

SCOPE OF EXEMPTION FROM STATE SECURITIES
REGULATION

OCTOBER 15, 2007.—Committed to the Committee of the Whole House on the State
of the Union and ordered to be printed

Mr. FRANK of Massachusetts, from the Committee on Financial
Services, submitted the following

R E P O R T

[To accompany H.R. 2868]

[Including cost estimate of the Congressional Budget Office]

The Committee on Financial Services, to whom was referred the
bill (H.R. 2868) to eliminate the exemption from State regulation
for certain securities designated by national securities exchanges,
having considered the same, reports favorably thereon without
amendment and recommends that the bill do pass.

CONTENTS

	Page
Purpose and Summary	2
Background and Need for Legislation	2
Hearings	3
Committee Consideration	3
Committee Votes	3
Committee Oversight Findings	3
Performance Goals and Objectives	3
New Budget Authority, Entitlement Authority, and Tax Expenditures	3
Committee Cost Estimate	4
Congressional Budget Office Estimate	4
Federal Mandates Statement	5
Advisory Committee Statement	5
Constitutional Authority Statement	5
Applicability to Legislative Branch	5
Section-by-Section Analysis of the Legislation	5
Changes in Existing Law Made by the Bill, as Reported	5

PURPOSE AND SUMMARY

H.R. 2868, a bill to eliminate the exemption from State regulation for certain securities designated by national securities exchanges, was introduced on June 26, 2007, by Mr. Meeks of New York. The purpose of the bill is to provide greater flexibility in applying the National Securities Markets Improvement Act of 1996 (“NSMIA”) so as to permit certain national securities exchanges to establish lower-tier markets, subject to approval by the Securities and Exchange Commission (“SEC”).

BACKGROUND AND NEED FOR LEGISLATION

The SEC is the federal agency responsible for enforcing the nation’s securities laws. Each individual State also has enacted and enforces its own securities laws, known as “blue sky” laws. Prior to 1996, State blue sky laws required securities offerings made in those States to be registered in the state or to be exempt from State registration requirements. State requirements were duplicative of, and often inconsistent with, the registration requirements under the Securities Act of 1933 (“1933 Act”). Most State laws permitted issuers to coordinate the federal/State registration process for some offerings, but the process could still be costly and burdensome.

NSMIA was intended, among other things, to realign the regulatory partnership between federal and State securities regulators and thereby eliminate the costs and burdens of duplicative and unnecessary regulation. NSMIA amended the 1933 Act to preempt State blue sky registration and review of “covered securities,” although it preserved the right of the States to investigate and prosecute fraud. Covered securities include: securities listed (or approved for listing) on the New York Stock Exchange (“NYSE”), the American Exchange (“Amex”) AMEX and the Nasdaq/National Market, and securities of the same issuer that are equal in rank or senior to such listed securities; mutual fund shares; securities sold to certain qualified purchasers; certain securities exempt under Section 3(a) of the 1933 Act (including government or municipal securities, bank securities and commercial paper); and securities issued in a private offering in compliance with Rule 506 of the SEC’s Regulation D.

Covered securities listed on the NYSE, AMEX and a portion of the Nasdaq Stock Market (collectively, the “Exempted Exchanges”), are subject to an automatic blanket exemption from State “blue-sky” laws, in recognition of the high listing standards of those exchanges. NSMIA gave the SEC authority to exempt securities listed on other exchanges from State law via rulemaking where appropriate. NSMIA did not give the SEC explicit authority to remove covered securities listed on the Exempted Exchanges from the automatic blanket exemption from State law.

Foreign exchanges, such as the London Stock Exchange’s Alternative Investment Market, have developed tiered listing standards that expand opportunities for small companies or companies with alternative business models. U.S. exchanges not specified in NSMIA have been able to establish such lower-tier listing markets pursuant to State law. The Exempted Exchanges, however, have been prevented from establishing lower tier markets, with limited

exceptions (for instance, the NYSE was able to establish a second-tier listing market through its acquisition of ARCA, formerly the Pacific Stock Exchange, whose securities were not exempt from state securities regulation under NSMIA and thus could establish alternative listing standards). While the SEC believes securities issued pursuant to lower listing standards should be subject to state law, it does not have explicit authority to subject covered securities listed on the Exempted Exchanges to State regulation.

The bill would amend the 1933 Act to allow the Exchanges to establish additional tiers of listing standards, and to subject securities listed on those lower tiers to state law, all contingent upon SEC approval. The intention is to facilitate development of domestic markets for smaller companies that do not meet higher primary market listing standards, and to allow the Exempted Exchanges to compete more effectively in the global marketplace.

COMMITTEE CONSIDERATION

The Financial Services Committee met in open session on September 18, 2007, and ordered H.R. 2868, a bill to eliminate the exemption from State regulation for certain securities designated by national securities exchanges, reported with a favorable recommendation by a voice vote.

COMMITTEE VOTES

Clause 3(b) of rule XIII of the Rules of the House of Representatives requires the Committee to list the record votes on the motion to report legislation and amendments thereto. No record votes were taken in conjunction with the consideration of this legislation. A motion by Mr. Frank to report the bill to the House with a favorable recommendation was agreed to by a voice vote.

