2020 PIABA Mid-Year Meeting

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DEALING WITH BROKER DEALER ABUSIVE PRACTICES IN ARBITRATION

Jason Kane, Judson Lee, and Stuart Meissner[1]

Introduction

Recently, there have been numerous highly publicized instances of FINRA arbitrators ordering that respondent broker-dealer firms pay sanctions to claimants for discovery abuses. While those orders are to be celebrated by PIABA members (with kudos extended to the PIABA members who obtained them) a question lingers: what else are brokerage firms doing in discovery and getting away with? For every sanctions award issued, there must be numerous instances of broker-dealers withholding discoverable material or engaging in other discovery abuses that the Panel does not learn about before issuing a Final Order. After all, the broker-dealers keep hiring the lawyers that lead them into discovery sanctions. They must view this as a cost of doing business and that more times than not it is an effective strategy that helps their bottom lines.

Our presentation at PIABA's mid-year meeting will discuss steps to take to: (1) prevent discovery abuses from the broker-dealers we arbitrate against; and (2) use the discovery abuses we discover during the course of a pending arbitration against the offending respondents. We will exchange our own stories and strategies that have been effective while highlighting the tools we all know exist in the FINRA Rules.

Recent Examples of Broker-Dealer Discovery Abuse and Lessons to Be Learned for PIABA Members

The most common sanctionable conduct that broker-dealers engage in is simply refusing to produce obviously discoverable documents.

1. Quintana, Torres v. Morgan Stanley

The best recent example of a broker-dealer going to great lengths to avoid making a relevant production occurred in *Isabel Litovich-Quintana, Jose A. Torres v. Morgan Stanley Smith Barney, LLC d/b/a Morgan Stanley*, FINRA Case No. 17-01908. There, Morgan Stanley's discovery abuses resulted in a $3,000,000 monetary sanction. In ordering such a sanction – in an arbitration that resulted in a $261,420.63 compensatory award – the Panel sent a clear message that Morgan Stanley's repeated refusal to produce documents which resulted in numerous delays to the proceeding was not to be tolerated. According to the Panel:

> Respondent is liable and shall pay to Claimants the sum of $3,000,000.00 in monetary sanctions, in accordance with ***Rules 12212 and 12511 of the Code of Arbitration Procedure*** (the "Code"). The Panel has provided the following explanation for their finding:

[1] Jason Kane is a shareholder at Peiffer, Wolf, Carr & Kane and works out of that firm's office in Rochester, New York. Judson Lee is the founder of Judson M. Lee, Attorney at Law in Madison, Mississippi. Stuart Meissner is the founder of Meissner Associates in New York.

During the course of the evidentiary hearing, the Panel was made aware of Respondent's alleged failure to comply with a discovery request Order, which was granted pre-hearing by the prior Chairperson with respect to the production of documents related to the termination of a key employee of Respondent. After hearing oral argument on the issue by both parties, the full Panel issued the same Order as was previously issued by the prior Chairperson for production of "all" related documents by midnight. The Panel noted that the prior Chairperson's Order did not limit itself to "pre-termination" or "post-termination" documents when it stated "all." Respondent did not send the requested documents to Claimants' counsel by midnight, nor did Respondent's counsel provide opposing counsel with the courtesy of an email by midnight explaining why "all" the ordered documents were not being produced. The evidentiary hearing was delayed, for a second time, to permit both parties to provide oral argument on the "settlement privilege" which Respondent's counsel alleged applied to the documents that Respondent was withholding and proposing to have the Panel review "in camera." The Panel again ordered the withheld documents to be handed to Claimants' counsel, and not to the Panel for in camera review. ***The Panel took note of the extreme prejudice*** Respondent's failure of compliance caused Claimants' counsel in preparing their case and asserting their claims without the withheld documents which the Panel deemed were highly relevant to the dispute in question, the central figure of which was the terminated employee whose related documents were being withheld. ***Claimants' counsel repeatedly requested that Respondent be assessed monetary sanctions*** for its failure of compliance with the Panel's Orders. At the conclusion of the evidentiary hearing, the Panel ordered both parties to submit post-hearing briefs on the issue of the sanctions requested by Claimants against Respondent.

