

Written Testimony in Support of Proposed Securities Litigation Fund

Submitted to the House Committee on Financial Institutions

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Joshua Ney - interim or acting Commissioner

I am pleased to submit this testimony to highlight the important work the Office of the Securities Commissioner is doing to protect investors. Financial fraud against our citizens is a topic that our agency cares about deeply.

Protecting investors is one of the most important issues of our time. Given the news topics we see every day in the papers and on the internet, it would be simple for me to echo the common refrain of the Wall Street v. Main Street disparity, or to make a broad case for investment oversight and investor protection.

However, I think a more useful explanation of the importance of our bill is to focus on the true magnitude of the new responsibilities that our agency faces both in the immediate term and in the future.

It is estimated that Americans 65 and older hold \$10 trillion in assets. Yet nearly a third of that group claims they do not have enough money even to meet their basic living expenses. Those with sufficient funds to invest may be tempted to take higher risks with their investments in order to achieve higher returns, instead of switching into low-yield, safe investments like the retirees of yesteryear. That will make them prime targets for scam artists and unscrupulous financial advisors.

According to the Federal Reserve Bank, households led by people over 40 already own over 90 percent of America's net worth, and Americans aged 55 to 64 have the highest income and the highest net worth of any age group.

As the baby boomers continue to age, it will be a very short time before the vast majority of the nation's savings are in the hands of America's elderly. I can promise you that the individuals who have their own financial interests in mind know this fact as well. By 2018, the number of personal financial advisors is expected to increase by more than 60,000, a 30% growth from 2008. This rate is significantly more than the national average job growth rate.

We have long known that the elderly are especially vulnerable to the financially devastating impact of frauds and scams. However, our agency recognizes that the targets of securities fraud are no

longer limited to the proverbial elderly widow. In fact, contrary to popular belief, relatively savvy investors are the most likely victims of financial fraud.

A comprehensive study commissioned by the financial services industry with the assistance of AARP found that victims of financial fraud tend to be male, college-educated and married. Most have higher income than the average population.

Our citizens have worked hard to build both our state's economic prosperity and lifetime's worth of savings. As regulators, we must do all we can to ensure that their golden years are not tarnished by investment fraud. While our cases of investment fraud may not make national headlines, they are devastating in their impact to the victims and their families.

Investment fraud has existed in Kansas for over 100 years; it is a serious ongoing problem and we fear that it will only grow without targeted enforcement and enhanced investor education. The most effective weapon against investment fraud is a one-two punch of aggressive enforcement efforts combined with financial education to protect investors from unscrupulous individuals. Our agency needs all of the tools available to stop investment scams aimed at our citizens.

Securities Litigation Fund

Through the years, states have been the undisputed leaders in criminal prosecutions of securities violators because we believe in serious jail time for securities-related crimes. We have successfully exposed and addressed the profound conflicts of interest among Wall Street stock analysts by requiring changed behavior. We led all regulators on late trading and market timing in mutual funds. We address on a daily basis abusive sales practices targeting citizens from all walks of life. In the last few years, state securities regulators have been at the forefront of investor protection. Our record demonstrates clearly that we have the will and ability to regulate.

While my colleagues and I currently see a proliferation of troubling schemes involving unlicensed individuals promoting and selling unregistered securities in our state, we are also concerned about the way in which otherwise legitimate securities are marketed and sold by licensed financial advisors.

Our agency, along with other government agencies and self-regulatory organizations has seen an increase in the sale of complex securities. With the increase in the marketing and sale of these products, a corresponding increase in compliance deficiencies and investor complaints has occurred as well.

A complex security does not bear that title by accident or convenience. These products include an investment strategy with novel, complicated or intricate derivative-like features, such as structured notes, inverse or leveraged exchange-traded funds, hedge funds and securitized products, such as asset-backed securities. These features may make it difficult for a retail investor to understand the essential characteristics of the product and its risks, including the possibility that the product will not perform as many investors anticipate, or that it might be inappropriately sold on the basis of

enhanced yield, principal protection or the tracking of an index or a reference asset. In many cases, our office has examined established firms that have no written procedures for vetting these products or supervising the sale and marketing of the products to retail investors.

While these complex securities may be legitimate and suitable investments for some, unfortunately these products are unsuitable for many and are being aggressively pitched to older investors.

Other trends we are seeing include a rise in energy and precious metals scams, and fraudulent offerings of investments tied to natural gas, wind and solar energy and the development of new energy-efficient technologies.

As matters pertain to criminal enforcement, state securities regulators have the determination, willpower and experience to pursue perpetrators of financial crime. We have learned how to accomplish more with less. However, there is little doubt that additional resources would enhance our ability to uncover and prosecute securities fraud during this economic downturn, which has resulted in vulnerable investors looking to recover their losses.

All of the attorneys in our agency have been deputized to serve as special assistant attorneys general to prosecute or assist in the prosecution of criminal violations on behalf of the state. Deputizing a state securities attorney gives a county prosecutor or district attorney the ability to formally utilize the expertise of our attorneys in prosecuting complex securities cases. This is a valuable leveraging of talent and resources and should continue to be encouraged.

Prosecuting securities fraud is not a simple task, nor is it inexpensive. When our office pursues a criminal violation of our securities act, it is coordinated with the district attorney in the county where the crime took place. While our attorneys serve as first-chair prosecutors and assume responsibility for all aspects of the case, it is the county that bears the cost of the prosecution. Only a few counties in Kansas have the budget necessary to warrant a full-scale securities fraud prosecution; even then it can be a significant and unplanned drain on their resources. It is a likely scenario that when we uncover a fraud in a smaller, less-populated county, that the costs of prosecution could be greater than a county's prosecution budget for the entire year. Gone are the days where our cases can be pursued as simple theft-by-deception crimes. The matters that cross my desk today demand the resources to explain derivatives trading to a jury, forensic accounting reports, and in an increasing number of matters in western Kansas, the hiring of Spanish-speaking translators.

By authorizing this securities litigation fund, our enforcement and legal staff can be self-sufficient and more nimble, which will improve our effectiveness.