COMMITTEE OVERSIGHT FINDINGS

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the Committee has held hearings and made findings that are reflected in this report.

PERFORMANCE GOALS AND OBJECTIVES

Pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee establishes the following performance related goals and objectives for this legislation:

The national securities exchanges will be authorized to establish multiple listing standards and, subject to approval by the Securities and Exchange Commission, securities listed on the lower tiers will be subject to regulation by the States.

NEW BUDGET AUTHORITY, ENTITLEMENT AUTHORITY, AND TAX EXPENDITURES

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee adopts as its own the estimate of new budget authority, entitlement authority, or tax expenditures or revenues contained in the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act.

COMMITTEE COST ESTIMATE

The Committee adopts as its own the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

CONGRESSIONAL BUDGET OFFICE ESTIMATE

Pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the following is the cost estimate provided by the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974:

SEPTEMBER 28, 2007.

Hon. BARNEY FRANK,
Chairman, Committee on Financial Services,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 2868, a bill to eliminate the exemption from state regulation for certain securities designated by national securities exchanges.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Susan Willie.

Sincerely,

PETER R. ORSZAG.

Enclosure.

H.R. 2868—A bill to eliminate the exemption from state regulation for certain securities designated by national securities exchanges

H.R. 2868 would authorize the Securities and Exchange Commission (SEC) to permit certain stock exchanges to designate a new tier of securities that could be listed. Companies listing such securities would be subject to state registration requirements; under current law, securities listed on those exchanges are exempt from state regulation. While the SEC would be required to write regulations that would guide the exchanges in developing the new tiers, CBO expects that the securities listed would be for small, less-capitalized companies that do not meet the current listing standards.

Based on information from the SEC, CBO estimates that implementing H.R. 2868 would have an insignificant effect on the federal budget. SEC would be required to develop and enforce regulations related to a new listing tier, but CBO expects that such activities would not significantly increase SEC's workload or its costs. Enacting the bill would not affect direct spending or revenues.

H.R. 2868 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act and would impose no costs on state, local, or tribal governments.

The CBO staff contact for this estimate is Susan Willie. This estimate was approved by Peter H. Fontaine, Assistant Director for Budget Analysis.

FEDERAL MANDATES STATEMENT

The Committee adopts as its own the estimate of Federal mandates prepared by the Director of the Congressional Budget Office pursuant to section 423 of the Unfunded Mandates Reform Act.

ADVISORY COMMITTEE STATEMENT

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

CONSTITUTIONAL AUTHORITY STATEMENT

Pursuant to clause 3(d)(1) of rule XIII of the Rules of the House of Representatives, the Committee finds that the Constitutional Authority of Congress to enact this legislation is provided by Article 1, section 8, clause 1 (relating to the general welfare of the United States) and clause 3 (relating to the power to regulate interstate commerce).

APPLICABILITY TO LEGISLATIVE BRANCH

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of section 102(b)(3) of the Congressional Accountability Act.

SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

Section 1. Scope of exemption from state securities regulation

This section updates the Nasdaq references in section 18(b)(1) of the 1933 Act, from the National Market System of the Nasdaq Stock Market, to the Nasdaq Stock Market. The amendment acknowledges that Nasdaq is now an integrated exchange. This section further amends the 1933 Act to allow the Exchanges to establish additional tiers of listing standards, and to subject securities listed on those lower tiers to state law, all contingent upon SEC approval. The intention is to facilitate development of domestic markets for smaller companies that do not meet higher primary market listing standards, and to allow the Exempted Exchanges to compete more effectively in the global marketplace.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

SECURITIES ACT OF 1933

TITLE I

* * * * *

SEC. 18. EXEMPTION FROM STATE REGULATION OF SECURITIES OFFERINGS.

(a) * * *

(b) COVERED SECURITIES.—For purposes of this section, the following are covered securities:

(1) EXCLUSIVE FEDERAL REGISTRATION OF NATIONALLY TRADED SECURITIES.—A security is a covered security if such security is—

(A) listed, or authorized for listing, on the New York Stock Exchange [or the American Stock Exchange, or listed, or authorized for listing, on the National Market System of the Nasdaq Stock Market (or any successor to such entities)], *the American Stock Exchange or the Nasdaq Stock Market (or any successor to such entities)*, except that *a security listed, or authorized for listing, on the New York Stock Exchange, the American Stock Exchange or the Nasdaq Stock Market (or any successor to such entities) shall not be a covered security if the exchange adopts listing standards pursuant to section 19(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(b)) that designates a tier or segment of such securities as securities that are not covered securities for purposes of this section and such security is listed, or authorized for listing, on such tier or segment;*

(B) listed, or authorized for listing, on a national securities exchange (or tier or segment thereof) that has listing standards that the Commission determines by rule (on its own initiative or on the basis of a petition) are substantially similar to the listing standards applicable to *covered securities* described in subparagraph (A); or

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