The Panel noted that Rule 12506(b)(2) of the Code related to parties' obligation to ***"act in good faith when complying with subparagraph (1) of this rule.*** 'Good faith' means that a party must use its best efforts to produce all documents required or agreed to be produced. If a document cannot be produced in the required time, a party must establish a reasonable timeframe to produce the document." The Panel also took note of Rule 12212 of the Code related to sanctions: "(a) The panel may sanction a party for failure to comply with any provision in the Code, or any order of the panel or single arbitrator authorized to act on behalf of the panel. Unless prohibited by applicable law, sanctions may include, but are not limited to:

• Assessing monetary penalties payable to one or more parties; . . ."

In accordance with the above, after due deliberation and upon consideration of the negative effect that Respondent's noncompliance with the Panel's Orders had on its efforts to achieve a fair arbitration hearing, the Panel hereby orders Respondent to pay monetary sanctions to Claimants in the amount of $3,000,000.00. (Emphasis added).[2]

Obviously, this award highlights, more so than most, the extreme measures that broker-

[2] The award in *Quintana, Torres v. Morgan Stanley*, FINRA Case No. 17-01908, is attached hereto as Exhibit 1.

dealers are willing to take in order to keep important documents out of experienced practitioners' hands. It also provides some tips when seeking sanctions. First, it provides the foundation upon which the discovery rules are built – parties are required to "act in good faith when complying with" FINRA Rule 12506. Failing to live up to that standard is sanctionable conduct. Second, demonstrating "extreme prejudice" was important to the panel, noting that the hearing was delayed for a "second time." Finally, PIABA member Jeff Erez stressed his repeated request to the clearly annoyed panel that monetary sanctions be issued.

2. *Fratto v. Wells Fargo*

Another example of a discovery abuse occurred in *Fratto v. Wells Fargo Advisors Financial Network*, FINRA Case No. 19-00957. There, Stuart obtained a more creative sanction prior to the final hearing that was designed to get Wells Fargo to comply with its discovery obligations prior to the evidentiary hearing. According to the order:

> The Arbitration Panel rejects the Respondent's objections to Claimant's request for documents production. We order that the Respondent provide all documents requested by the Claimant no later than Nov. 22, 2019. ***Respondent shall affirm in writing that the documents produced constitute all documents that exist***, are in Respondent's possession and have been located after a reasonable search. ***The Claimant's attorney fees for preparing the [Associated Briefs] will be paid by the Respondent. The Respondent will pay all FINRA arbitration fees. Respondent will pay a penalty of $200 per day starting Nov. 12, 2019 through Nov. 22, 2019. If all documents are not delivered to the Claimant's attorney by Nov. 22, 2019 as ordered, the penalty will increase to $400 per day until all documents have been produced and delivered to the Claimant's attorney.*** (Emphasis Added).[3]

Stuart's motion to compel and imposition of retroactive sanctions is a great example of the steps to take while highlighting a broker-dealer's refusal to conduct discovery in good-faith. First, he highlighted the relevant rules including Rules 12505, 12506 and 12508 which call for parties to cooperate to the fullest extent possible, identify and explain why documents can not be produced, and act in good faith when complying with discovery. Second, he highlighted Respondent's refusal to cooperate to the fullest extent possible. Finally, he effectively highlighted Notice to Members 03-70 which noted that FINRA panels have faced discovery abuses many times and have imposed sanctions with increasing frequency.[4] He then highlighted numerous instances of panels assessing penalties against FINRA members for discovery abuses.

This order itself also highlights a discovery step that every practitioner should take whenever broker-dealer firms are not producing relevant documents that they should possess. Obtain an order mandating that respondent affirm in writing that it had produced all documents.

