Salience

There is a limited literature on the prevalence of securities fraud. Interviewees agreed that they fail to detect much, or most, of that conduct in their jurisdictions, although they did not know how much misconduct they spot versus what goes unseen.[106] Whatever the frequency of securities misconduct, improving detection depends partly on raising the awareness of the public, as well as actors in the securities industry; law enforcement; and adult protective services to the existence and characteristics of that misconduct.[107] This task is challenged by victims who are ashamed, embarrassed, or in denial about what they have experienced, making them less likely to

106. *Cf.* Interviewee #13 (observing that around 4,000 customer disputes are filed in FINRA arbitration annually and suggesting that "[w]ith the number of broker-dealers and representatives out there, it's very hard to believe there are only 4,000 times that someone has misrepresented an investment"); Interviewee #72 ("I would guess we see less than 10% of potential wrongdoing that's our bread and butter. I'm sure there's a lot going on out there that we don't know about."). When Interviewee #24 was asked for a sense of fraud underreporting in the state, the enforcer replied:

> [I]t would seem to me that we should be receiving more complaints than we do. . . . We've [adopted policies like the Model Senior Act and] we think that'll generate some information for us. The problem is people are so embarrassed. . . . I think a lot of people don't realize who they could complain to. Who do they call first? Most of the time, they might not even know there's an issue. They build up these trust relationships with sales representatives or investment advisers. . . . It's not until something happens that they complain.

107. *See* Interviewee #19 ("[B]ecause of our awareness in the community—we talk to over 8,000 people—we get various calls, not a large number, but a lot of them turn into actual cases because we were out there teaching people . . . ."); Interviewee #29 ("The public is our first line of defense."); Interviewee #72 ("Even if we had more resources, it's not clear to me that without people reaching out that we'd be able to find [cases].").

complain or to cooperate.[108] Enforcers also pointed to economic growth over the last decade prior to the recession sparked by the COVID-19 pandemic as reducing fraud complaints.[109] In good times, frauds like Ponzi schemes might appear successful until economic conditions cause them to collapse, and during those good times investors are less likely to closely monitor their investments.[110] In a recession, however, this misconduct becomes evident, spiking complaint volumes. Shortly after interviews for this Article were completed, the country entered the COVID-19 period; its full impact on complaints remains to be seen.[111]

Actions generally originate from investor complaints or referrals from agencies to whom investors have complained, like local police.[112] Detecting violations is in turn partly a function of how aware the public and local law enforcement are of what investment-related fraud is and what it looks like, and the availability of a state regulator that can investigate and take action. Similarly, investors who have substantive knowledge to identify fraud, or who know that they can contact their state regulator as a due-diligence step, can reduce the risk that they are harmed.[113]

Enforcers see a connection between detection and prevention on the one hand, and public and law-enforcement awareness on the other.[114] Some interviewees touted their public and law-

108. *See* Email from Interviewee #1 (on file with author) ("One barrier we see is that some victims are embarrassed when they are scammed and are not willing to come forward. Another barrier is when victims are part of an affinity-fraud scheme.").

109. *See, e.g.*, Interviewee #36 ("I worry how we'll be poised to respond in a time of economic downturn. I'm thinking about how we might be flooded with complaints and having to prioritize or turn away . . . ."); *cf.* Jill Gross, *The Improbable Birth and Conceivable Death of the Securities Arbitration Clinic*, 15 CARDOZO J. CONFLICT RESOL. 597 (2014) (discussing the countercyclical nature of private securities claims and macroeconomic conditions).

110. *See, e.g.*, Interviewee #36 (noting that economic downturns expose Ponzi schemes).

111. *See, e.g.*, *id.*; *see also NASAA Forms COVID-19 Enforcement Task Force*, N. AM. SEC. ADM'RS ASS'N (Apr. 28, 2020), https://www.nasaa.org/54844/nasaa-forms-covid-19-enforcement-task-force/ (announcing the formation of a task force to proactively surveille for COVID-19-related frauds).

112. *See, e.g.*, Interviewee #50 ("The bulk of cases come from complaints. We get referrals from public agencies too.").

113. *See* Interviewee #19 ("[W]e were out there teaching people that they should call us before they invest to see if the person's registered and the product is registered. We've taught people to identify fraud and report it.").

114. *See supra* note 107 and accompanying text.

enforcement outreach and education efforts,[115] while others acknowledged that staffing levels limit their outreach and education efforts.[116] These efforts, interviewees explained, serve two main purposes. First, they give investors substantive information, like how to spot potential offering fraud or how to diligence a financial adviser, that, they hope, will steer investors away from outright frauds.[117] Second, they increase the awareness among investors and local law enforcement that issues involving securities are not merely contractual matters.[118] If local law enforcement unintentionally misleads a complaining investor into believing that a potential securities violation is a private contractual dispute, that investor might miss out on obtaining public redress, like restitution. The enforcer will also lose an opportunity to identify other victims or to stop an imminent or ongoing fraud.[119]

Most divisions post information online about enforcement actions.[120] In some instances, press releases assist in ongoing investigations. For example, if an enforcer announces an emergency order against a Ponzi schemer, investors in the scheme

115. The most commonly cited examples of public education included presentations to elders and to civic groups. Law enforcement outreach includes presentations to police-leadership conferences, as well as to new-recruit academies. *But see* Lauren E. Willis, *Against Financial-Literacy Education*, 94 IOWA L. REV. 197 (2008) (questioning the effectiveness of financial-literacy education—including investor education—and noting the lack of empirical support for it). *See* Interviewee #37:

> [W]e also do outreach to prosecutors and law enforcement. In many instances these people are on the initial intake. We tell them it's not "civil." Many of them aren't aware that we have really good criminal authority, so we educate them so that when they're taking the intake they know to reach us and not to dismiss it as civil . . . .

116. *See* Interviewee #24 ("[W]e don't have a program in [this state] and it would enable us to be out on the road and put on seminars at senior-citizen centers, tell people how to protect themselves. But I don't have the staff.").

117. *See supra* note 113.

118. *See supra* note 115; *see also* Interviewee #4 ("[In this state we had a local prosecutor.] He had a case come across his desk and looks at it: a bad actor who has no money, looks like a civil matter. We worked with him on it and it opened his eyes . . . . We ultimately put someone in prison for life for what they did to seventeen victims.").

119. Interviewees offered anecdotal cases of public education having positive direct impacts on investors. Some enforcers also keep statistics on the number of people they reach. They lack, however, metrics that would allow them to estimate the overall effect of these efforts on preventing securities violations, raising the salience of their role among the public and law enforcement, or increasing the detection of violations.

120. *See* Interviewee #37 (discussing posting enforcement orders and press releases online as a recidivism-prevention method).

might realize for the first time that they are victims and come forward with useful information.[121] Online publication also has a prophylactic effect: investors doing even modest diligence about private offerings, broker-dealers, or investment advisers will search online. If those searches return relevant enforcement records, prospective investors might decide it is too risky to deal with a potential recidivist.[122] One enforcer in a state with a well-developed restitution fund remarked that the fund's presence does encourage some victims to come forward, because although the principal is gone, having some recovery opportunity from a public fund is enough to overcome the embarrassment of coming forward.[123]

Despite efforts at raising public and law enforcement awareness, however, interviewees reported having no data on the direct effects of these efforts at allowing members of the public to spot investment-related fraud or increasing the likelihood that frauds come to regulators' attention. For example, in the 2017 fiscal year, the Utah Securities Division "presented 68 investor seminars to 14,096 attendees to protect Utahns from fraud."[124] There is no telling, though, what effect those seminars had on the attendees or others, a worrisome question across regulators' outreach programs. Generating attribution data would allow regulators to improve the targeting and content of their outreach programs, as well as to demonstrate their value within the securities-enforcement system.

Getting these impact data might require surveys or other marketing-attribution methods to quantify effects of education efforts. For this Article, however, the question "where do people turn when they have been victims of securities fraud" can be partly answered. In a survey delivered via Amazon's MTurk platform, respondents were asked what organizations they would recommend an investment-fraud victim to turn to, or that they

121. *See, e.g.*, Interviewee #18 ("Once an indictment is handed down, we'll do a press release to identify other potential victims.").

122. One enforcer reported hearing from potential investors who found orders online against promoters of opportunities that they were considering investing in. Interviewee #32 ("We get a lot of calls that 'I found your order against so and so and he just solicited me to buy such and such.'"). *Cf.* Barnard, *supra* note 18, at 25 (proposing that NASAA, the SEC, and other agencies form a registry of securities offenders to facilitate investor due diligence and monitoring for recidivism).

123. *See* Interviewee #4 (expressing pride in the outcomes of the state's securities-restitution fund).

124. UTAH DEP'T OF COM., 2017 ANNUAL REPORT 1 (2017).

themselves would turn to.[125] Respondents were given sixteen randomized multi-select options of local, state, federal, and non-governmental agencies. Of 419 respondents, about a fourth, 112, reported that they would not recommend any of the options to a fraud victim, or pursue any themselves.[126] The most common recommendation was to contact a private attorney (40.10%), followed by the Better Business Bureau (23.87%) and the SEC (19.57%); "the local police department" came in sixth at 16.95% and "the state securities regulator" came seventh at 15.99%.[127] The SEC's top-three ranking came even as respondents were given the option of contacting a state securities regulator, suggesting that federal securities regulation in general, or the SEC as an institution, enjoys higher public salience than state regulation or regulators. This result is consistent with a point made by one enforcer that complainants sometimes believe that they are talking to the SEC and refer to the state regulator as the "SEC."[128]

Although state regulators were not the highest-salience resource, state and local agencies were collectively looked to more than federal authorities: there were 323 responses for state and local agencies versus 223 for the SEC, FINRA, the FBI, and U.S. attorneys' offices.[129] On the state level, "local police" received seventy-one responses versus forty for "state police," and "local prosecutor's office" received sixty-one responses versus forty-seven for "state attorney general."[130] These data suggest that although the SEC may be more salient than its state counterparts, on the whole victims are more likely to go to state and local agencies. This point supports that raising awareness among state and local agencies matters for securities policing: they will often be the first stop for complaints, which they can channel to the regulator if they know to do so.

The survey data suggest that the most common stops, however, are private attorneys (40.10% of respondents). Although some

125. For a full explanation of the survey and this question, see *infra* APPENDIX, Table 12.

126. *Infra* APPENDIX, Table 12.

127. *Infra* APPENDIX, Table 12.

128. Interviewee #50; *see also* Interviewee #17 ("I don't think most people know who we were, what the securities division did, even in the [securities] industry.").

129. *Infra* APPENDIX, Table 12.

130. *Infra* APPENDIX, Table 12. "Federal prosecutor's office" was close behind "state attorney general" at thirty-five responses. *Infra* APPENDIX, Table 12.

interviewees discussed their outreach efforts with the practicing bar, private attorneys were largely absent players in discussions about such efforts.[131] Private attorneys, however, have the potential to be important on-the-ground channels of investor complaints to regulators. States that develop these relationships—such as through targeting communications at or organizing advisory committees of investor advocates and securities practitioners—stand to enhance detection.

In all, the data suggest that when victims report experiencing securities fraud, they are most likely to turn to state—particularly local—authorities for help. This observation in turn points to a state advantage in policing local frauds because there are private attorneys, prosecutors, police departments, and adult protective services in most communities. Combining these actors' distributed reach with state regulators' technical expertise can foster an efficient and effective intrastate securities-enforcement system. In comparison, given the geographic dispersion of local securities violations, it would be impracticable for federal authorities to build comparable networks that give them presence in every community.

E. Legislation, Policy, and Autonomy

Securities regulators have among the deepest stores of securities-law expertise in many states, as well as broad insight into their capital markets and, through coordination with other states, national trends.[132] These factors allow enforcers to inform policy. Cryptocurrency and digital tokens offer a good example of state enforcers' ability to inform and drive policy development. As the regulation of digital currency has continued to vex the SEC, CFTC, and Internal Revenue Service, a number of states have taken action to confront fraud in connection with cryptocurrency and digital tokens.[133] One interviewee recounted the regulator's role in the enactment of the state's digital-tokens statute. That

131. One interviewee at a regulator with a well-resourced outreach program did mention that the regulator does regular trainings for bar associations. Interviewee #19.

132. In some states, this expertise may not be readily available to legislators from members of the practicing bar or legal academy. One interviewee, for example, noted that there was only one known practicing securities lawyer in the state. Interviewee #47.

133. *See, e.g.*, *Alabama Securities Commission Updates Coordinated Crypto Crackdown*, ALA. SEC. COMM'N (Aug. 7, 2019), asc.alabama.gov/News/2019%20News/8-7-19%20Coordinated-crypto-background-NASAA-Revised.pdf.

effort included shepherding the bill through multiple legislative sessions and, in the process, using its expertise to shift the bill from excluding digital tokens to adopting a functional approach to securities classification.[134] One former elected agency leader—who might be expected, as an elected official, to have engaged more freely with legislators than career enforcers—recounted seeking and obtaining statutory enhancements to the regulator's securities-enforcement authority.[135]

Interviewees reported that their enforcement work goes mostly untouched by external politics. Even within states whose leaders are less favorable to economic regulation, the need to prevent and act against fraud is largely uncontroversial.[136] One interviewee framed the bipartisan appeal of securities enforcement: "[F]or Republicans, I talked about law enforcement and for Democrats, I talked about consumer protection."[137] Another enforcer saw administration transitions as having no impact on the regulator's work: "I've worked under Democratic and Republican [agency leaders]. On the securities side, there's zero political influence."[138] Another enforcer at a regulator with low turnover remarked that the longevity of the staff bolsters the regulator's independence.[139]

Enforcers also point to the need for uniformity between states as serving incidentally as a bulwark for their independence.[140] Most states, for instance, follow either the 1956 or 2002 Uniform Securities Act.[141] These acts' anchoring effects have given some enforcers laws that better empower enforcement than would be expected if their legislatures wrote bespoke statutes.[142] Thus, by coordinating formally and informally, including through NASAA,

134. Interviewee #1.

135. Interviewee #44.

136. *See supra* note 73.

