Thank you for the opportunity to speak today on the important topic of unpaid arbitration awards. My name is Christine Lazaro, and I am the President of the Public Investors Arbitration Bar Association (PIABA), and a Professor of Clinical Legal Education and the Director of the Securities Arbitration Clinic at St. John's University School of Law. PIABA is a national bar association whose mission is to promote the interests of the public investor in securities arbitration; to make securities arbitration as just and fair as systematically possible; and to create a level playing field for the public investor in securities arbitration. PIABA has almost 400 member attorneys who practice across the country and have represented thousands of investors in arbitration cases.

Investors place their trust in their financial advisor. Often, an investor will turn over her life savings to a broker, in an attempt to do the right thing and ensure a secure retirement. And often, the broker will do the right thing, and properly advise the investor. But sometimes, a broker will act improperly. A broker may act negligently, by not properly assessing an investor's risk tolerance or investment objectives. We have seen brokers focused wholly on generating income for investors by placing them in complex, illiquid investments, like non-traded REITs or structured products. Unfortunately, the broker may not fully understand the risks associated with the investment, meaning he or she could never explain those risks to the investor, who ends up suffering the losses when those risks manifest themselves. Other times, brokers may act fraudulently, by engaging in excessive trading intended to increase the broker's compensation, or by placing the investor in fraudulent investment schemes, like a ponzi scheme.

Whether the broker has acted negligently or fraudulently, the result is the same. An investor who tried to act responsibly to secure her retirement is left financially insecure. The broker's misconduct leaves the investor to figure out whether she will eat, or take her medicine that day, because she doesn't have enough money to do both.

Investor protection goes farther than simply making arbitration available. It is not enough that an investor be told by an arbitration panel that the broker did in fact act improperly. This leaves the investor no better off financially. Protection means the investor is able to recover the funds lost because of the broker's misconduct.

Unfortunately, far too often, investors who have gone through the very arduous arbitration process, receive an arbitration award that is never paid. An unpaid award is as worthless to the investor who just lost her life savings as was the poor advice and conduct that caused the losses in the first place. Unpaid arbitration awards have been a concern for some time, with the GAO first examining the issue in 2000. PIABA has long been concerned about this issue as well, as we see firsthand the impact on investors when they are unable to recover for broker and brokerage firm misconduct.

Take for example the Sheas. The couple has been together for over 40 years. Mr. Shea started out with a dairy route in southern Illinois. After saving for about a decade, the couple purchased a dairy farm, which they operated for the next twenty years. Although they have given up the dairy part of the farm, they continue to grow crops. As you can imagine, the life of a farmer is not an easy one. The Sheas saved their money over time, and eventually accumulated about $1.5 million. As they approached retirement, they considered what to do with their life savings. Their broker, with the firm Windsor Street Capital, aggressively pursued the Sheas, eventually convincing them to invest with him. Within one year, the Sheas lost a significant portion of their savings. The broker traded their account for his own benefit, something commonly called churning. His trading resulted in annualized turnovers of between 10 and 38, far in excess of what would be considered reasonable (which is typically something between 0 on the low side and 6 on the extreme high side). Earlier this year, the Sheas were awarded over $1.3 million in compensatory damages, and $3 million in punitive damages after the arbitration hearing. Although the Sheas lost so much of their life savings, and the arbitration panel agreed that the firm engaged in misconduct, the Sheas have not recovered from the firm. And it is unlikely they will as the firm has shut down.

The Sheas' situation is not unique. Another investor recently received an award against Legend Securities, Inc., a firm which had been expelled by FINRA in April 2017. This investor opened an account with his broker after hearing what is a fairly common pitch – invest a little now, and if the broker is able to show good returns, invest more. And that is exactly what the investor did, convinced that the early successful trade demonstrated that the broker was trustworthy. Unfortunately, the broker was anything but trustworthy. Over a relatively short period of time, the broker lost all of this investor's money; with the exception of the little he had been able to withdraw to cover medical bills. The investor sued Legend, which did not appear at the arbitration hearing. The case proceeded under FINRA's default rules, which require that the customer prove their claim to the arbitrator. After considering the submissions, the arbitrator awarded the full amount the investor lost at Legend Securities: $33,000, as well as interest of over $15,000. The award has gone unpaid, and will likely never be paid since the firm has ceased operations. Unfortunately, that leaves this investor with no hope of recovery, and left to wonder how he will pay his medical bills going forward.

PIABA has published two papers on this topic. The first was an extensive paper drafted in 2016, which walked through the history of the problem, and evaluated possible solutions to the problem. PIABA updated the paper earlier this year. There, PIABA talked about Mr. Wilkerson's case. Mr. Wilkerson is a former NFL player. He trusted his savings to a broker, who used the funds to pay his own personal expenses, the expenses of a company he controlled, and to pay so called dividends and proceeds to other investors for false securities transactions he claimed to have made on their behalf. Mr. Wilkerson was awarded losses of $600,000 and other statutory damages by an arbitration panel. However, the firm had been shut down by the time the award was issued, and Mr. Wilkerson didn't get paid what he had been awarded. Like so many other investors, he was left with a hollow victory.

There are a number of possible ways to address this issue. Insurance is one possibility, but its biggest shortcoming is that it will not help those who have been harmed by the most egregious conduct. It cannot provide assistance to those who were defrauded by their broker.

The best solution is a national investor recovery pool. There are a number of ways such a pool may be funded and administered. In our opinion, it would be best that a pool be administered by FINRA, the entity already responsible for tracking whether arbitration awards are paid.

As the industry regulator, FINRA is also in the best position to fund the pool. There are a number of viable funding options. FINRA may fund a pool with money collected from fines. Between 2014 and 2016, FINRA has assessed fines far in excess of unpaid awards. For example, in 2016, FINRA assessed $173.8 million in fines, while $14 million in awards went unpaid. Using fine money also ensures that those firms and brokers who have engaged in misconduct are the ones compensating harmed investors.

Alternatively, FINRA may fund a pool through a member surcharge. Based on the number of registered representatives, assessments of $23 to $120 per broker would have fully compensated investors with unpaid awards each year between 2012 and 2016. But, it is not necessary to charge firms the same for each broker. FINRA can assess a surcharge based on the overall risk of the firms' businesses. FINRA has said it is using a risk-based framework to conduct member examinations. It can utilize the same framework to fund a pool. Those members engaged in high risk conduct, conduct most likely to result in investor harm, would pay a larger fee.

PIABA has also offered guidance on the administration of a pool to ensure that frivolous claims are not paid. First, we proposed that FINRA rules require that an investor meet her burden of proof, even if the broker or firm do not appear at the arbitration hearing. Second, PIABA suggests that awards be confirmed by a court of competent jurisdiction before being eligible to be paid. Next, PIABA suggests that the pool be funded based on a five year average of unpaid awards. If, in a given year, there are not enough funds in the pool to pay all awards, compensatory damages should be paid before punitive damages, and investors may be paid on a pro-rata basis. Additionally, investors would subrogate their interest in the award to FINRA to the extent they have been paid by the pool. This would give FINRA the ability to pursue the broker or firm for any sums paid out.

We understand that there are concerns that payment of awards by anyone other than those found responsible could create moral hazards. However, certain of our suggestions for administering the pool should address such concerns. For example, the broker and the firm will not be let off the hook for misconduct. The pool would retain the ability to pursue the parties involved to obtain payment. Additionally, FINRA will continue to condition membership on full payment of awards.