When there is an affirmation, and documents start appearing, counsel is on solid ground to start asking for sanctions. Notably, the stick approach of increasing penalties after a set period of time was a creative suggestion from Stuart that was ultimately adopted by the panel.

[3] The Discovery Order in *Fratto v. Wells Fargo Advisors Financial Network*, FINRA Case No. 19-00957, is attached hereto as Exhibit 2.

[4] Stuart's motion to compel and imposition of retroactive sanctions is attached hereto as Exhibit 3.

3. Fitzpatrick v. AXA

A third example of a broker-dealer withholding pertinent discovery was serendipitously discovered by Jason at the final hearing in *Fitzpatrick v. AXA*, FINRA Case No. 16-03454. In that arbitration, AXA played a previously unproduced telephone recording while cross examining the claimant. The incident was described in an article that appeared in *Financial Planning* on June 13, 2019, "'That's not me!' What happened when AXA played a recording in an arbitration."[5]

Although he continues to wonder if there was a better way, at the same time, his client started protesting, as the article indicates: "That's not me!", Jason objected to the playing of the recording because it had not been produced. The Panel side-barred on the issue. It was late in the day, so the Panel ordered that the parties figure out if the recording had been produced and, if not, ordered AXA to produce it by midnight the next day. Unlike Morgan Stanley, AXA did produce it that night and Jason used the recording the next day to impeach the broker who had to admit that it was him on the recording, impersonating the claimant.

It was the strangest moment that Jason has ever encountered at a hearing. He ultimately did not make a motion for sanctions but believes that the moment helped the panel in its determination to award attorneys' fees to his clients.[6] AXA obviously intended the recording to provide a "gotcha" moment that backfired.

4. Other Broker-Dealer Gamesmanship

Jud recently dealt with a broker-dealer firm that filed a frivolous counterclaim in order to manufacture a discovery dispute with claimants in an attempt to invade the attorney work product doctrine.[7] This involved a claim for a second group of claimants Jud represented after successfully representing a first group against the same respondents for the same fraudulent activity. Broker- dealers have filed counterclaims in the past as an intimidation tactic, but it is a very interesting abuse of the discovery process that all investor representatives should be prepared for.

Arbitrators Are Trained to Deal with Discovery Abuses

As referenced in the awards and orders discussed above, as well as in other PIABA presentations from annual meetings past, FINRA trains arbitrators to demand that parties act in good faith act when conducting discovery as required by Rule 12506.[8] Arbitrators and practitioners alike should use FINRA's discovery guide to their advantage, engage in motion practice to obtain discovery rulings, ensure discovery requests and discovery orders are complied with, and obtain orders of appearance and production. Finally, when the time comes,

[5] The incident was described in an article published in Marsh, Ann. "That's not me! What happened when AXA played a recording in an arbitration." *Financial Planning*, 13 June 2019. Attached hereto as Exhibit 4.

[6] The Final Award in *Fitzpatrick v. AXA Advisors, LLC,* FINRA Case No. 16-03454 is attached as Exhibit 5.

[7] A redacted version of an opposition Jud filed is attached as Exhibit 6.

[8] The relevant sections of FINRA's Basic Arbitrator Training from October 2018 is attached as Exhibit 7.

practitioners should be prepared to ask the Panel for sanctions. According to FINRA's Basic Arbitrator Training:

> Failure to cooperate in the exchange of documents and information as required under the Code may result in sanctions. The panel may issue sanctions against any party in accordance with Rule 12212(a) for:
>
> - failing to comply with the discovery provision of the Code, unless the panel determines that there is substantial justification for the failure to comply; or
> - frivolously objecting to the production of requested documents or information.[9]
>
> Unless prohibited by law, sanctions may include, but are not limited to:
>
> - assessing monetary penalties payable to one or more parties;
> - precluding a party from presenting evidence;
> - making an adverse inference against the party;
> - assessing postponement and/or forum fees;
> - assessing attorneys' fees, costs and expenses;
> - initiating a disciplinary referral; and
> - dismissing with prejudice a claim, defense, or proceeding.[10]

Finally, arbitrators and practitioners should also be aware that where a broker-dealer claims that a document can not be produced because it no longer exists (a claim with SEC document retention implications), arbitrators "may direct the party to state in a sworn, written statement called an affidavit that it doesn't exist." As described above, it is these affidavits that are often one of the first steps laid in ultimately obtaining a sanctions order for abusive discovery practices. In other words, stating falsely under oath that a document does not exist, when it does exist, should lead a panel to at least consider sanctioning a broker.