137. Interviewee #45.

138. Interviewee #32.

139. Interviewee #57.

140. Interviewee #42; Interviewee #50.

141. *See U.S. Survey: State Adoption of Uniform Securities Act*, NAT'L ASS'N FOR FIXED ANNUITIES (Oct. 12, 2012), nafa.com/wp/wp-content/uploads/2012/07/20120920-NAFA-Uniform-Security-Act-Adoption_At-A-Glance.pdf.

142. Interviewee #42 ("I am glad we have the Uniform Securities Act because (in my opinion) it provides us with broader authority than that statutorily given to our sister divisions.").

state enforcers act collectively to set policy that political actors might acquiesce to for uniformity's sake.[143]

Nevertheless, political influence on securities enforcement remains an incomplete picture. Most interviewees were either current enforcers, or former enforcers who practice law adjacent to their former employers. In those roles, they may have been less than unvarnished in discussing this sensitive question. One former enforcer cautioned that over time an enforcer will accumulate enemies, perhaps including those who have sway with political officials.[144] Although securities regulators' expertise may give them influence with political officials, a countervailing effect is the relative ease for politically influential actors to capture state elected officials.[145]

III. WHAT DO STATE SECURITIES ENFORCERS DO?

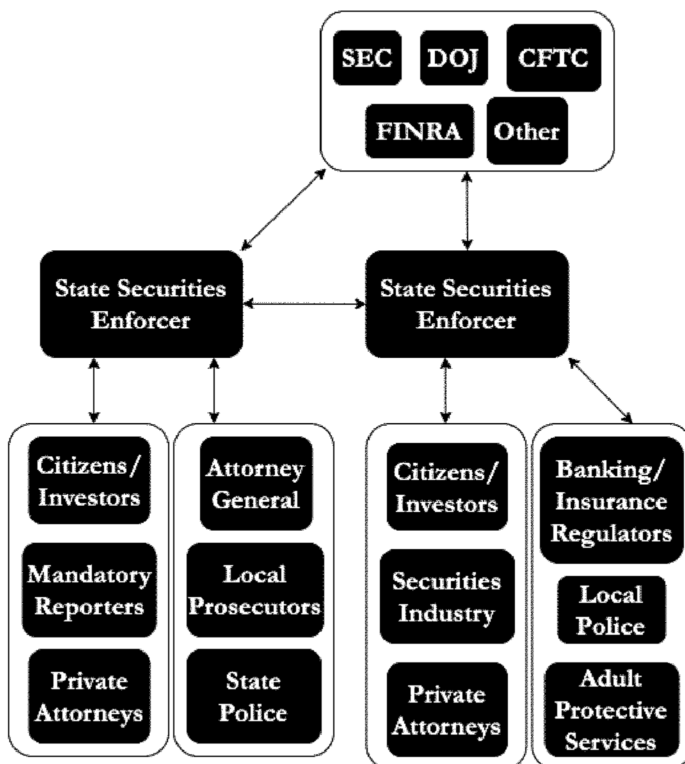
This Part frames state securities enforcement as a system in which each state enforcer sits as a hub in a two-way horizontal and vertical enforcement network of state securities regulators, federal agencies, in-state agencies, local and state law enforcement and prosecutors, and private actors.[146] The network's structure, with state securities regulators as hubs, can be seen in the following figure:

143. *See* Interviewee #50 ("[E]specially on the enforcement side, fraud's fraud. We have a new administration in now; they've been very supportive of that work. Plus with the Uniform Act, most of the states are doing the same thing, so that helps with consistency too.").

144. *Id.* This interviewee described complaints to a new gubernatorial administration that the securities regulator was "unfriendly" to business, particularly that it did not issue broker-dealer licenses to applicants who received them in other states. To counter this complaint, the interviewee conducted an internal study showing that the regulator approved 98% of license applications within twenty-four hours, another 0.5% within two days, and that only 0.5% of applicants had special conditions imposed on their licenses or were asked to withdraw. *Id.*

145. *Id.* In one instance, an in-state public company lobbied during the legislature's regular session for a restriction on trading in its shares; the head of the securities regulator counseled the governor that the proposal was federally preempted. The restriction was later quietly enacted during a special session, which the regulator's head learned about the next day. *Id.*

146. See Verity Winship, *Enforcement Networks*, 37 YALE J. ON REG. 274 (2020), for a conceptual explanation of enforcement networks and an empirical study of vertical and horizontal incoming referrals to the SEC (including from state securities regulators).



In this network, state enforcers are horizontally and vertically situated to detect securities offenses and either to take action directly or channel them to more efficient actors. Beyond serving as detection hubs, state enforcers' institutional positions, expertise, and broad enforcement jurisdiction allow them to serve as residual enforcers in a national securities-enforcement system. Local police or prosecutors, for instance, might enjoy criminal jurisdiction over securities misconduct but lack the expertise or resources to pursue such cases. Thus, they refer complainants to the regulator. A regional SEC office might have expertise to pursue that very same misconduct but lack resources to police small-dollar frauds in addition to doing resource-intense investigations. It would thus refer the matter to the complainant's state regulator. In this light, state securities enforcers have been largely missing from the literature's efforts to theorize and understand American securities

enforcement. This Part expands that understanding by explaining what state regulators do and how they do it.

A. Investigation Sourcing

States source investigations from four places: complaints and tips; referrals from other agencies; audits and examinations; and self-sourcing. Of these four, complaints are the most important source.[147] Complaints come mostly from aggrieved investors, who might contact regulators via online forms, phone, or even walk-in visits.[148] Some come from members of the securities industry or the public. This point is borne out in a sample of seven states' enforcement data.[149] These states together received 903 complaints or tips for recent one-year periods.[150] By comparison, during that time they received less than a tenth that number of referrals from the SEC, 56 of which were to one state (Florida) with a large population of retirees.[151] The same group reported receiving 21 referrals from FINRA; 29 referrals from state and local law enforcement and prosecutors; 19 from other in-state agencies, like insurance or banking regulators; and 7 from sister state securities regulators.[152]

These sample counts likely mask, however, the part in-state actors play in channeling investor complaints to their securities regulators. Local police departments and prosecutors, as well as adult protective services, are important indirect sources of referrals. When aggrieved investors speak to local police, police might refer them to the regulator.[153] This observation is consistent with the Part

147. *See* KURT EICHENWALD, SERPENT ON THE ROCK 355 (1995) (recounting the Idaho securities commissioner's practice of staying late at the office for drop-in investor complaints).

148. Private attorneys reported sometimes being the source of complaints, consistent with the Section II.D.2 study finding that private attorneys are by far the most salient resource for aggrieved investors. *See infra* APPENDIX, Table 12. These attorneys expressed uncertainty around submitting complaints, though, and described three concerns that lead them not to report: (1) decisions not to charge or to bring minor charges indirectly cast aspersions on the merits of clients' claims in FINRA arbitration, (2) delay in investigations can have similar prejudicial effects, (3) and regulator interviews with uncounseled victims or witnesses can lead to unwitting statements that needlessly prejudice private claims. *See supra* note 98.

149. *See infra* APPENDIX, Table 8 (Delaware, Florida, Michigan, Minnesota, Oklahoma, South Dakota, and Wisconsin).

150. *Infra* APPENDIX, Table 8.

151. *Infra* APPENDIX, Table 8.

152. *Infra* APPENDIX, Table 8.

153. *See* Interviewee #71:

II.D.2 salience study: even when respondents are given an option of reporting to a state securities regulator, local police still had a slight edge as reporting channel.[154] The importance of local agencies as on-the-ground referrers explains regulators' efforts to educate local law enforcement and adult protective services. Several enforcers expressed concern that without proper training for identifying potential securities cases, local police deem those complaints to be "civil" issues.[155] They thus unintentionally mislead complainants into believing that their only recourse is civil litigation. When that happens, a case that might merit public enforcement never reaches the regulator. Such a failure is not necessarily isolated to one victim: a single complaint referred to a regulator could help uncover dozens more victims.

Beyond referrals (direct or indirect) from in-state agencies, state enforcers receive referrals from federal counterparts, particularly the SEC. Current and former enforcers identified most of these referrals as relating to intrastate conduct falling under a monetary threshold that would motivate the SEC or a U.S. attorney's office to keep the case.[156] No interviewee gave a confident estimate what that "threshold" is; one rule of thumb is that federal authorities might be interested in cases involving a million dollars or more.[157] There are glimmers of this threshold in the Dodd-Frank Act's whistleblower provisions, which deal with cases whose monetary sanctions exceed a million dollars.[158]

> Local law enforcement tends not to investigate securities fraud cases; they don't have the capacity to do that. But there is a state agency, the regulatory agency for securities . . . they have a number of lawyers who investigate and analyze securities cases. If complaints come in from the public, [local law enforcement] would contact the securities division.

154. *See infra* APPENDIX, Table 12.

155. *See* Interviewee #50:

> [W]e work with the police training academy, share information with them to teach recruits that they should be contacting us. But we also work joint cases with police departments around the state. We've seen the "that's civil" problem in the past, but we've taken steps to try to address it.

156. *See supra* note 39 and accompanying text.

157. Interviewee #20 ("[I]f a case is of significance, $1,000,000 of victim losses, then that's a threshold that the U.S. attorney's office might be interested in.").

158. 15 U.S.C. § 78u-6(a)(1).

In the previously mentioned seven-state sample,[159] the SEC referred eight times as many cases to the states (seventy-two) as they referred to the SEC (nine).[160] This difference suggests that aggrieved investors submit complaints to the SEC because it is the nation's highest-profile securities regulator, and that it often determines complaints would be more appropriately handled by a state regulator.[161] That referral mechanism is consistent with the Part II.D.2 salience study's finding that the SEC is the securities agency that the public is most likely to turn to.[162] Other interviewees mentioned receiving federal referrals due to geography (e.g., the state regulator was geographically closer to the relevant individuals and records than the SEC regional office) or internal dynamics (e.g., SEC leadership was uninterested in or outright opposed to bringing a case).[163] One mentioned receiving reports from financial-industry whistleblowers who went to the state regulator because they did not trust the SEC to investigate.[164] On the other side of that referral network, referral from states to

159. *See infra* APPENDIX, Table 8.

160. Verity Winship's study of acknowledgments in SEC enforcement releases from 1998 to 2018 found that, among acknowledged state and local entities, the top three were the Texas State Securities Board, New York Attorney General, and Massachusetts Secretary of the Commonwealth. *See* Winship, *supra* note 146, at 306. These securities regulators accounted for twenty percent (165/824) of acknowledgments of state and local entities. *Id.* Although some of those acknowledgments might not reflect those regulators' referrals to the SEC, many likely do. *Id.*

161. *See* ENF'T DIV., U.S. SEC. & EXCH. COMM'N, ENFORCEMENT MANUAL 94 (2017):

> Congress created a dual securities regulatory system in which both federal and state agencies serve specific, valuable functions in protecting investors. . . . Assigned staff should discuss with their supervisors whether it may be appropriate to refer a matter or certain conduct to the state informally. For example, a state may have a particular interest in a case or type of case, the victims or parties may be concentrated in a particular geographic location, the conduct may be limited, though significant, or there may be no federal jurisdiction.

162. *See infra* APPENDIX, Table 12.

163. *See* Interviewee #4 ("The SEC refers matters to us. No one wants to come to [our state]: [the weather is too extreme]."); Email from Interviewee #56 (on file with author) (describing internal conflicts within the SEC that led to cases being referred to the state regulator).

164. Interviewee #38 ("We had whistleblowers come to us and told us they're not going to SEC because they assume the SEC will sit on it. They're not going to FINRA for the same reasons. So often whistleblowers make or break the entire area."). There is precedent for states opening cases based on whistleblower reports after the SEC did not act upon those reports. *See* Jones, *supra* note 6, at 120 (recounting a whistleblower going to the Massachusetts secretary of the commonwealth after the SEC's Boston regional office failed to act on the whistleblower's report).

federal authorities—whether to the SEC or a U.S. attorney's office—is frequently driven by whether a case has significant interstate components. Federal authorities have advantages in such cases in terms of obtaining evidence.[165]

Although enforcers reported that most of their enforcement work comes from complaints—a point supported by the data in Table 8—they also detect issues through their examinations of broker-dealer branches and state-registered investment advisers.[166] Florida, for example, has a reputation for a robust examination program. In 2017, it brought 105 enforcement actions for books-and-records violations—all involving broker-dealers or investment advisers—whereas it brought 69 actions involving unlicensed firms or individuals.[167] This role for examinations reveals an interplay between their prophylactic and enforcement functions: they ensure and promote compliance while also detecting enforcement issues.

