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Before the
United States Senate Committee on the Judiciary
Crime and Drugs Subcommittee

"Evaluating S. 1551: The Liability for Aiding and Abetting Securities Violations Act of 2009"

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Chairman Specter, Ranking Member Graham, members of the Subcommittee,

I am Tanya Solov, Director of the Illinois Securities Department, and I am honored to convey the North American Securities Administrators Association's (NASAA)[1] support for S. 1551, the " Liability for Aiding and Abetting Securities Violations Act of 2009."

Background

The U.S. members of NASAA are responsible for administering state securities laws and regulations. Their activities include licensing broker-dealers, registering local securities offerings, and conducting compliance examinations. Especially important is their enforcement role: protecting the nation's investors by bringing thousands of enforcement actions every year against the firms and individuals who have committed securities fraud. State securities regulators often seek restitution to help make injured investors whole. However, given the large number of investors in the market today, private civil actions are a necessary and important complement to state and federal actions. S. 1551, is a positive step in restoring the ability of defrauded investors to seek damages from all entities that knowingly and substantially participate in the fraud.

State securities regulators have witnessed first-hand the devastation of financial fraud on victims and their families. Shareholders in the U.S., both retail and institutional, invest in the market with the assumption that the financial information provided by public companies is accurate. Investor education materials teach investors to conduct research on companies prior to investing, but no amount of research will allow investors to make appropriate decisions if the financial and other public information provided by companies is false and misleading. The integrity of the U.S. markets depends on accurate information and our laws must send the message to corporate management, as well as their lawyers, accountants, investment bankers, and other so-called "secondary actors," that they will be held accountable for aiding and abetting in deception and fraud.

Aiding and Abetting

One of the purposes of the Securities Exchange Act of 1934 was to establish higher standards of conduct in the securities industry than already existed in common-law. In passing this law, Congress implicitly authorized a private right of action and for decades thereafter, courts allowed private suits. The right to bring a private suit for aiding and abetting was restricted by the Supreme Court in *Central Bank of Denver v. First*

[1] The oldest international organization devoted to investor protection, the North American Securities Administrators Association, Inc., was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, the U.S. Virgin Islands, Canada, Mexico and Puerto Rico. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

Interstate Bank of Denver and basically eliminated in *Stoneridge Investment Partners, LLC v. Scientific –Atlanta, Inc.* The decisions in these cases interpret the securities laws in a way that protects big business, emboldens secondary actors to engage in manipulative practices, and sets an extremely high bar for defrauded shareholders to seek compensation from wrongdoers. Corporations and secondary actors often seek short-term profits, big bonuses, and large fees and, many times these goals can be achieved by cooking the books or engaging in sham transactions. Given the complexity of corporate activity, secondary actors such as accountants and lawyers now play a critical role in the preparation and dissemination of public information. If they are allowed to avoid liability for their actions, there will be no deterrent to prevent them from engaging in fraudulent schemes.

State regulators and the Securities and Exchange Commission ("SEC") filed numerous cases against corporations and secondary actors in the past decade. However, many more cases of fraud were not pursued by the regulators due to their limited resources. In denying investors the right to bring private aiding and abetting actions, the majority in *Stoneridge* contends that such actions can be brought by the SEC on behalf of shareholders. While it is true that the SEC can pursue such cases, in reality, the SEC is not in the position to take on this task. In an April 2009 speech[2], Chairman Mary Schapiro stated: "Quite frankly, our enforcement and examination resources have been seriously constrained in recent years." The SEC's immediate agenda includes proxy access, compensation disclosure, credit rating agencies, money market fund liquidity, hedge funds, credit default swaps, and other projects that need regulatory attention. These priorities play an important role in restoring market integrity, and significant SEC resources will be expended working on these priorities as well as large Ponzi scheme cases and fraudulent activity having national impact. Scarce resources will remain for cases involving a limited number of shareholders in a particular company.

Critics of private securities actions claim that such cases provide little benefit to victims, punish innocent shareholders, and unjustly reward plaintiffs' lawyers. These arguments are faulty. With regard to victim compensation, over the years, private actions resulted in greater recoveries for shareholders than the compensation from regulatory actions. The fact that victims were not able to recover full damages is the result of a number of factors including the corporation's inability to pay and shareholders' desire to settle for less rather than to spend more time in litigation. The contention that paying defrauded victims harms innocent, current, shareholders is not really applicable in cases involving secondary actors such as accountants. As evidenced by the amici briefs filed in the *Stoneridge* case, shareholders want accountability and the right to sue for wrongdoing; management and secondary actors are the ones invoking shareholder harm arguments in their attempt to avoid all accountability. If management is concerned about current shareholders, it might alleviate the cost to shareholders by stripping away the bonuses, high salaries, and stock options awarded to those who participated in the fraud and place those assets in the victim restitution fund. With regard to plaintiffs' lawyers' fees, it is

[2] Mary Schapiro, Chairman, Securities and Exchange Commission, Address to the Council of Institutional Investors, (April 6, 2009).

important to understand that class action settlements, including attorneys' fees, are reviewed by the courts. Judges decide whether plaintiffs' attorneys' fees are appropriate.

Allowing investors to file aiding and abetting cases will not open the floodgates of litigation and stifle business development. Private suits were allowed prior to the *Central Bank* and *Stoneridge* decisions and businesses grew and flourished during those years. Deceptive and manipulative transactions that are intended to defraud investors cannot be classified as ordinary business decisions and do not promote economic development.

The dissent in the *Stoneridge* case noted that Congress enacted Section 10(b) of the Securities Exchange Act with the understanding that federal courts respected the principle that every wrong would have a remedy. If aiding and abetting liability is not restored by Congress, innocent victims of investment fraud will be left without a remedy against the entities that assisted in perpetrating the fraud. S. 1551 restores the right of defrauded shareholders to bring private actions against aiders and abettors. Given the recent financial scandals and corporate fraud, this legislation is a positive step in restoring accountability and the integrity of the U.S. markets.

I thank the Chairman and each member of this Subcommittee for allowing me the opportunity to appear today. I look forward to answering any questions you have and providing additional assistance to you in the future.