State of Washington
Department of Licensing
Olympia, Washington

August 31, 1981

Mr. John Evans
Commissioner
Securities & Exchange Commission
Washington, D. C. 20549

Dear Mr. Evans:

My memorandum to Al Mackey was not designed to suggest a "solution" for remedying the proposed uniform exemption. It was designed only to point out problems.

Your letter requests that I make more positive input into the rules to make it more acceptable to the states and the Commission.

Before a common consensus can be reached on the mechanics of a rule, the parties must first agree on the purpose behind the need for the rule.

I conclude that the U.S. Securities & Exchange Commission is in existence in part to regulate the capital formation and the flow of capital in this society. One offshoot of this mandate is the protection of investors. I would believe that one rationale for the protection of investors is that should investors be "fleeced": (1) their money would be subverted from legitimate capital needs and (2) loss of investor confidence would adversely affect the entire capital formation process.

Thus, the traditional role of the SEC has been to ensure that the investor has adequate information upon which to make a judgement for himself as to potential merits and risk of a business enterprise (full disclosure).

Exemptions from the federal act have often been justified on the basis that the states could regulate such "small" intrastate offerings. In addition to the traditional SEC approach of looking to the states to regulate certain exemptions from the federal act, other exemptions have been focused upon whether the investors needs the protection of the "Act".

Certainly, the exemption embodied in Section 4(2) and now Rule 146 suggests that if a person has "sophistication" then he presumably would not need some governmental regulatory agency to fend for him.

Thus, the proposed Regulation D is consistent with past federal practices and from a policy standpoint seems sound. However, the proposal that the states adopt, the same or similar rule, seems to remove one of the principal rationales behind previous federal exemptions.

To support the current proposal from both the state and federal levels, we must conclude that either the benefits to society as a whole outweigh the harm or potential harm or the regulating agencies are not really preventing abuses when they review a file during the registration process.

If you believe as I do that the registration process reduces the potential for harm to the investors then the rationale for the exemption must be the greater good of society. I do not believe that we must sacrifice hapless investors for the greater good of society.

I believe that the states should adopt exemptions from the registration process where there is some rational basis to believe that the potential harm to investors is at a minimum. I do not care specifically about the number of investors but rather am S concerned about their makeup. Specifically, one must look at who will be sold under this exemption. I would have no trouble exempting banks, trusts and other large corporations. Such entities presumably have accountants and attorneys and sufficient business experience to be well able to evaluate for themselves the quality of information provided to them before making an investment decision.

Likewise, the true decision-making executives of an issuer are probably in a sufficiently good position to be able to make a reasoned judgement. When one then moves out of this domain to the public at large, there must be additional safeguards imposed before such persons can be sold.

A large investment is no assurance of any protection to such class. It is easy to imagine numerous examples, many drawn from actual experience, of the widow who just sold her house for $150,000 and moved into a retirement center. She is the last person who should put her money into these types of securities.

I applaud the theory of Rule 146's "sophistication" test. However, I find such standards too illusory to provide a true safe-harbor for the conservative attorney.

It would seem that if one was to select investors from a group that has a large stream of income or a large net worth and restrict the amount that such investors

could put in such program or similar programs, then a reasoned basis for establishing an exemption could be found.

I believe that if investors were required to have an income of at least $100,000 (excluding extraordinary items as sales of homes, farms, etc.) or a net worth of $1,000,000 (excluding such things as the personal residence) and could not invest more than 20% of their annual income or net worth we could have a basis for believing that investors with this much income or accumulated wealth probably have experts (accountants, attorneys, brokers) to provide them with information and if not, we are not left with the elderly retirees who are totally wiped out by an unsuitable investment.

An exemption that carries a restriction on who could purchase would be supported by me. I do not find such items as restrictions on advertising of much use in protecting investors.

One last comment, I do not believe that the adoption of such exemption will have much benefit to "small businesses". I find that most Rule 146 offerings in this state are put together by what I call professional securities offerors. The exemption's principal use is to avoid merit standards such as promoter compensation. New issue of unseasoned corporations is and has been on the rise notwithstanding the "burden" of regulation. I am not supporting an exemption because I believe that it will help small business, but rather because I believe it will reduce our overloaded desks and those persons purchasing under it are a class which will not be subject to undue risk.

I am hopeful that some compromise can be reached to satisfy the needs of both the federal government and the states.

Sincerely,

Ralph R. Smith
Securities Administrator