For many enforcers, investigative capacity is largely limited to handling incoming complaints.[168] Others, though, have capacity to generate cases through proactive surveillance and similar efforts. On the broker-dealer front, proactive surveillants reported monitoring FINRA's Central Registration Depository (CRD) for arbitral and enforcement actions involving broker-dealer licensees in their states.[169] Investigations or enforcement by FINRA, or private claims by brokerage customers, might lead state regulators to look into the underlying alleged conduct for state-licensing purposes. No interviewee reported proactively

165. *See* Interviewee #32 ("[H]ow much activity occurred out of state[;] that would give the feds an advantage in trying to get the evidence you'd need . . . .").

166. *See* Interviewee #60 (discussing examination procedures and observing that enforcement actions often result from the regulator's examinations).

167. *See infra* APPENDIX, Table 9.

168. *See supra* note 85 and accompanying text.

169. *See, e.g.*, Interviewee #24 ("One of the other ways [we monitor] is we kind of troll in the CRD system, where complaints have to be recorded. Just because some complaints are filed with the firm or FINRA, that doesn't prevent us to investigate ourselves to see if we need to take actions."). FINRA enforcement actions may, of course, have bases that motivate state enforcers less than pure investor-protection-type violations would. *See* James Fallows Tierney, *The Political Economy of Securities Industry Bars* (Mar. 8, 2021), https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=1349730 (work in progress) (offering a political-economy theory for enforcement by FINRA in its capacity as an SRO).

monitoring non-FINRA litigation data for leads. For instance, although the SEC reviews private securities litigation for enforcement leads, no state enforcer reported doing so.[170] The SEC also develops enforcement cases by reviewing regulatory filings;[171] in contrast, interviewees expressed concern that promoters of NSMIA-covered offerings routinely flout state notice-filing obligations that NSMIA preserves, thus limiting regulators' surveillance over their capital markets.[172] Among states that have capacity to do proactive surveillance, a common approach is monitoring investment opportunities being advertised to the public, particularly online.[173] A few states even do undercover work.[174] Like the SEC, states sometimes find leads in newspapers.[175]

These practices around case sourcing mean that state regulators have less ability to set priorities than their federal counterparts do, with investigations being largely driven by a flow of investor complaints. Indeed, interviewees felt duty-bound to tackle complaints. This "all comers" approach has a secondary benefit, however, in forcing states to spot emerging issues. For

170. *See supra* note 131 and accompanying text.

171. *See* Alexander I. Platt, *"Gatekeeping" in the Dark: SEC Control Over Private Securities Litigation Revisited*, 72 ADMIN. L. REV. 27, 55–56 (2020) (discussing the policing role of the SEC's Division of Corporation Finance, which reviews and comments on securities filings and can refer matters to the agency's Division of Enforcement).

172. *Cf.* Interviewee #4 (expressing concern over lack of surveillance over Regulation D offerings); Interviewee #42 ("[I]t seems like the biggest and most serious offenders that we see are usually not registered in any capacity. It's usually some sort of private offering. The offering is usually not registered. They often will say, 'oh it's a Reg D 506,' but they never filed with anybody."); Interviewee #61 (noting that registration staff sometimes identify potential enforcement cases).

173. *See* Interviewee #31 (describing online investigative techniques). *But see* Interviewee #48 ("We are not on the [method omitted] surveillance train. I hope if we have this conversation in a year to be able to tell you that we are.").

174. Interviewee #31 ("I'm aware that some other states do [undercover investigations], but I don't believe that many. More and more are doing it. In most cases [whether to do them is] simply a matter of policy.").

175. *Compare* Interviewee #57 ("We may see things in the newspaper that would cause us to open a file."), *with* Letter from Daniel Greenspan, U.S. Sec. & Exch. Comm'n, Div. of Corp. Fin., to John D. Sheehan, CFO, Mylan N.V. (July 22, 2015), https://www.sec.gov/Archives/edgar/data/0001623613/000000000015038019/filename1.pdf (requesting information about a land transaction first reported in the Wall Street Journal), *and* Mylan N.V., Form 10-K (Feb. 15, 2016), https://www.sec.gov/Archives/edgar/data/0001623613/000162361316000046/myl10k_20151231xdoc.htm#s419EE01492945D02B28F0DDDB1384707 (disclosing an SEC investigation into the transaction).

instance, if there is a sudden rise in complaints involving cryptocurrency, regulators must confront it. If sister states see the same problem in their own complaints, that suggests a national problem that they can coordinate to tackle on enforcement, legislative, and other fronts.

B. Investigations and Enforcement Actions

States' investigative processes are driven by case-specific factors, making a "typical" investigation elusive to outline. Numerous enforcers, for instance, reported not having an enforcement manual, as the SEC and some states, like Texas and Florida, do, meaning that they take a case-by-case approach.[176] The general contours of state securities investigations and enforcement can be sketched out, though. Investigations tend to involve alleged misconduct with one or more discrete victims. After intake, investigations follow four stages: vetting, informal investigation, formal investigation, and charging. In general, interviewees could not estimate typical timelines—from the initial opening of a file to resolution—but they did suggest a broad range of a month to up to years.[177]

In the vetting stage, cases are either assigned directly to an investigator—who typically is not an attorney[178]—or are triaged by the regulator's enforcement chief.[179] The investigator or enforcement chief reviews the complaint, referral, or tip for whether it facially relates to a violation of the state's securities statute or raises some promise of identifying one.[180] A case that

176. *Cf.* Interviewee #64 (explaining that although the regulator has access to an enforcement manual provided by NASAA, practices and procedures are taught informally by the division's leader to new and junior personnel).

177. *See* Interviewee #29 (explaining that investigations "can take anywhere from a matter of weeks to months and years" depending on factors including the number of victims and the level of document review required).

178. Investigators are sometimes sworn law-enforcement officers with power to arrest, carry firearms, and obtain and execute search warrants.

179. TEX. STATE SEC. BD., POLICY AND PROCEDURE MANUAL FOR THE ENFORCEMENT DIVISION OF THE TEXAS STATE SECURITIES BOARD ¶ 48 (2018) (setting procedures for opening an investigation, including review and approval by the enforcement chief) [hereinafter TEXAS ENFORCEMENT MANUAL]; *see also* Interviewee #29 (describing an informal procedure in which a supervisor reviews complaints and assigns them to investigators).

180. *See* TEXAS ENFORCEMENT MANUAL, *supra* note 179.

does not pass this vetting might be referred out to a responsible agency; a dispute over insurance products, for instance, would be sent to the insurance regulator.[181] Matters that merit further factfinding become investigations. States are mixed in whether opening an investigation requires an investigator to obtain approval from leadership, with larger offices likely to have more formal processes for obtaining such approvals.[182]

In the informal-investigation stage, an investigator first takes steps that do not require the issuance of subpoenas. These steps include interviewing complainants or other potential victims (and, sometimes, potential targets);[183] making (mandatory) information and document requests to registered persons or (voluntary) requests to potential targets;[184] and conducting research like reviewing public solicitations or materials found through internet or law-enforcement-database searches or as entries in CRD.[185] This stage might include informal inquiries to and sharing of information with fellow regulators.[186] A small number of states also conduct undercover investigations, a technique that the SEC does

181. *See, e.g.*, Interviewee #53 ("We'll get [calls] from the public . . . complaining about time shares. . . . We don't do timeshares or banking. Insurance we get a lot of calls about: we refer them to [the state insurance regulator].").

182. *See, e.g.*, TEXAS ENFORCEMENT MANUAL, *supra* note 179.

183. *See* Interviewee #17 (discussing these steps); Interviewee #34 (same).

184. Under the Uniform Securities Act, broker-dealers and investment advisers must produce documents and submit to examination when requested to do so by a state securities regulator. *See* UNIF. SEC. ACT § 411 (NAT'L CONF. OF COMM'RS ON UNIF. STATE L., amended 2005) (recordkeeping and production requirements for securities licensees); *see also* Interviewee #16 ("If we have less time to [issue a subpoena], we may send a letter requesting voluntary disclosure, and sometimes entities will cooperate, but generally after doing some homework and thinking there's some 'there' there."); Interviewee #25 ("We'll send out a subpoena tomorrow if they're not registered. If they are, we send out an information request because they have to respond.").

185. *See supra* notes 169, 173 and accompanying text.

186. *See* Interviewee #23 ("[B]ecause regulators know regulators invest in certain issues, if an entity is in one state but we're seeing bad acts related to our state, we might reach out . . . and see if they'd issue some [requests for information] or join up in the investigation itself.").

not itself use[187] but that is well suited to gathering evidence of street-level securities violations.[188]

The use of subpoenas or search warrants to obtain records and testimony marks the formal-investigation stage. Investigations skip this stage when enforcers collect all needed documents and witness accounts through informal investigative methods. For example, a subpoena might not be needed to obtain records from a bank because account records were already voluntarily produced by accountholders. Investigations of registered persons in particular might not reach this stage, not only because broker-dealers and investment advisers must produce records upon regulator request but also because they are more likely than unregistered targets to cooperate with an investigation. Indeed, there are potential risks to subpoenaing targets, who might destroy documents, hide assets, flee, or take other steps to impede investigations.[189] When an enforcer perceives this risk, it might rely on its informal options to avoid tipping off the target.[190] Enforcers must nevertheless

187. Mary Jo White, Chair, U.S. Sec. & Exch. Comm'n, All-Encompassing Enforcement: The Robust Use of Civil and Criminal Actions To Police the Markets (Mar. 31, 2014), https://www.sec.gov/news/speech/2014-spch033114mjw ("Criminal investigations unquestionably bring great value—search warrants, wiretaps, and undercover operations are not in the SEC's toolbox."). Although the SEC itself does not conduct undercover operations, it does make use of evidence gathered from state regulators' undercover investigations. *See, e.g.*, Admin. Proc. No. 3-9896, U.S. Sec. & Exch. Comm'n, Commission Institutes Administrative Proceeding Against Three Alleging Fraud in Offering of Prime Bank Securities (May 11, 1999), https://www.sec.gov/litigation/admin/33-7680.htm ("The Commission today announced the institution of an administrative proceeding against three individuals alleged to have offered, during the spring and summer of 1998, prime bank investments to an Arizona Corporation Commission undercover investigator.") [hereinafter ACC Undercover Investigator].

188. An example of an undercover investigation would be an investigator requesting offering materials from an unregistered promoter or asking the promoter questions that establish the making of material misstatements. *See, e.g.*, ACC Undercover Investigator, *supra* note 187; Complaint at 12–13, Sec. & Exch. Comm'n v. Mercer Cap., Inc., No. 06-81080 (S.D. Fla. Nov. 22, 2006) (alleging that a promoter cold called an undercover Pennsylvania securities investigator, offered him a fraudulent oil-and-gas offering at $0.50 per share, and claimed that the shares would be worth $3.00 or $5.00 in a year's time).

189. *See* Interviewee #20 (discussing these considerations).

190. Once targets know that an enforcer has opened an investigation or might bring an enforcement action, they sometimes engage defense counsel. Targets are particularly likely to hire counsel if a matter has the potential to result in criminal prosecution. *See supra* Section II.D. Management of registered firms often handle investigations themselves, an approach consistent with registered persons being targeted for less serious matters (e.g., compliance issues) than unregistered persons. *See* Interviewee #1 ("Licensees will handle situations on

sometimes use subpoenas or search warrants to obtain needed information.[191] Analyzing bank-account inflows and outflows might be necessary, for example, to prove that a promoter operated a Ponzi scheme.[192] A target's records might also allow enforcers to identify victims who have not come forward, including those who might not know that they are victims.

In the final stage, charging, the enforcer determines if the investigation uncovered violations of the state's securities statute and, if so, what charges and venue—administrative or civil, or, sometimes, criminal—would be most appropriate. Charges and venue are driven in part by the conduct itself. For instance, an enforcer might refer outright thefts for criminal prosecution. Charges and venue are also driven by remedial concerns. A civil lawsuit, say, might allow for injunctive relief whereas an administrative proceeding would not.[193] Victim restitution is a top priority, followed by recidivism prevention. No interviewee reported penalties or fines as a focus and there was skepticism around collectability.[194] This point is partly borne out in the data: between 2012 and 2018, states imposed $1.887 billion in penalties for securities violations, a little more than half the $3.527 billion restitution they imposed.[195]

Practice varies in the charging evaluation. In some states, an investigator or line attorney prepares a memorandum summarizing the facts and making a recommendation, with the

their own. Their focus is to keep their license, and those are cases where someone's not focusing on compliance.").

191. *See supra* note 184 and accompanying text.

192. *See* Interviewee #34 (discussing bank-record analysis).

193. *See generally* Berdejó, *supra* note 7 (reviewing states' remedial powers); *see also* Interviewee #37 (discussing charging evaluations):

> [I]t depends on the facts. Clearly if someone is stealing money, there's a better possibility that will go criminal. If it is a compliance-type violation, books-and-records or disclosures on the CRD, it's more likely to go administrative. If you have a current licensee who's stealing money, it would be administrative and criminal to suspend or revoke license and refer to criminal. If we find ourselves down the civil pathway for an injunction, we have the ability to freeze accounts. Generally, we look to file a civil action if we find a pot of funds that can be frozen for the benefit of investors.

194. *See* Interviewee #18 ("If we can find assets to pay back victims—that's rare—then we use that as an opportunity to let the public know what the fraud was all about . . . . We always ask for a restitution order. Whether it gets collected or not is a question.").