Practical Tips

Like all major decisions an attorney makes during the course of an arbitration, filing a motion for sanctions will test the claimant's and the attorney's credibility. It is important to ensure that the claimant has clean hands, before accusing the broker-dealer of having unclean hands. In other words, as Stuart did in the motion he filed in *Fratto v. Wells Fargo*, make sure your client or clients can credibly claim that they are acting in good faith by complying with FINRA's Discovery Guide and that broker-dealer's reasonable, non-objectionable discovery request, before accusing the broker-dealer firm of not acting in good faith.

Finally, and this pertains to all substantive documents the panel will review, take the opportunity to educate the panel about why the broker-dealer does not want to produce the documents. As mentioned above, the decision to produce or not, like all decisions broker-dealer firms make,

[9] *Id.*, at p. 37 of 132.

[10] Exh. 7, at p. 38 of 132.

comes down to a bottom line, risk assessment. Producing the document it does not want to produce will certainly increase the value of what it ultimately has to pay Claimant. Tell the arbitration panel why that is the case. After coloring the Panel's opinion about the merits, describe the risk assessment the broker-dealer made, how that does not comport with FINRA's good-faith requirements, and then argue that sanctions should be ordered. At a minimum, you have accomplished the goal of educating the panel about the merits of the case.

Conclusion

Broker-Dealer misconduct in the discovery process is obviously a problem that effective counsel will try to prevent. When it occurs but get discovered, effective counsel can press that knowledge to their client's advantage.

Exhibit 1

Award
FINRA Office of Dispute Resolution

In the Matter of the Arbitration Between:

Claimants
Isabel Litovich-Quintana
Jose A. Torres

Case Number: 17-01908

vs.

Respondent
Morgan Stanley Smith Barney, LLC d/b/a Morgan Stanley

Hearing Site: Miami, Florida

Nature of the Dispute: Customers vs. Member

This case was decided by an all-public panel.

REPRESENTATION OF PARTIES

For Claimants Isabel Litovich-Quintana and Jose A. Torres: Jeffrey Erez, Esq., Sonn & Erez, PLC, Miami, Florida and Eliezer A. Aldarondo-Lopez, Aldarondo & Lopez-Bras, PSC, Guaynabo, Puerto Rico.

For Respondent Morgan Stanley Smith Barney LLC d/b/a Morgan Stanley: Joseph C. Coates, III, Esq. and Jason M. Fedo, Esq., Greenberg Traurig, P.A., West Palm Beach, Florida, and Luis N. Saldana-Roman, Esq., Saldaña, Carvajal & Vélez-Rivé, P.S.C., San Juan, Puerto Rico.

CASE INFORMATION

Statement of Claim filed on or about: July 19, 2017.
Claimants signed the Submission Agreement: July 19, 2017.

Answer to Statement of Claim filed by Respondent on or about: November 6, 2017.
Morgan Stanley Smith Barney LLC d/b/a Morgan Stanley signed the Submission Agreement: August 16, 2017.

Amended Statement of Claim filed on or about: November 29, 2017.

Answer to Amended Statement of Claim filed by Respondent on or about: December 29, 2017.

CASE SUMMARY

In their Statement of Claim, as amended, Claimants asserted the following causes of action: breach of fiduciary duty; negligence; negligent supervision; fraud; breach of

contract; breach of contract – third party beneficiary; violation of Sections 10(b) of the Securities Exchange Act and Rule 10b-5 of the Securities and Exchange Commission; violation of the Florida Securities and Investor Protection Act; and violation of the Puerto Rico Uniform Securities Act. The causes of action relate to Claimants' investments in Puerto Rico bonds and closed-end bond funds, as well as the use of a securities-backed loan.

