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Understanding The NSMIA And Navigating  
State Blue Sky Laws- Part 1

The following is written by Laura Anthony, Esq., a going public attorney focused on OTC listing requirements, direct public offerings, going public transactions, reverse mergers, Form 10 and Form S-1 registration statements, SEC compliance and OTC Market reporting requirements.

**The National Markets Improvement Act of 1996 (NSMIA)**

Generally, an offering and/or sale of securities must be either registered or exempt from registration under both the federal Securities Act of 1933 (“Securities Act”) and state securities laws. As a result of a lack of uniformity in state securities laws and associated burden on capital-raising transactions, on October 11, 1996, the National Securities Markets Improvement Act of 1996 (“NSMIA”) was enacted into law.

The NSMIA amended Section 18 of the Securities Act to pre-empt state “blue sky” registration and review of specified securities and offerings. The preempted securities are called “covered securities.” The NSMIA also amended Section 15 of the Exchange Act to pre-empt the state’s authority over capital, custody, margin, financial responsibility, making and keeping records, bonding or financial or operational reporting requirements for brokers and dealers.

In this Part I, I summarize the NSMIA pre-emption provisions. Part II discusses state blue sky laws.

**Section 18; Exemption from State Regulation of Securities Offerings**

Section 18 specifically prohibits a state or political subdivision of a state from imposing any “law, rule, regulation, or order, or other administrative action” requiring registration or qualification of securities or securities transactions involving “covered securities.” A state may not “directly or indirectly prohibit, limit, or impose any conditions upon the use of ... any offering document that is prepared by or on behalf of the issuer; or... any proxy statement, report to shareholders, or other disclosure document” related to

“covered securities.” In addition, a state may not “directly or indirectly prohibit, limit, or impose conditions, based on the merits of such offering or issue or upon the offer or sale of any such security.”

Securities that are “covered securities” under the NSMIA, and therefore not subject to blue sky registration and review, include:

1. Nationally traded securities – includes a security that is listed or authorized for listing on a national securities exchange such as the NYSE or NASDAQ;
2. Investment companies – any security issued by an investment company that is registered under the Investment Company Act of 1940;
3. Sales to Qualified Purchasers – A security is a covered security with respect to the offer or sale of the security to qualified purchasers, as defined by the SEC. The SEC may define the term “qualified purchaser” differently with respect to different categories of securities, consistent with the public interest and the protection of investors. The SEC generally defers to the definition of “accredited investor” to define a “qualified purchaser.”
4. Certain Exempt Offerings/Transactions – includes securities transactions under:
  - (i) Section 4(a)(1) – sales by persons that are not an issuer, underwriter or dealer where the issuer is subject to the reporting requirements of the Exchange Act;
  - (ii) Section 4(a)(2) including Rule 506, except that a state may still require a notice filing and payment of a notice fee;
  - (iii) Section 4(a)(3) – dealer transactions;
  - (iv) Section 4(a)(4) – broker transactions on behalf of customers where the issuer is subject to the reporting requirements of the Exchange Act;
  - (v) Section 4(a)(6) – securities issued under Title III Crowdfunding;
  - (vi) Section 3(b)(2) – Regulation A/A+ offerings – as long as such securities are either (a) offered or sold on a national securities exchange; or (b) offered or sold only to qualified purchasers which are defined consistently with number 3 above;

(vii) Section 3(a) – almost all exempt securities under Section 3(a) are covered securities. Not included is Section 3(a)(4) – securities issued by religious, educational and charitable organizations; 3(a)(10) – securities issued in exchange for a bona fide outstanding security, claim or property interest in a court proceeding; and 3(a)(11) – securities issued in intra-state offerings;

The NSMIA specifically preserves the states’ right and jurisdiction to investigate and bring enforcement actions with respect to fraud or deceit, or unlawful conduct by a broker, dealer or funding portal in any transaction or unlawful conduct by an issuer in a Title III Crowdfunding transaction.

Covered securities may still be, and generally are, subject to notice filing requirements by the individual states. The NSMIA specifically allows the states to require a copy of any document filed with the SEC, together with annual or periodic reports of the value of securities sold or offered to be sold to persons located in the state (if not already included in the SEC filing) as long as such filing is solely for notice purposes and for the assessment or calculation of a fee. States may also require the filing of consent to service of process.

The timing and fees associated with blue sky notice filings for covered securities vary. Accordingly, even for covered securities, a review of state blue sky laws is necessary.

States may also require the payment of a fee in connection with a notice filing except that fees are specifically prohibited in connection with securities that are listed or authorized for listing on a national securities exchange such as the NYSE or NASDAQ and securities in Title III crowdfunding transactions except where 50% or greater of the securities are sold in a single state. Although a state may not condition the federal pre-emption granted by the NSMIA upon the payment of a fee, it can suspend an otherwise covered offering in its state for the failure to file a notice filing and pay the fee.

In enacting the NSMIA, the legislature purposefully left certain securities as not covered and subject to the dual regulation of states and the federal government. Examples of securities that were specifically excluded from the NSMIA list of “covered securities” include (i) securities that trade on the over-the-counter market; (ii) Rule 504 offerings; (iii) Rule 505 offerings; and (iv) Regulation A offerings.

## Section 15; Broker-Dealer Exemptions from State Law

The NSMIA also amended Section 15 of the Exchange Act to partially pre-empt the state's authority over capital, custody, margin, financial responsibility, making and keeping records, bonding or financial or operational reporting requirements for brokers and dealers. In particular, the NSMIA makes it unlawful for states to impose regulation on broker-dealers (and municipal securities dealers, government securities brokers, or government securities dealers) that are different from or in addition to the federal regulations.

The NSMIA also prohibits a state from preventing a broker or registered representative from processing de minimis transactions on behalf of existing clients even though such broker or representative is not registered in that state as long as (i) the broker is registered with FINRA and at least one state; (ii) the broker is not ineligible to register in that state; and (iii) the customer has been a customer of the firm for at least 30 days and of that particular representative for at least 14 days.

In Part II of this blog I will discuss the state blue sky laws. I am and remain an advocate of further federal preemption in all levels of registration and exemption requirements for the direct issuance and secondary trading of securities. Regardless of offer and sale preemption, the states retain jurisdiction over anti-fraud protections and the right and ability to investigate and prosecute fraud in any offering. They play an important role in this regard. I support allowing the federal government to control the disclosure process, including forms and review process, and continuing the combined efforts of both the states and federal authorities in policing, preventing and prosecuting fraud.

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Securities Law Blog is written by Laura Anthony, Esq., a going public lawyer focused on OTC Listing Requirements, Direct Public Offerings, Going Public Transactions, Reverse Mergers, Form 10 Registration Statements, and Form S-1 Registration Statements. Securities Law Blog covers topics ranging from SEC Compliance, FINRA Compliance,

DTC Chills, Going Public on the OTC, and OTCQX and OTCQB Reporting Requirements. Ms. Anthony is also the host of LawCast.com, the securities law network.

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