195. *See infra* APPENDIX, Table 7.

decision to be made by the enforcement chief or the regulator's senior leader.[196] In others, the evaluation is done through informal consultation within the regulator.[197] Even when violations have been substantiated, enforcers sometimes exercise discretion against charging targets who acted in good faith, lack prior history, accept responsibility, and correct the violation by reimbursing funds or complying with regulatory requirements.[198]

Apart from this modal process, distinctions in investigative and enforcement practices abound. At least one state, for example, invites targets to make a Wells-type submission as part of its charging evaluation.[199] Investigative practice also varies in response to a state's enforcement focus and local needs. Alabama, for example, emphasizes criminal enforcement, whereas Florida invests considerable effort into its examination program.[200] Practice also reflects the size of a regulator, and indirectly, the size of a state in terms of population and capital markets. Larger enforcers have more hierarchical processes to manage larger caseloads and staffs. Enforcers with smaller staffs, on the other hand, do not require such processes.[201]

196. *See, e.g.*, Interviewee #17 ("At the end of the investigation, the investigator drafts a report submitted to [the senior division leader and deputy leader] with recommendations for legal action or a conclusion of no violations and a recommendation to close.").

197. *See, e.g.*, Interviewee #1 (discussing a regulator's charging process).

198. *See supra* note 49. A number of enforcers mentioned insurance salespersons as frequent culprits of unregistered-securities violations. *See* Interviewee #48 (discussing issues with unlicensed-securities activity by insurance agents). A common problem is an insurance licensee who sells securities based on the erroneous representation by the promoter that the instruments being sold are not "securities." These insurance licensees are regular targets for enforcement. *See* Interviewee #42 ("[S]ome of the worst offenders are insurance agents. I think somebody tells them it's not a security and they believe it and sell it and make a lot of money."). If the sales would not have been fraudulent if made by a licensed broker-dealer representative and the insurance licensee takes responsibility and comes into compliance (i.e., obtains a securities license), the enforcer might not bring an action. But if the insurance licensee were to insist, for example, that the investments were not securities, an action would be far more likely. Interviewee #56.

199. Interviewee #52.

200. *See* Interviewee #4 (regarding Alabama); Interviewee #33 (same); *see also* Interviewee #43 (regarding Alabama and Florida).

201. John T. Scholz & Feng Heng Wei, *Regulatory Enforcement in a Federalist System*, 80 AM. POL. SCI. REV. 1249, 1258 (1986) ("State bureaucracies are small enough to be able to rely more on informal, personal supervision than can federal bureaucracies, which require more formal procedures, standards, and reports to ensure uniformity of actions in geographically dispersed areas.").

These variations in state practice suggest a flexibility advantage over federal authorities. The SEC's Division of Enforcement has 1,385 personnel between its headquarters and eleven regional offices.[202] As a matter of consistency and accountability, that scale and dispersion require standardized, hierarchical procedures for opening, closing, conducting, and resolving enforcement cases.[203] These requirements in turn would be expected to limit line enforcers' ability to adapt to case-by-case factors, as well as to slow investigations. More, the sheer variety of matters handled by the SEC—from foreign-bribery and market-manipulation investigations to insider trading—limits its ability to tailor investigative processes to a narrower band of familiar violations, something states perhaps can do.[204]

On the criminal side, U.S. attorneys' offices have more independence from Main Justice than SEC regional offices have from the SEC, and, unlike the SEC, the DOJ has offices in each state.[205] Yet although the DOJ perhaps gains flexibility by being less centralized than the SEC, it has even less ability to tailor investigations due to its broader portfolio of civil and criminal subject-matter jurisdictions. State securities regulators, in contrast, are free to focus on a relatively narrow set of violation types and to tailor their processes to their distinct geographies, demographics, and economic profiles. These factors in turn allow states to police local frauds with greater granularity than their federal counterparts.[206]

202. *See* U.S. SEC. & EXCH. COMM'N, *FY 2020 Budget Request Tables*, *in* FISCAL YEAR 2020 CONGRESSIONAL BUDGET JUSTIFICATION ANNUAL PERFORMANCE PLAN 13, 15 (2020); *cf.* Letter from Christopher Gerold, President, N. Am. Sec. Adm'rs Ass'n, to Maxine Waters, Chairwoman, and Patrick McHenry, Ranking Member, House Comm. on Fin. Servs. (Oct. 16, 2019) ("State securities regulators are often on the front lines in the battle against elder exploitation. We are in every state and every community.").

203. *Cf.* Scholz & Wei, *supra* note 201.

204. *See infra* APPENDIX, Table 11.

205. For example, even the U.S. attorney for the least populous state has a headquarters and three branches. U.S. ATT'Y'S OFFICE D. WYO., *Contact Us*, https://www.justice.gov/usao-wy/contact-us (last visited Oct. 16, 2021).

206. *See, e.g.*, Interviewee #2 ("We took . . . quick action against [a regional investment adviser] in civil court for fraud and it turned out that the firm used an options strategy and lost $40,000,000 in one day . . . . States can often act quickly, and they don't have the political red tape.").

C. Criminal Prosecution

Most state securities violations are both civil and criminal offenses.[207] Only a small number of cases would be expected to proceed criminally, of course. Criminal prosecution, after all, is costly, imposes social cost in the form of correctional expense and collateral consequences, and often is not a morally or pragmatically appropriate response to violations that were not deliberate and that did not harm victims. Indeed, for each criminal prosecution the states bring, they bring seven administrative or civil actions.[208] Still, that ratio shows that states do frequently enforce their securities laws criminally. No interviewee expressed an aversion to criminal enforcement and several affirmatively mentioned the importance of criminal enforcement as an enforcement option.[209] It is a question that arises early in an investigation: Does the information collected suggest that a violation has occurred, and if it does, does the misconduct appear to be civil or criminal in nature?[210]

Theft is the key divider between civil and criminal enforcement,[211] including outright fake offerings,[212] misuse or

207. *See* UNIF. SEC. ACT § 508(a) (NAT'L CONF. OF COMM'RS ON UNIF. STATE L., amended 2005)) (excluding only violations of notice-filing and advertising-filing requirements from criminal liability).

208. *Compare infra* APPENDIX, Table 1, *with infra* APPENDIX, Table 2.

209. *See, e.g.*, Interviewee #29 ("If we do decide—which we do often—that the respondents should probably be going to jail, we'll refer those cases to the criminal authorities . . . .").

210. *See, e.g.*, Interviewee #50 ("[F]or some cases that appear to be so egregious that they might be criminal, we work with outside agencies on those as co-investigators . . . .").

211. Interviewee #18 ("[M]ost cases are assumed to be administrative or civil, until such time that we figure out there's fraud, theft, phony securities, Ponzi or pyramid schemes, advanced-fee loan schemes, which immediately becomes a criminal matter."); Interviewee #37 ("[C]learly if someone is stealing money, there's a better possibility that will go criminal. If it is a compliance-type violation—books-and-records or disclosures on the CRD—it's more likely to go administrative."). In comparison, during remarks at the NASAA 2020 annual meeting, Marc Berger, deputy director of the Division of Enforcement at the SEC, also highlighted "theft" as an SEC decision point for referring a case to criminal prosecutors. Berger explained that he does not factor the monetary value or number of victims of the theft into whether a criminal referral is appropriate, although those considerations might affect to what agency he makes a referral. N. Am. Sec. Adm'rs Ass'n, 2020 Virtual Annual Meeting, Developments and Trends in Enforcement (Sept. 2, 2020).

212. For example, a promoter sells securities that lack any economic substance or intended substance.

conversion of funds in otherwise colorably legitimate investments,[213] unsuitable recommendations made by conflicted broker-dealers or investment advisers,[214] or egregious misstatements or omissions. This approach is modal, but a state might also *favor* criminal enforcement as a matter of policy and in those jurisdictions theft-based conduct would not always be necessary for the regulator to consider criminal prosecution to be warranted.[215]

This theft assessment is driven by the presence of investor harm. Several enforcers reported that if a defendant makes victims whole, then violations are less likely to be pursued criminally.[216] Although this practice would not be uncommon in other non-securities criminal contexts, it does raise equitable concerns. Providing restitution to victims is one function of criminal prosecution, but punishing wrongful conduct, incapacitating potential recidivists, effecting general deterrence, and expressing the community's moral outrage are also public functions of criminal prosecution. Allowing well-resourced offenders to avoid criminal consequences could undermine these criminal-law purposes.[217] Not prosecuting violators because they pay refunds also risks that they obtain

213. For example, a promoter does use some funds toward the purpose disclosed but also uses funds in undisclosed ways or converts them to personal use.

214. For example, an investment adviser receives substantial commissions from private-placement promoters that are not disclosed to clients.

215. *See* Interviewee #61 (discussing an internal policy of leaning more heavily on criminal enforcement than other states).

216. *See* Interviewee #4 (discussing the administrative/criminal decision):

> The ability to get money back: more likely to lean administrative rather than criminal. If the only thing we can do is take away liberty, then criminal. If we take a license or give them a statutory bar, they become FINRA barred. It removes them from the securities industry going forward. And obviously administrative is easier, less time consuming, and more expeditious.

See also Interviewee #31:

> [I]t's really hard to use civil process. If someone is stealing money, they're spending it. They do not have sufficient assets for a court to appoint a receiver to marshal those assets for investors' benefit. You have to identify perfect cases for civil. Otherwise, we look to the criminal process as an opportunity to punish those who commit securities crimes.

217. For example, in the first episode of *Real Life Regulators*, a podcast produced by NASAA, Connecticut securities enforcers discuss a settlement in which a licensed representative defrauded $300,000 from a customer, a loss his father repaid "so that he could probably stay out of jail." The regulators also discussed their due diligence to ensure that the repayment funds were not themselves obtained through unlawful means. Real Life Regulators, *The Advisor and the Widow*, N. AM. SEC. ADM'RS ASS'N (Jan. 2, 2020), https://www.nasaa.org/investor-education/multimedia-library/real-life-regulators/.

repayment funds by victimizing others, thereby putting the enforcer in the position of incenting fraudulent behavior. To reduce this risk, enforcers diligence repayment funds to ensure that they were not themselves wrongfully obtained.[218] Despite these equitable and recidivism concerns, enforcers pointed to an alternative, pragmatic view on their civil-versus-criminal determinations. Although they prefer obtaining restitution for victims through administrative or civil processes, in many cases—especially these involving unregistered activity—restitution is unlikely to be paid.[219] Stolen funds will have been spent and offenders will likely never have clean funds to satisfy restitution awards. The retributive and incapacitating effects of a criminal conviction and sentence,[220] then, are pursued as second-choice justice.[221]

Although enforcers' assessment of cases as meriting criminal prosecution is an important step toward prosecution, they generally do not have final say. The prosecutorial authorities they possess fall into three categories: direct, indirect, and referral.[222]

A few enforcers like the Alabama Securities Commission have direct statewide authority to prosecute criminal cases. These enforcers empanel grand juries, seek indictments, negotiate plea bargains, and conduct trial without the involvement of a local

218. *See* Interviewee #26 ("[S]ometimes we're willing to come down off a prison type of offer if they're willing to pay the money. Sometimes individuals have recruited a new class of victims and defrauded them to repay prior investors, so we're careful about watching where the money comes from.").

219. *See supra* note 217.

220. Recidivism is also a consideration for whether criminal prosecution is appropriate. Enforcers may decide that defendants who persists in conduct that they have already been warned about represent a higher risk and thus may merit prosecution. *See, e.g.*, Interviewee #36 ("We see a lot of recidivism, two- or three-time bad actors. I try to assess, where is that balance between allowing reform and second opportunities and being complicit in future victimization of consumers[?]"). *See also* Barnard, *supra* note 18, at 223–24 (noting the failure of repeated SEC civil enforcement to deter recidivists and recommending that second offenses be referred to the DOJ for criminal prosecution).

221. *See supra* note 217; *see also* Barnard, *supra* note 18, at 224 (observing that criminal prosecution can help satisfy the retributive needs of securities-fraud victims).

222. It is difficult to quantify a breakdown because some regulators' criminal-enforcement roles are partly statutory and partly based on informal arrangements with in-state prosecutorial agencies. Although many enforcers were interviewed for this Article, the data are insufficient to assign states to these categories with high confidence.

prosecutor or a member of the attorney general's office.[223] When a securities regulator is located in an attorney general's office, the agency might have direct prosecutorial authority, but the regulator itself would need to refer the case internally.

Several enforcers have indirect prosecutorial authority. Under this model, a local or federal prosecutor must agree to bring a case it has jurisdiction over, but the case is handled by an attorney from the regulator who is seconded as a special assistant district attorney or special assistant U.S. attorney.[224] Some large urban counties have economic-crime units that do not need assistance from seconded regulator attorneys, whereas suburban and rural counties do.[225] These secondments are especially likely to happen in localities whose prosecutors lack time, resources, or expertise to prosecute securities crimes.[226] In contrast, in areas with economic-crime specialists, local law enforcement and prosecutors sometimes source and prosecute securities cases without any involvement from, or even the knowledge of, civil regulators.[227]

But in most states, securities regulators have neither direct nor indirect prosecutorial authority. When they determine that a case merits criminal prosecution, they refer it to a local prosecutor, the

223. One prosecutor in a mid-size county spoke about the barriers to prosecuting a securities case: "I do murders and rapes and drug dealers, and so a securities case is utterly and completely foreign. A lot of paper, bank records. The statutes are utterly foreign to me. It was awfully daunting. I've done maybe three, and I've been doing this for 22 years." Interviewee #55. The prosecutor also explained that without investigative and trial assistance from the state securities regulator, bringing a criminal securities case would be infeasible: "[D]oing a securities case without someone who specializes in that area, I can't imagine. They had to take me to school to teach me how to stand up." *Id.*; *see also* Interviewee #12 ("Most DA offices don't have forensic accounting to look at offerings and contracts and promissory notes . . . . They're intimidated by securities-fraud cases and usually put those off.").

