M E M O R A N D U M

June 21, 2001

TO: Steve Junior

FROM: Robert J. Sullivan

CC: Stan Hoffert
Craig Olafsson
Richard Quinlan

Re: National Securities Markets Improvements Act of 1996

This memorandum addresses the issue of whether the amendments made to United States federal securities laws under the National Securities Markets Improvements Act of 1996[1] ("NSMIA") preempt Wis. Stat. § 644:13, a provision of Wisconsin's insurance laws which places restrictions on the legal and beneficial ownership of voting stock held by directors, officers and other members of management of a mutual insurance holding company, any intermediate stock holding company of the mutual insurance holding company, and the converted insurance company of which the mutual holding company is a parent.

This memorandum concludes that federal securities laws do not preempt Wis. Stat. § 644:13 because the amendments passed under NSMIA govern, among other

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[1] Pub. L. No. 104-290, 110 Stat. 3416 (codified in scattered sections of 15 U.S.C. (Supp. II 1996)).

things, the registration and qualification of certain security offerings, and not the stock ownership rights of certain persons.

In October, 1996, Congress passed NSMIA. This bill became law and extensively amended various provisions of the Securities Act of 1933 (the "Securities Act"), the Securities Exchange Act of 1934 (the "Exchange Act"), the Trust Indenture Act of 1939, the Investment Company Act of 1940, and the Investment Advisers Act of 1940. These amendments preempted state regulation of certain security offerings, divided supervision of the investment advisors between the U.S. Securities and Exchange Commission ("SEC") and state regulators, and impose significant limitations on the state regulation of broker-dealers. The amendments most relevant to the issue addressed in this memorandum are those amendments to the Securities Act.

NSIMA amended Section 18 of the Securities Act, which had originally provided for concurrent federal and state control over securities regulation. The amended section now preempts most state authority to regulate several categories of securities offerings referred to as "covered securities".[2] With respect to these

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[2] The NSMIA lists four categories of securities that are "covered," or exempt from state regulation. These categories include nationally traded securities, securities issued by an investment company that is registered or had filed a registration statement under the Investment Company Act of 1940, securities sold to qualified purchases, and securities issued under certain types of exempt offerings. *15 U.S.C. 77(r)(1) - (4).*

"covered securities", Congress withdrew the preexisting power of the states to require pre-sale registration disclosure by issuers, including the power to conduct pre-sale disclosure review, merit review, or any other kind of fairness review in connection with these covered securities.[3]

NSMIA also limits the power of states to impose conditions on the use of proxy statements, reports to shareholders, or other disclosure documents that are required to be filed with the SEC. An exemption to this preemption provision leaves states free to enact laws and rules governing corporations incorporated within their own state.

Section 18 of the Securities Act preserves certain state authority with respect to anti-fraud, notice filings and fee collection relating to offerings of covered securities. However, states are prohibited from using their retained control in a way that would amount to regulation of securities which are covered under the NSMIA.[4]

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[3] In addition to requiring that certain securities be registered with a state before they are sold within that state, many states also have qualification standards that an issuer needs to satisfy before being permitted to offer securities in that state. These qualification standards, which are now preempted by NSMIA with respect to "covered securities", essentially work "like consumer legislation by prohibiting sales of securities that are considered to be defective." Rutherford B. Campbell, Jr., Blue Sky Laws and Recent Congressional Preemption Failure, 22 Iowa J. Corp. L. 175 (1997) (citing Joseph C. Long, State Securities Regulations - An Overview, *32 Okla. L. Rev. 541, 543 (1979).*

[4] H.R. Rep. No. 104-622, at 34 (1996), reprinted in 1996 U.S.C.C.A.N. 3877,

(continued...)

The amendments made to the Securities Act, as discussed above, relate to the regulation of the registration and qualification of securities offerings. Conversely, the concept of placing limits on the stock ownership rights of certain persons, when addressed by federal securities laws, tends not to be addressed in the Securities Act but rather in the Exchange Act. The concept of limiting the stock ownership rights is therefore separate and a part from those federal securities laws governing the registration process. For example, Section 16 of the Exchange Act governs the federal rules on short-swing trading by directors, officers, and 10 percent beneficial owners of a corporation's stock. This section seeks to deter insider trading by establishing filing requirements for directors, officers, and 10 percent beneficial owners, and restricting the extent to which such persons can profit from the buying and selling of such stock. Wisconsin defines "beneficial ownership" under Wis. Stat. § 644:13 as having the same meaning as provided by the rules administering Section 16 of the Exchange Act. Neither of these statutory provisions deals with the registration or qualification of securities offerings. Based on the foregoing and given the purpose of NSMIA, it is very likely that Congress did not intend to preempt those

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[4] (...continued)
3896. "The legislation preempts authority that would allow the States to employ the regulatory authority they retain to reconstruct in a different form the regulatory regime for covered securities that Section 18 has preempted." Id.

state laws not regulating the registration or qualification, or an exemption from registration, of securities.

In addition to the above, the concept of primacy of state regulation of insurance is relevant here. The Gramm-Leach-Bliley Act[5] provides substantial deference to the McCarran-Ferguson Act's anti-preemption rule which attempts to assure the primacy of state regulation of insurance over federal intrusions. The McCarran-Ferguson Act would seem to preclude interpreting NSMIA to preempt state insurance law provisions. In particular, 15 U.S.C. § 1012(b) provides: "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance....unless such Act specifically relates to the business of insurance...." This combined with the fact that Wis. Stat. § 644:13 does not deal with the registration or qualification of security offerings leads to the conclusion that the Wisconsin statutory provision is not preempted by federal securities laws.

If you have any questions, or would like to discuss this memorandum, please call me at (212) 735-2930.

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[5] Pub. L. No. 106-102 (codified at 12 U.S.C. 1811-3222 (West Supp. 2000)).