224. *See, e.g.*, N.C. GEN. STAT. § 78A-57(b) ("[T]he district attorney may request that a duly employed attorney of the [state securities regulator] prosecute or assist in the prosecution of the [securities-law] violation or violations on behalf of the State. Upon approval of the [state securities regulator], the employee may be appointed a special prosecutor for the district attorney . . . .").

225. *See* Interviewee #12 (describing the economic-crimes unit in a big-city district attorney's office).

226. *Id.*

227. The criminal-enforcement data discussed in this Article are incomplete and undercounted because they are reported by state securities regulators. Although these enforcers are an important node for most securities cases in their states, some prosecutions occur without their knowledge. *Id.*

state attorney general, or a U.S. attorney's office.[228] Interviewees described these referrals as a package of investigative materials that, they hope, allow the referee to quickly get up to speed, avoid duplicative investigation, and move efficiently.[229] Experience is mixed whether the regulator remains involved in the criminal matter beyond the point of referral, a question that relies heavily on the working relationships between regulators and their counterparts. In many instances, the regulator's investigators and examiners actively consult with prosecutors or provide ongoing technical assistance and securities-law expertise.[230] In other instances, securities regulators make referrals and then hear little about what happened to the referral.[231]

For both the indirect-authority and referral states, the leader of the securities division, or its parent agency, has ultimate control over bringing and settling civil and administrative actions, but leaders typically do not have direct influence over how seconded or referred cases are handled.[232] Those decisions are left to the prosecutorial authority. Yet despite having criminal jurisdiction, many local prosecutors lack the expertise to prosecute securities cases, which present a different set of legal issues and fact patterns than street crimes at the heartland of local criminal dockets.[233] Interviews with local prosecutors suggested, however, that securities frauds involving individual victims are not wholly

228. Interviewees noted that they refer matters to federal prosecutors if the cases have substantial interstate aspects, given the federal advantage in marshalling witnesses and resources nationally. *See supra* note 166 and accompanying text. One interviewee offered local prosecutors' lack of expertise and resources as a reason for referring cases federally. Interviewee #20.

229. *See* Interviewee #20 ("[W]e try to package a case up that's tight. . . . We will have conversations with them, declarations for them. We had [a securities enforcer] testify in a trial this year.").

230. *See* Interviewee #6; Interviewee #37; Interviewee #55 (discussing their post-referral consultative roles).

231. *See, e.g.*, Interviewee #33 ("[W]e have our files that we have put together and hand to them and say we think this merits prosecution. We have no coordination other than that. . . . They'll tell us if they get an indictment or they settle, but beyond that we don't have a whole lot.").

232. *See, e.g.*, Interviewee #44 ("Once we began a criminal investigation and we would begin working with U.S. attorneys or even local prosecutors, I stepped away. I had no interaction with the investigative team. They were free to work with prosecutors.").

233. *See supra* note 224.

different from other street crimes. These prosecutors reported learning the substantive securities law, sometimes with the assistance of expert witnesses or seconded regulator attorneys.[234] As with other types of criminal cases, securities prosecutions typically end with negotiated guilty pleas.[235] But cases do sometimes go to trial. Prosecutors reported that their evidence at trial is often overwhelming and that juries are able to appreciate complex securities concepts like the materiality of misstatements or omissions.[236] They also note that cases are often bolstered by sympathetic victims[237]—ordinary people who have lost personally meaningful sums—although juries also convict when the victims are wealthy individuals who remain so even after experiencing securities fraud.[238]

D. Coordination and Cooperation

Section 608 of the Uniform Securities Act instructs regulators to "cooperate, coordinate, consult, and, subject to [the act's data-protection provisions], share records and information" with other state and provincial securities regulators, the SEC, the DOJ, the CFTC, the FTC, the Securities Investor Protection Corporation, self-regulatory organizations, banking and insurance regulators, and other law-enforcement agencies.[239] This section sketches how they abide that instruction.

State-to-state cooperation is extensive. State enforcers talk to each other frequently about matters of common interest. This

234. *See* Interviewee #6 (discussing this process).

235. *See* Interviewee #12; *infra* note 237.

236. Interviewee #12:

> One out of five cases go to jury trial. We've had very good success going to trial. Juries are pretty typically offended by the conduct. There are clear financial pictures: taking the money for personal use, pretty salacious uses. Guys buy airplanes, condos, tens of thousands on trips to Vegas or the Caribbean. We're able to paint a good picture such that juries are outraged.

But see Interviewee #30 (discussing the difficulty of conveying securities concepts to juries).

237. Interviewee #6 ("Our case was really sympathetic. A lot of victimization. This guy just fleeced these people and lied to them and used his church to take advantage. One victim was early 40s, developmentally disabled. Not in every case do you have that, and here we did.").

238. *See* Interviewee #12 (discussing a securities-fraud trial that resulted in a conviction despite the victim being "filthy rich and not likable").

239. UNIF. SEC. ACT § 608 (NAT'L CONF. OF COMM'RS ON UNIF. STATE L., amended 2005).

informal communication is often about enforcement concerns, but not always. For example, some interviewees mentioned that there had been state-to-state communication about this Article and the progress of its interviews. This informal horizontal coordination is supplemented, and facilitated by, formal coordination through NASAA. NASAA has 23 employees and an approximately $7 million annual budget, with the bulk of its revenue coming from the Series 63, 65, and 66 licensing examinations and notice-filing fees.[240] NASAA serves as a focal point for state enforcers to communicate face-to-face and to develop personal relationships that foster coordination. The association's work is driven by subject-matter committees whose volunteer members work at state regulators.[241] They include committees for enforcement, which oversees topical working groups for commodities and derivatives enforcement, training, publications and manuals, and technology.[242] Apart from the national and continental coordination it fosters, NASAA sponsors eight geographic "enforcement zones," which allow for coordination around regional concerns.[243] A number of enforcers reported membership in regional financial-crime taskforces of state agencies, the SEC, U.S. attorneys' offices, the FBI, the U.S. Postal Inspection Service, FINRA, the IRS, and other agencies.[244] These taskforces meet periodically to discuss regional trends and issues.[245] Although these meetings provide an opportunity for building personal relationships that might be expected to facilitate cooperation, the agencies generally do not share information about their investigations at them.[246]

This limited sharing might be driven by disclosure restrictions, like grand-jury proceedings, or prudential discretion.[247] Yet it does

240. *See* N. Am. Sec. Adm'rs Ass'n, IRS Form 990 (2018) (on file with author).

241. UNIF. SEC. ACT § 501.

242. *See Committees and Project Groups*, N. AM. SEC. ADM'RS ASS'N, https://www.nasaa.org/about/committees-and-project-groups/ (last visited Oct. 17, 2021).

243. *See* Interviewee #24 (discussing regional coordination via NASAA enforcement zones).

244. *See, e.g.*, Interviewee #8 (describing membership in a financial-crime taskforce whose members include FBI, IRS, and Postal Inspection representatives).

245. *See* Interviewee #25 (discussing regional meetings).

246. *Id.*; *see also* Interviewee #25; *infra* note 250.

247. *Cf.* Thomas Brewster, *Massive Oklahoma Government Data Leak Exposes 7 Years of FBI Investigations*, FORBES (Jan. 16, 2019), https://www.forbes.com/sites/thomasbrewster/

contrast with interviewees' descriptions of open communication and coordination among state enforcers.[248] One interviewee reported, for example, not notifying federal authorities before bringing actions, nor receiving that courtesy in return; the interviewee would, however, coordinate filings with sister states that planned to bring cases against the same defendants.[249] Another enforcer noted that referrals from the SEC—of complaints the SEC itself chose not to pursue—come heavily redacted, with even the alleged misconduct being redacted.[250] In contrast, an enforcer in one state would not hesitate to call colleagues in neighboring states to discuss a matter that could cross their borders.[251] These distinctions imply robust horizontal coordination among state enforcers and comparatively weaker vertical coordination. Strong horizontal coordination would be expected to allow states more easily to see a complete view of related violations affecting multiple jurisdictions, an advantage that federal agencies forgo if their investigations are kept overly siloed.

2019/01/16/massive-oklahoma-government-data-leak-exposes-7-years-of-fbi-investigations/?sh=4ee08e256e11.

248. *But cf.* Interviewee #31:

> We have [several] personnel detailed at FBI offices. They work at those FBI offices [several] days a week as part of state-federal taskforces investigating securities violations. It gives us access to [a] broad range of investigative tools and prosecutorial remedies. It gives us the opportunity to discover cases we otherwise would lose, access to critical information such as [method omitted] that can tip us off to fraud schemes before the[y] collapse. It's an opportunity to pursue criminal remedies without having bureaucratic road block[s] or red tape between state and federal prosecutors.

249. Interviewee #28. *Compare* Interviewee #25:

> I think there's ebb and flow at the SEC. Certainly from the line attorneys to us is very good. But I think as you get higher up, the SEC tends to be more cautious on sharing information. The SEC is not calling me to tell me when they're filing cases in [my state]. On the flip side I'm not necessarily calling them. But we do share information and run into one another in investigations. If I have a lot of time and resources in the case, I'm not going to drop it just because they're in it. I'm open to cooperating, filing on the same day. If they're really far ahead, I might let them have it unless I have compelling reasons to get involved[,]

with id. ("Cooperation among agencies, state to state, is fabulous. . . . I can pick up the phone and talk to any state administrator and get cooperation from them and there's no infighting about who brings a case, whose turf is it.").

250. Interviewee #53.

251. *Id.*

E. Multistate Coalitions

Beyond policing local frauds, regulators have formed multistate coalitions to investigate the financial industry, major national firms, and whole product lines.[252] In a multistate coalition, state regulators share personnel and other resources while investigating large, complex organizations or whole industries.[253] When coalition investigations identify cross-border violations of state laws, states are able to obtain global settlements to resolve them. Global settlements are efficient not only for *states* but also for *targets*: they allow targets to avoid overlapping investigations and transaction costs while receiving global releases of potential public-enforcement claims against them.[254] This practice developed organically, but the contemporary process for multistate enforcement emerged from the Prudential-Bache scandal of the early 1990s and the microcap sweeps of the late 1990s.[255] That model has carried to the present.[256]

Coalitions form to coordinate and provide investigative economies of scale over misconduct that is widespread but that shares characteristics with local frauds that states regularly police. For example, a broker-dealer operating a "boiler room" might conduct business nationwide, but its tactics and effects are similar to any local fraudster who sells worthless securities. Coalitions can also serve political purposes. After the passage of NSMIA, for example, regulators were eager to prove that they continued to play

252. See *infra* APPENDIX, Table 13, for a selected list of multistate actions and their results. *See also Operation Cryptosweep*, N. AM. SEC. ADM'RS ASS'N, https://www.nasaa.org/policy/enforcement/operation-cryptosweep/ (last visited Oct. 17, 2021) (discussing a multistate task force focused on fraudulent cryptocurrency offerings resulting in eighty-five enforcement actions).

253. Elysa M. Dishman, *Enforcement Piggybacking and Multistate Actions*, 2019 BYU L. REV. 421, 450 (observing that multistate actions allow state enforcers to pool resources so as to take on more challenging targets).

254. *Contra id.* at 451 (suggesting that multistate actions lead states to piggyback on each other's investigations, causing overenforcement rather than preventing overenforcement by allocating a single settlement among states and giving targets a global release).

255. Interviewee #43; Interviewee #56.

256. *See infra* APPENDIX, Table 13.

a vital role in investor protection, and the sweeps of boiler-room brokerages were pursued with that goal in mind.[257]

A typical multistate coalition begins when a state identifies a potential issue and its enforcement chief presents a theory of the case, persuading others to join.[258] Multistate securities coalitions are thus in large part driven by the personalities, and personal initiative, of individuals. This individual initiative would generally be from a member of the civil service rather than an elected official or political appointee.[259] Although NASAA does not drive coalition formation, its committees—particularly its enforcement committee—serve as fora that facilitate coalition building among representatives from the states.[260]

When a multistate investigation forms, states fill one of four roles: leader, taskforce member, non-taskforce member, or non-member. The operational unit of a coalition is a taskforce comprising four to six states, with the state that identified the issue commonly serving as leader or, in some instances, sharing that role with another state.[261] Leadership selection might also be influenced by an enforcer's expertise on a target.[262] For example, an enforcer that has examination experience with a particular broker-dealer might bring existing knowledge to bear in a multistate investigation of that firm. Within a taskforce, all members contribute investigative resources, thereby reducing states' disadvantage in conducting large, complex, nationwide investigations. Splitting the workload also allows taskforce members to maintain adequate local enforcement activity. That is, apart from coalition resource-sharing, they would not have personnel to respond to day-to-day complaints and referrals *and* conduct a largescale investigation on their own.[263] Disagreements

257. Interviewee #43. Interviewee #43 gave particularly comprehensive insight into multistate coalitions and so is relied on most heavily in this section. Other interviewees offered consistent insights.

258. *Id.*

259. Although it might be imagined that elected agency leaders would have political incentives to seek out multistate actions, no interviewee familiar with the multistate process described elected leaders or their political appointees as having a driving role in initiating multistate cases. *Id.*

260. *Id.*

261. *Id.*

262. *Id.*

263. *Id.*

sometimes arise within taskforces over work and settlement allocations.[264] These disagreements must be resolved interpersonally: taskforces make decisions through consensus, and there are no governing procedures other than practice accumulated from prior multistate matters.[265]

For industry-wide investigations, multiple taskforces form.[266] Each focuses on a single firm; for example, one taskforce for Goldman Sachs, another for J.P. Morgan, and so on.[267] This approach is pragmatic in that investigating any given firm is a whole taskforce of work. It also presents the possibility that coordinated, but parallel, investigations allow for more dynamic and flexible factfinding than if a single agency investigated multiple firms at the same time. This state advantage could be lost, of course, if states fail to share information adequately and thus miss out on investigative economies of scale.

Once a coalition has formed, NASAA sometimes funds travel, conferences, and experts.[268] This direct support helps overcome a potential collective-action problem. Taskforce states contribute substantial staff hours that could result in enforcement actions being joined by a larger group of non-taskforce coalition members. Without NASAA funding, taskforce membership would mean not only contributing personnel hours, but also making cash outlays from already limited enforcement budgets. This financial burden would incent states not to join a taskforce but instead to free ride. If states became unwilling to bear the financial cost of participating in taskforces, then there would be no multistate investigations to free ride on.

When investigations uncover violations, the taskforce negotiates a settlement with the target firm.[269] The lead state drafts and

264. *Id.*

265. *Id.*

266. Industry cases emerge when a concerning practice at one firm appears to be common in the industry.

267. Interviewee #43.

268. *Id.*

269. Multistate investigations do not necessarily lead to settlement. In the microcap sweep of the late 1990s, states coordinated to file actions on the same day against a number of broker-dealers operating as boiler rooms. Firms caught up in the sweep had to close. *Id.*

conducts negotiations, but taskforce members have input.[270] Although non-taskforce states do not have formal input in investigations or settlements, the taskforce provides them with periodic updates.[271] Taskforces present settlement agreements in largely final form, subject to state-by-state technical customizations.[272] After review by the NASAA board and president for their endorsements, states decide whether to join.[273] Not all states join settlements. The Investor Protection Bureau of the New York attorney general and the Securities Division of the Massachusetts secretary of the commonwealth often act independently of other states.[274] Other enforcers decline to join settlements that they view as imposing inadequate sanctions.[275] But to avoid undercutting sister states, these holdouts do informally agree not to bring actions, provided that settling firms offer the same relief to their in-state victims as to settling states' residents.[276] Enforcers also decline to join settlements due to philosophical disagreement with the actions themselves.[277] The non-joining states' silence is important because a coalition's ability to give defendants a global release is a critical point of leverage for taskforce negotiations. If too many states go their own way, targets would be less willing to engage, and give, in

270. *Id.*

271. *Id.*

272. *Id.*

273. *Id.*

274. Interviewee #25 (discussing New York and Massachusetts in bringing their own cases).

275. Interviewee #43.

276. *Id.* State regulators have special incentive to join a global settlement if their allocation of the settlement fund is greater than the statutory maximum they could directly impose in civil-money penalties. In other words, a defendant might agree to a global settlement that in effect provides some states with better resolutions than if they acted alone. For example, in 2008 the North Carolina secretary of state joined a global settlement with Wachovia Capital Markets in connection with the market-analyst multistate investigation; its share of the nearly $25 million settlement was $611,526. This share was deposited in the agency's investor-protection fund, which state law designated for *settlement* proceeds. *See* Consent Order, Wachovia Capital Markets, LLC, N.C. Sec'y of State, Case No. 02-030-RF (July 31, 2006). Under the North Carolina Securities Act, however, the agency would have been limited to imposing a $25,000 penalty, which it would have been required to be deposited in the state's civil-money-penalty fund, had it brought the case directly. *See* N.C. GEN. STAT. § 78A-47(c) (2001).

277. Interviewee #43.

negotiations, thereby undermining the efficacy of multistate coalitions as an enforcement mechanism.[278]

Multistate investigations sometimes result in settlements that have considerable impacts on the financial industry and that garner the kind of press attention often seen for major SEC or DOJ actions. State enforcers, for example, drove multiple broker-dealers that used boiler-room tactics out of business during the late 1990s.[279] In that sense, the states' "Wall Street" investigations appear inconsistent with their "Main Street" priorities, as well as this Article's conclusions that states have advantages in policing local frauds and thus focus their efforts on that front. This inconsistency might prompt questioning the propriety of multistate coalitions within the national securities-enforcement system, and indeed some of the literature does raise that concern.[280] Yet the history of multistate coalitions reveals a process in which states' on-the-ground work exposes systemic securities violations in kind

278. Interviewee #56 ("[T]he [defendant] would say 'I need a global resolution. I can't settle with just California, Florida, and New York: a bunch of other states might come in and piggyback . . . ."). SERPENT ON THE ROCK provides an account of not only the multistate Prudential-Bache investigation, but also the taskforce's settlement negotiations with Prudential executives. After a breakdown in negotiations, taskforce members prepared to brief their sister-state colleagues at a NASAA conference on the expectation that without a global settlement, states would pursue separate enforcement actions, including revoking the firm's broker-dealer licenses. Faced with this credible threat, however, Prudential ultimately agreed to the taskforce's demands. *See* EICHENWALD, *supra* note 147, at 414–27.

279. Interviewee #43.

280. For example, the Rose & LeBlanc study found that firms disclosing a public-enforcer securities investigation also reported a striking 93% rate of being investigated by at least one other securities enforcer for the "same or related misconduct." *See* Rose & LeBlanc, *supra* note 7, at 421. Taking multistate actions into account makes that figure less striking, however. The study showed that 85% of the disclosed investigations related to "highly publicized industry-wide scandals." *Id.* The mutual-fund market-timing scandal accounts for 46% of the study's disclosure occurrences. *Id.* That case was first uncovered by state regulators and pursued through the multistate-coalition framework, suggesting that at least 46% of the events in the study represented coordinated, rather than independent, action and decision-making. Interviewee #43; *see also Ensuring Effectiveness, Fairness, and Transparency in Securities Law Enforcement: Hearing Before the Subcomm. on Cap. Mkts., Sec., & Inv.*, 115th Cong. 116 (2018) (statement of Joseph P. Borg, President, N. Am. Sec. Adm'rs Ass'n) ("[I]t should be noted that state securities regulators are often first to discover and investigate our nation's largest frauds. . . . [From] 'market timing' in mutual funds, and to uncovering problems in the auction rate securities market, state securities regulators have consistently been in the lead.").

with the localized frauds they focus on day-to-day.[281] What happens in one place might happen in and affect local investors in towns and cities across the country. In those cases, it would be a logical extension for states to take a coordinated approach once they discover that their in-state cases are part of larger patterns.

IV. STATE SECURITIES ENFORCEMENT AS RESIDUAL SECURITIES ENFORCEMENT

State and federal authorities and private plaintiffs all play a role in the national securities-enforcement system. Drawing from the institutional account of Parts I, II, and III, this Part frames the states as the nation's residual securities enforcers. All in, state enforcers reported being willing, and indeed obliged, to respond to violations too small in scale or scope for federal enforcement. State enforcers also police cases that private plaintiffs might not. Plaintiffs' attorneys explained that losses of a few thousand, or tens of thousands of dollars are uneconomical to litigate in court or FINRA arbitration and thus they cannot help small-dollar victims who appear to have meritorious claims.[282] Claimants could bring arbitral claims pro se or with the aid of pro bono counsel, such as law-school securities clinics, but many claimants will lack the sophistication needed to represent themselves successfully and the demand for pro bono representation likely outstrips supply.

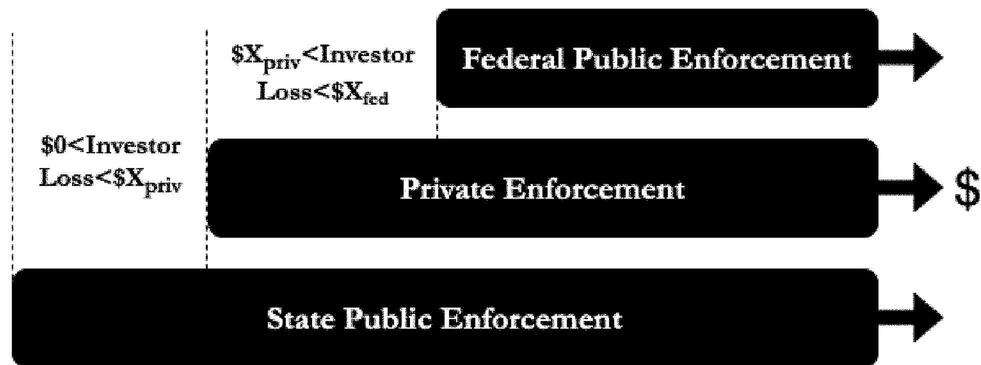
These points suggest that many frauds fall into an enforcement gap. Federal enforcers lack the resources or willingness to take routine fraud cases falling below threshold $\$X_{fed}$ in investor losses, whereas private attorneys lack the economic incentive to bring cases below threshold $\$X_{priv}$,[283] which is usually lower than $\$X_{fed}$ but

281. *Ensuring Effectiveness, Fairness, and Transparency in Securities Law Enforcement: Hearing Before the Subcomm. on Cap. Mkts., Sec., & Inv.*, 115th Cong. 116 (2018); *see also* Interviewee #56.

282. *See* Interviewee #7; Interviewee #9; Interviewee #10 (discussing private attorneys' inability to accept small-dollar securities cases).

283. The SEC or DOJ might still take cases with low loss amounts (or no investor harm at all) if the cases align with broader enforcement-policy priorities, such as small-dollar insider trading, delinquent filings, or improper use of confidentiality provisions in severance agreements. *See, e.g.*, Complaint at 1, Sec. & Exch. Comm'n v. Yan, No. 1:17-cv-05257 (S.D.N.Y. July 12, 2017) (alleging $120,000 in illicit insider-trading gains); Cease-and-Desist Order for Admin. Proc. No. 3-17396, Health Net, Inc. (Sec. & Exch. Comm'n Aug. 16, 2016) (ordering an issuer to clarify to former employees that the confidentiality provisions in their severance agreements did not prohibit making disclosures to the SEC).

still far greater than $0.[284] If a defendant is insolvent—as would be the case in many financial street crimes—then private enforcement is infeasible regardless the loss amount because there is no chance for recovery. That leaves only state enforcers to take cases involving investor losses between $0 and $\$X_{priv}$. Although enforcement overlaps could hypothetically occur between securities enforcers and impose social costs through duplicative enforcement or overenforcement, there is still a large slice of localized, small-dollar frauds for which public enforcement by state regulators or prosecutors is realistically the only recourse. State enforcers recognized this gap as a driver of their enforcement missions,[285] believing that for many cases, if they do not investigate and (when needed) take action, no one will.[286] The following figure illustrates these gaps between what actions federal, private-plaintiff, and state enforcers will bring, even if they share overlapping enforcement authority:



Of course, states are not the *only* public enforcers with jurisdiction over the small-dollar theft-based violations at the core of this Article's account. The SEC and DOJ have jurisdiction, too. But their own resource constraints limit their efforts to matters that either meet high loss thresholds—such as public-company

284. *See* James D. Cox, Randall S. Thomas & Dana Kiku, *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737, 744 (2003).

285. *Cf. id.*; *see also* Interviewee #50; Interviewee #53 (expressing this sentiment).

286. *Cf.* Interviewee #4 ("Our priority is always to right any economic wrongdoing. There's no case too small for us. Some have been too big for us, but we've taken them on anyway.").

accounting frauds, major interstate Ponzi schemes[287]—or that involve national priorities like insider trading.[288] Some point to high levels of undetected or unprosecuted securities violations and have urged increased federal white-collar enforcement and increased budgets to address those matters. Yet the role of state regulators, as well as state prosecutors and law-enforcement agencies, is missing from those calls for greater white-collar enforcement. For most securities cases, these agencies are closest to victims and, often, offenders. This Article's account suggests that even if the SEC and DOJ were to receive substantial new resources for white-collar enforcement, state public enforcement would remain a necessary part of the national securities-enforcement system. That is because states enjoy two key advantages—detection granularity and institutional decentralization—over their federal counterparts that uniquely enable them to police local frauds.

First, detection granularity: state enforcers are better situated than federal counterparts to detect highly localized frauds and to work directly with the victims of those frauds.[289] This capacity is a function of local and in-state enforcement networks: victims are most likely to seek out private attorneys or local or state law enforcement, who can in turn channel complaints to the state regulator in its role as an expert hub. Federal enforcers, on the other hand, are unlikely to have similar in-state enforcement networks because they lack the physical presence and resources to foster them, much less to follow up on leads they generate.[290]

And second, institutional decentralization: as distinct regulators that also closely cooperate with each other, state enforcers can—by diversifying their perspectives, know-how, and

287. *See supra* notes 39, 157 and accompanying text.

288. *See infra* APPENDIX, Table 11.

289. *See* Rose, *supra* note 24, at 2208 (considering the possibility that state securities regulators have detection advantages over federal authorities, in part because they are more accessible to complainants).

290. It is conceivable that the SEC would expand its regional presence from eleven regional offices to fifty. And the DOJ already has multiple offices in each state. Yet it is likely that coordination between agencies that are part of the same sovereign unit would still be able to interact more cohesively than federal and local agencies could. State law, for example, predominates in the lives of both local police and prosecutors and state regulators, and all share their states' broad civil-service cultures and norms. Victims might also be more likely to trust local and state authorities over federal authorities who, even when they are physically nearby, might seem remote and inscrutable.

techniques—avoid the myopic enforcement priorities and potential for capture that can manifest within centralized enforcement agencies.[291] No single administration controls state securities enforcement in terms of priorities, techniques, or remedies. If some states identify a new form of securities misconduct or a new, problematic product, they might alert their sister states, some of whom might have been unaware that their residents are experiencing similar problems. Yet although state securities enforcement is headless, it is not leaderless: through close cooperation among states, it takes only a few enterprising enforcers to elevate an interstate issue to national or regional attention or to develop new approaches or policies to address common issues.

Together, these advantages complicate views that concurrent state and federal jurisdictions risk wasted resources or overenforcement on one hand, while on the other hand creating the potential for healthy regulatory competition and protection against capture.[292] To the extent that the literature has considered state securities enforcement, it has generally done so with some implicit assumption that state and federal enforcers target the same types of cases, if not the very same cases.[293] This Article has shown, though, that public securities enforcement is predominantly not "state *and* federal" or "state *versus* federal," but rather is *either/or*.[294] States have residual enforcement missions, and their constraints restrict them mostly to those missions, like tackling the complaints from investors calling, writing, or walking into their offices. A lack of appetite to expand these missions is shown by states' readiness to refer cases they perceive as better suited for an SEC regional office,

291. John C. Coffee, Jr., *Competition Versus Consolidation: The Significance of Organizational Structure in Financial and Securities Regulation*, 50 BUS. LAW. 447, 454 (1995) (observing that regulatory competition can lead to costly turf battles, but that it can also guard against myopic policymaking and agency capture).

292. *See generally supra* note 6 and accompanying text.

293. *See* John C. Coffee, Jr. & Hillary A. Sale, *Redesigning the SEC: Does the Treasury Have a Better Idea?*, 95 VA. L. REV. 707, 763 (2009); Jones, *supra* note 6, at 121–26; Jonathan R. Macey, *Positive Political Theory and Federal Usurpation of the Regulation of Corporate Governance: The Coming Preemption of the Martin Act*, 80 NOTRE DAME L. REV. 951, 973 (2005). *But see* Berdejó, *supra* note 7 (focusing on state policing of local securities frauds).

294. This Article touches on the exceptions—like multistate coalitions focused on systemic industry or market practices—but they are limited departures from typical state practice and largely grow out of their day-to-day policing.

a U.S. attorney's office, or another in-state agency. The expected presence of substantial numbers of undetected local frauds suggests that even if state-enforcement resources were significantly increased, that would merely enable states to pick up slack rather than newly pursue "national" cases. For its part, the SEC faces its own resource constraints and so refers cases that it sees as better aligned with its state counterparts' work.

True, with different incentives and mutually plentiful resources, there could be turf battles between state and federal actors that would raise economic-federalism concerns of resource waste and overenforcement. But now, the state and federal turfs are largely distinct, and it is doubtful that that condition will appreciably change in the future. In that light, state and federal authorities follow a roughly nonoverlapping allocation reflective of each actor exploiting its advantages, adhering to its institutional constraints, and pursuing its perceived enforcement mission.

Given that existing allocation, if it is accepted that local frauds and their victims matter, then state enforcement is necessary. Neither federal enforcers nor private attorneys have resources or incentives to police a large number of securities violations that, although small in the scale of the capital markets, are personally meaningful to individual investors. But state regulators, consistent with the resource constraints they operate under, take all comers. They are the nation's residual securities enforcers. Federal authorities and private plaintiffs, in contrast, serve specialized roles within the national system of securities enforcement. Together they handle cases that are particularly large in dollar terms, that have interstate or international scope, or that respond to national priorities. From there, states provide many victims and would-be victims with their only line of defense. Considerations of securities law and policy, then, are incomplete when states are missing from view.

This state-federal allocation should guide securities enforcers as they cooperate and complement each other's enforcement missions. Given state advantages at policing local frauds, and assuming that the rough state-federal allocation under current conditions holds, this Article's call is simple, broad, and forward-looking: as federal policymakers and scholars consider or seek changes to national securities policy, they should do so in ways that bolster states' residual enforcement work or that at least mitigate negative impacts

on it. Although it is hard to predict where this call may lead, or how heeding it might manifest, this Part's closing footnotes offer three illustrative examples around exempt-offering notice filings,[295] whistleblower protection,[296] and broker-dealer regulation.[297]

CONCLUSION

This Article has addressed a gap in the literature by providing the first institutional account of who state securities enforcers are, what motivates them, and what they do to police local capital markets and protect local investors. It has identified two key advantages—detection granularity and institutional

295. Consider the exclusion of federally covered securities from state ex-ante regulation. Interviewees expressed concern that the expansion of federally covered transactions harms states' capital-markets surveillance because promoters do not comply with still-valid state notice-filing requirements. This effect makes it hard to stop frauds in their tracks rather than after investors have already suffered substantial losses. *See supra* note 172 and accompanying text. Expanding the scope of private offerings, and preempting ex-ante state registration requirements in the process, could perhaps affect sound economic and regulatory policy. If that is the policy that policymakers will pursue, or scholars will advocate, however, it is worth considering how the policy might inadvertently facilitate fraud and how to mitigate that risk. For example, the availability of federal exemptions for covered securities under NSMIA could be conditioned on making notice filings that are mandated by state law, which can be done via a single filing in NASAA's EFD system. Although NSMIA continues to permit state notice-filing requirements, a conditioning rule like the one just described would provide a substantive federal bulwark for state surveillance and enforcement capability without requiring any outlay of federal resources or significant effort on the part of those engaging in covered transactions. *See supra* note 172 and accompanying text.

296. The Dodd-Frank Act contains a provision that protects securities whistleblowers from retaliation. The substantive protection includes blowing the whistle internally inside a company, yet the provision's definition of "whistleblower" is one who provides information "to the [Securities and Exchange] Commission," thus rendering the provision's non-SEC reporting channels largely ineffective for qualifying for anti-retaliation protection. *See* Digital Realty Trust, Inc. v. Somers, 138 S. Ct. 767, 770 (2018). But NASAA, after public comment, has issued a new model whistleblower act that gives anti-retaliation protections to internal-only whistleblowers. N. AM. SEC. ADM'RS ASS'N, MODEL WHISTLEBLOWER AWARD AND PROTECTION ACT (2020).

297. The SEC's adoption of Regulation Best Interest sets a standard for broker-dealer conduct that falls short of a fiduciary standard, which some states have adopted. *See* Melkonyan, *supra* note 3, at 1598 ("California, Missouri, South Carolina, and South Dakota courts have been clear about uniformly imposing fiduciary duty under common law.") Although Regulation BI does not appear to preempt stricter state standards, *see generally id.*, if future amendments to it were to force a national standard, settled expectations for in-state securities-industry behavior and enforcement could be disrupted in states that now impose a fiduciary standard.

decentralization—that states enjoy over their federal counterparts in policing localized frauds involving individual, often small-dollar, victims.

Based on this evidence, this Article concludes that state and federal securities enforcement are largely complementary, not theaters of turf battles. Thus, under current conditions of enforcement incentives and resource constraints, state and federal authorities follow a roughly non-overlapping enforcement allocation reflective of each exploiting its advantages, adhering to its institutional constraints, and pursuing its perceived enforcement mission. And states enjoy considerable advantages in policing the local turf. In light of these advantages, the need for local investor protection, and the states' role as residual securities enforcers, this Article calls on federal policymakers and scholars to bolster state enforcement work and to mitigate negative impacts on it when considering or seeking changes to national securities policy.

APPENDIX

Table 1: State-securities regulator and SEC enforcement actions, 2012–2018.[298]

	Administrative Actions			Civil Actions			Total Actions		
Year	**SEC**	**States**	**States %**	**SEC**	**States**	**States %**	**SEC**	**States**	**States %**
2012	462	1,925	417%	272	232	85%	734	2,157	294%
2013	469	1,740	370%	207	182	88%	676	1,922	284%
2014	610	1,634	268%	145	137	115%	755	1,771	235%
2015	645	1,630	253%	162	152	94%	807	1,782	221%
2016	692	1,606	232%	176	138	78%	868	1,744	201%
2017	–	1,682	–	–	116	–	754	1,798	238%
2018	–	1,640	–	–	146	–	821	1,786	218%
AVG	–	1,694	–	–	158	–	774	1,826	239%

Table 2: State and federal criminal securities cases, 2013–2017.[299]

Year	DOJ*	States	States (as % of DOJ)
2013	283	262	93%
2014	237	271	114%
2015	218	253	116%
2016	221	241	109%
2017	230	255	111%
AVG	234	256	109%

298. These statistics are excerpted from two sets of reports: the NASAA annual enforcement surveys, and the SEC's enforcement annual reports. State statistics are excerpted from the 2013, 2014, 2015, 2016, 2017, 2018, and 2019 NASAA enforcement surveys (on file with author and available at N. AM. SEC. ADM'RS ASS'N, ENFORCEMENT STATISTICS, https://www.nasaa.org/policy/enforcement-statistics (Jan. 16, 2020)). SEC statistics are excerpted from the SEC's 2012, 2013, 2014, 2015, 2016, 2017, and 2018 enforcement reports (on file with author and available at SEC. & EXCH. COMM'N, REPORTS AND PUBLICATIONS, https://www.sec.gov/reports (Jan. 16, 2020)).

299. State statistics are excerpted from the NASAA 2014, 2015, 2016, 2017, and 2018 annual enforcement surveys. *See* N. AM. SEC. ADM'RS ASS'N, *supra* note 298. Federal statistics are excerpted from U.S. Sentencing Commission abstracts on securities and investment-fraud offenses, *see Quick Facts*, U.S. SENTENCING COMM'N, https://www.ussc.gov/research/quick-facts/quick-facts-archives (last visited Jan. 20, 2020); COURTNEY SEMISCH, U.S. SENTENCING COMM'N, WHAT DOES FEDERAL ECONOMIC CRIME REALLY LOOK LIKE? (2019), https://www.ussc.gov/sites/default/files/pdf/research-and-publications/research-publications/2019/20190130_Econ-Crime.pdf. DOJ data refer to *convicted* offenders only. State criminal data in Table 2 are likely undercounted. State regulators provide the information for this survey, but they do not always know if their criminal referrals result in prosecutions or if prosecutors bring cases without them.

Table 3: Top reported state securities-fraud issues, 2012–2015.[300]

	2012	2013	2014	2015
1	Rule 506 offerings	Ponzi schemes	Ponzi schemes	Ponzi schemes
2	Oil and gas	Real estate	Rule 506 offerings	Real estate
3	Ponzi schemes	Internet fraud	Real estate	Oil and gas
4	Real estate	Rule 506 offerings	Internet fraud	Internet fraud
5	Affinity fraud	Affinity fraud	Oil and gas	Affinity fraud
6	Precious metals	Oil and gas	–	–

Table 4: State enforcement investigations by product/scheme type.[301]

2017 or 2018 enforcement actions	**DE***	**FL***	**MI**	**MN**	**RI**	**SD**	**WI**
Affinity fraud	0	95	6	1	0	0	2
Annuities – equity indexed	0	0	0	0	0	0	0
Annuities – variable	0	0	3	45	0	0	0
Commodities – precious metals	1	0	2	0	0	0	0
Commodities – non-precious metals	1	4	0	0	0	0	0
EB-5 Visa Fraud	0	0	0	0	0	0	0
Exchange-Traded Funds/Notes	0	0	7	0	0	0	0
Foreign exchange	0	2	2	1	0	0	0
Hedge/private-equity funds	0	6	8	1	4	0	0
Internet or social-media fraud	0	0	9	4	0	0	2
Life and viatical settlements	0	0	1	0	0	0	1
Marijuana-industry investments	0	0	0	1	0	0	0
Oil-and-gas investments/interests	0	2	2	2	0	1	4
Ponzi and pyramid schemes	0	12	15	2	0	1	3
Promissory notes	0	10	0	3	0	4	3
Real-estate investments	0	0	56	2	0	3	5
Rule 506(b) offerings (no general solicitation)	0	0	3	0	0	0	1
Rule 506(c) offerings (general solicitation)	0	0	2	0	0	14	1

300. These data are excerpted from the NASAA 2013, 2014, 2015, and 2016 annual enforcement surveys. *See* N. AM. SEC. ADM'RS ASS'N, *supra* note 298.

301. These data are extracted from the Michigan, Minnesota, Rhode Island, South Dakota, and Wisconsin responses to the NASAA Enforcement Survey—Covering the 2018 Calendar Year and from the Delaware and Florida responses to the NASAA Enforcement Survey—Covering the 2017 Calendar Year (on file with author).

Self-directed IRAs/other third-party custodians	1	0	7	1	0	0	3
Binary options	0	0	0	0	0	0	1
Stock/equity options	0	35	0	0	0	0	1
Stocks and similar equities	0	0	0	0	0	8	3
Stream-of-income investments (e.g., pension rights)	1	0	0	2	0	1	2
Structured products	1	0	0	0	0	0	1
Cryptocurrencies/initial coin offerings (ICOs)	1	0	2	3	0	2	0
Other	0	0	7	0	0	0	3

Table 5: Jurisdiction, leadership, and structure of state securities regulators.

	Jurisdiction			Leadership		Structure	
Agency	**Sec.**	**Sec./ Fin.**	**Sec./ Other**	**Appt**	**Elect**	**Exec**	**Comm'n**
Alabama Securities Commission	×			×			×
Alaska Department of Comm., Cmty. and Econ. Dev. Division of Banking and Securities			×	×		×	
Arizona Arizona Corporation Commission Securities Division			×		×		×
Arkansas Department of Commerce State Securities Department			×	×		×	
California Department of Business Oversight Division of Corporations		×		×		×	
Colorado Department of Regulatory Agencies Division of Securities			×	×		×	
Connecticut Department of Banking Securities and Business Investments Division		×		×		×	
Delaware Department of Justice (Attorney General) Fraud & Consumer Protection Division Investor Protection Unit			×		×	×	
District of Columbia Department of Insurance, Securities and Banking		×		×		×	
Florida Office of Financial Regulation Division of Securities		×		×		×	

Georgia Secretary of State Securities Division			×		×	×	
Hawaii Department of Comm. and Consumer Affairs Business Registration Division			×	×		×	
Idaho Department of Finance Securities Bureau			×	×		×	
Illinois Secretary of State Securities Department			×		×	×	
Indiana Secretary of State Securities Division			×		×	×	
Iowa Insurance Division			×	×		×	
Kansas Insurance Department Office of the Securities Commissioner		×			×	×	
Kentucky Department of Financial Institutions Securities Division		×		×		×	
Louisiana Office of Financial Institutions Securities Division		×		×		×	
Maine Department of Professional and Fin. Reg. Office of Securities		×		×		×	
Maryland Attorney General Securities Division			×		×	×	
Massachusetts Secretary of the Commonwealth Securities Division			×		×	×	
Michigan Department of Licensing and Reg. Affairs			×	×		×	

Securities Division							
Minnesota Commerce Department Securities Unit			×	×		×	
Mississippi Secretary of State Securities Division			×		×	×	
Missouri Secretary of State Securities Division			×		×	×	
Montana State Auditor Commissioner of Securities and Insurance		×			×	×	
Nebraska Department of Banking and Finance Bureau of Securities		×		×		×	
Nevada Secretary of State Securities Division			×		×	×	
New Hampshire Secretary of State Bureau of Securities Regulation			×	×		×	
New Jersey Attorney General Bureau of Securities			×	×		×	
New Mexico Regulation and Licensing Department Securities Division			×	×		×	
New York Attorney General Investor Protection Bureau			×		×	×	
North Carolina Secretary of State Securities Division			×		×	×	
North Dakota Securities Department	×			×		×	
Ohio Department of Commerce Division of Securities			×	×		×	
Oklahoma Securities Commissioner/ Department of Securities	×			×			×

Oregon Division of Financial Regulation		×		×		×	
Pennsylvania Department of Banking and Securities		×		×		×	
Rhode Island Department of Business Regulation Securities Regulation			×	×		×	
South Carolina Attorney General Securities Division			×		×	×	
South Dakota Department of Labor and Regulation Division of Insurance – Securities Regulation			×	×		×	
Tennessee Department of Commerce and Insurance Securities Division			×	×		×	
Texas State Securities Board	×			×			×
Utah Department of Commerce Division of Securities			×	×		×	
Vermont Department of Financial Regulation Securities Division		×		×		×	
Virginia State Corporation Commission			×	×			×
Washington Department of Financial Institutions Division of Securities		×		×		×	
West Virginia State Auditor Securities Commission		×			×	×	
Wisconsin Department of Financial Institutions Division of Securities			×	×		×	

Wyoming Secretary of State Compliance Division			×		×	×	
TOTALS	**3**	**16**	**32**	**34**	**17**	**46**	**5**

Table 6: State securities regulators' enforcement staffing.[302]

2017 or 2018 Enforcement Staffing	**DE***	**FL***	**MI**	**MN**	**RI**	**SD**	**WI**
Attorneys/Accountants/Analysts/Investigators/Other Non-Administrative Personnel	12	113	20	3	5	3	8
Total Personnel	12	133	23	3	6	3	8

Table 7: State securities regulators' complaints, investigations, enforcement actions, and investor monetary relief.[303]

Year	**Complaints**	$C \rightarrow I$[304]	**Investigations**	**Enforcement Actions**	**Investor Monetary Relief**	**Penalties Imposed**
2018	5,514	96.5%	5,320	1,872	$558m	$490m
2017	7,988	59.96%	4,790	2,105	$486m	$79m
2016	9,256	46.90%	4,341	2,017	$230m	$682m
2015	–	–	5,000	2,074	$538m	$230m
2014	11,340	42.80%	4,853	2,042	$405m	$174m
2013	9,693	54.70%	5,302	2,184	$616m	$75m
2012	10,272	57.01%	5,865	2,496	$694m	$157m

302. These data are extracted from the Michigan, Minnesota, Rhode Island, South Dakota, and Wisconsin responses to the NASAA Enforcement Survey—Covering the 2018 Calendar Year and from the Delaware and Florida responses to the NASAA Enforcement Survey—Covering the 2017 Calendar Year (on file with author).

303. These statistics are excerpted from NASAA annual enforcement surveys from 2013, 2014, 2015, 2016, 2017, 2018, and 2019 (on file with author and available at *Enforcement Statistics*, N. AM. SEC. ADM'RS ASS'N, https://www.nasaa.org/policy/enforcement-statistics (last visited Oct. 17, 2021)). Enforcement actions include administrative, civil, criminal, and "other," but they do not include licenses withdrawn, denied, revoked, suspended, or conditioned.

304. Not all investigations are sourced from complaints. The $C \rightarrow I$ ratio does provide an upper bound for how often a complaint develops into an investigation.

Table 8: State securities regulators' case sourcing and referrals.[305]

2017 or 2018 Sourcing	DE*	FL*	MI	MN	OK	SD	WI
Complaints/tips/inquiries	UNK	421	142	205	44	UNK	93
Referrals In							
SEC	0	56	8	1	7	2	0
FINRA	0	1	9	7	1	1	1
DOJ/FBI/IRS/Postal Inspectors/Secret Service	0	1	0	0	0	0	0
CFPB/FTC	0	0	0	0	0	0	0
State/local law enforcement/prosecutors/AG	0	1	17	1	5	1	4
State agency (insurance, banking, etc.)	0	7	6	0	1	1	4
Other U.S. NASAA Member	0	1	0	4	1	0	5
Other	1	0	0	0	0	0	1
Referrals Out							
SEC	0	4	0	1	1	1	2
FINRA	0	19	0	1	0	0	
DOJ/FBI/IRS/Postal Inspectors/Secret Service	0	0	0	0	1	1	2
U.S. Department of Labor	0	0	0	4	0	0	0
CFPB/FTC	0	0	0	1	0	0	1
State/local law enforcement/prosecutors/AG	3	0	37	0	1	0	6
State agency (insurance, banking, etc.)	0	1	0	0	2	0	0
CFTC	0	0	0	2	0	0	1
Other U.S. NASAA Member					1		
Other	0	58	0	0	0	0	0

305. These data are extracted from the Michigan, Minnesota, Oklahoma, South Dakota, and Wisconsin responses to the NASAA Enforcement Survey—Covering the 2018 Calendar Year and from the Delaware and Florida responses to the NASAA Enforcement Survey—Covering the 2017 Calendar Year (on file with author).

Table 9: State enforcement actions by violation type.[306]

2017 or 2018 enforcement actions	DE*	FL*	MI	MN	RI	SD	WI
Fraud (omissions/misrepresentations)	5	33	8	19	0	1	18
Unlicensed individuals or firms	3	69	31	11	1	1	4
Unregistered securities	1	15	43	6	0	6	7
Failure to supervise	0	2	1	3	0	0	1
Books and records	1	105	0	0	1	2	1
Suitability	1	0	0	6	0	0	2
Unauthorized trading	0	5	1	0	0	0	0
Churning	0	0	0	0	0	0	0
Selling away	0	1	0	0	0	2	1
Cybersecurity/ information security	0	0	0	0	0	0	0
Robo-adviser	0	0	0	0	0	0	0
Other dishonest/ unethical activity	2	83	5	4	1	1	0
Other violations	0	0	4	0	0	0	0

306. *Id.*

Table 10: Respondents named in state enforcement actions by type.[307]

Violation Type	2012	2013	2014	2015	2016	2017	2018
Broker-dealer firm	225	219	156	176	144	120	119
Broker-dealer agent	189	357	230	191	186	150	126
Investment adviser firm	181	174	146	229	157	187	204
Investment adviser representative	158	176	190	168	133	190	96
Unregistered firm	576	667	675	348	260	310	195
Unregistered individual	(both)	(both)	(both)	443	344	365	279

Table 11: SEC enforcement actions by type.[308]

Violation Type	2018	2018%
Broker-dealer	169	21%
Delinquent filings	121	15%
Foreign Corrupt Practices Act	13	2%
Insider trading	51	6%
Investment advisers/investment companies	170	21%
Issuer reporting and disclosure	106	13%
Market manipulation	33	4%
Nat'l recognized statistical rating org.	2	~0%
Public-finance abuse	18	2%
Securities offering	130	16%
SRO/exchange	1	~0%
Transfer agent	2	~0%

307. These statistics are excerpted from NASAA annual enforcement surveys from 2013, 2014, 2015, 2016, 2017, 2018, and 2019 (on file with author and available at *Enforcement Statistics*, *supra* note 303).

308. U.S. SEC. & EXCH. COMM'N, 2018 DIV. OF ENF'T ANN. REP. 20 (2018).

Table 12: Enforcer salience.[309]

If you or someone close to you experienced financial loss in connection with their investments, and that loss seemed at least partly caused by someone else's wrongdoing, which of the following places would you go to or recommend going to for help? (select all that apply) (all but last two options randomized)				
	Urban	**Suburban**	**Rural**	**Total**
A private attorney	55 (36.18%)	82 (42.27%)	31 (47.47%)	168 (40.10%)
Better Business Bureau	33 (21.71%)	47 (24.23%)	20 (27.40%)	100 (23.87%)
Securities and Exchange Commission (SEC)	27 (17.76%)	40 (24.23%)	15 (27.40%)	82 (19.57%)
The employer of the wrongdoer	23 (15.13%)	43 (22.16%)	16 (21.92%)	82 (19.57%)
Financial Industry Regulatory Authority (FINRA)	29 (19.08%)	32 (16.49%)	13 (17.81%)	74 (17.66%)
The local police department	29 (19.08%)	24 (12.37%)	18 (24.66%)	71 (16.95%)
The state securities regulator	23 (15.13%)	31 (15.98%)	13 (17.81%)	67 (15.99%)
Social media	27 (17.76%)	28 (14.43%)	12 (16.44%)	67 (15.99%)
A local prosecutor's office	24 (15.79%)	25 (12.89%)	12 (16.44%)	61 (14.56%)
The state attorney general	11 (7.24%)	23 (9.28%)	13 (10.96%)	47 (11.22%)
A press or media outlet	15 (9.87%)	19 (9.79%)	12 (16.44%)	46 (10.98%)
The state police	17 (11.18%)	10 (5.15%)	13 (17.81%)	40 (9.55%)
The state insurance regulator	11 (7.24%)	18 (9.28%)	8 (10.96%)	37 (8.83%)
A federal prosecutor's office	13 (8.55%)	11 (5.67%)	11 (15.07%)	35 (8.35%)
Federal Bureau of Investigation (FBI)	13 (8.55%)	9 (4.64%)	10 (13.70%)	32 (7.64%)
American Association of Retired Persons (AARP)	9 (5.92%)	11 (5.67%)	8 (10.96%)	28 (6.68%)
Someone else	11 (7.24%)	10 (5.15%)	5 (6.85%)	26 (6.21%)
None of these	44 (28.95%)	46 (23.71%)	22 (30.14%)	112 (26.73%)

309. A survey was conducted on the Amazon MTurk platform of 419 U.S. residents aged 18 or over. Respondents were asked the question in Table 10 with the following clarifying definition: "People 'close to you' include your friends, family, coworkers, members of your religious community, neighbors, and other people you interact with on a regular basis." The question, the clarifying definition, and the response options were designed to describe common types of securities violations in terms that would be accessible to a lay person. Respondents were also asked to classify the place where they live as urban (152), suburban (194), or rural (73).

Table 13: Selected multistate enforcement actions and relief.[310]

Year	Multistate Action	State Relief	Investor Relief
1993	Prudential Securities Settlement	$26m	$330m
2003	Global Research-Analyst Settlement	$487m	$387m
2008	Auction Rate Securities	$605m	$61b (repurchase)
2010	Morgan Keegan	$10m	$200m
2012	Bankers Life	$9.9m	–
2012	Uvest	$750k	–
2012	ProEquities	$435k	–
2013	UBS Financial Services	$4.6m	–
2015	LPL Financial	$2.8m	–
2015	Citigroup Global Markets	$1.9m	–
2018	LPL Financial	$26m	

310. Excerpted from Email from Interviewee #18 (on file with author).