Unless specifically admitted in its Statement of Answer, Respondent denied the allegations made in the Statement of Claim, as amended, and asserted various affirmative defenses.

RELIEF REQUESTED

In the Statement of Claim, as amended, Claimants requested: compensatory damages of between $1,000,000.00 and $5,000,000.00; interest; attorneys' fees; punitive damages; rescission; statutory damages; costs; and such other and further relief the Panel deemed just and proper.

In its Answer to the Statement of Claim, as amended, Respondent requested that Claimants' claims be denied in their entirety and that all forum fees and costs be assessed against Claimants.

At the close of the hearing, Claimants requested damages of at least $2,739,792.00, plus attorneys' fees in the amount of $515,624.00 and punitive damages in the amount of $10,959,168.00.

OTHER ISSUES CONSIDERED AND DECIDED

The Arbitrators acknowledge that they have each read the pleadings and other materials filed by the parties.

On or about November 2, 2017, Claimants filed a Motion for Leave to Amend the Statement of Claim in which Claimants sought to amend the Statement of Claim to add an additional count (Breach of Contract – Third-Party Beneficiary) against Respondent. Respondent did not oppose the Motion. On or about November 29, 2017, the Panel entered an Order granting Claimants' Motion.

On or about December 14, 2018, the Panel issued an Order which granted the parties' stipulation to change the hearing venue from Puerto Rico to Miami, Florida.

During the evidentiary hearings, Claimants made an oral Motion for Discovery Sanctions against Respondent. Respondent opposed the Motion. The Panel held any ruling on the Motion for Discovery Sanctions in abeyance until the conclusion of the evidentiary hearings. After the hearings concluded, the Panel issued an Order on April 30, 2019, instructing the parties to file briefs on the Motion for Discovery Sanctions. Both parties filed briefs on or about May 31, 2019. In its Motion for Discovery Sanctions post-hearing brief, Claimants argued that Respondent failed to produce critical documents responsive to Claimants' discovery request and thereby concealed documents relevant to the central issues in the matter. In its opposition to the Motion for

Discovery Sanctions post-hearing brief, Respondent argued, among other things, that it complied with all discovery obligations and did not engage in any conduct warranting sanctions. The Panel's decision with respect to Claimants' Motion is set forth in the Award section below.

The Arbitrators have provided an explanation of their decision in this award. The explanation is for the information of the parties only and is not precedential in nature.

The parties present at the hearing have agreed that the Award in this matter may be executed in counterpart copies or that a handwritten, signed Award may be entered.

AWARD

After considering the pleadings, the testimony and evidence presented at the hearing, and the post-hearing submissions, the Panel has decided in full and final resolution of the issues submitted for determination as follows:

1. Respondent is liable for and shall pay to Claimants the sum of $261,420.63 in compensatory damages.

2. Respondent is liable for and shall pay to Claimants interest on the above-stated sum at the rate of 0.1% per annum from March 31, 2013, through and including August 30, 2014.

3. Respondent is liable and shall pay to Claimants the sum of $3,000,000.00 in monetary sanctions, in accordance with Rules 12212 and 12511 of the Code of Arbitration Procedure (the "Code"). The Panel has provided the following explanation for their finding:

   During the course of the evidentiary hearing, the Panel was made aware of Respondent's alleged failure to comply with a discovery request Order, which was granted pre-hearing by the prior Chairperson with respect to the production of documents related to the termination of a key employee of Respondent. After hearing oral argument on the issue by both parties, the full Panel issued the same Order as was previously issued by the prior Chairperson for production of "all" related documents by midnight. The Panel noted that the prior Chairperson's Order did not limit itself to "pre-termination" or "post-termination" documents when it stated "all." Respondent did not send the requested documents to Claimants' counsel by midnight, nor did Respondent's counsel provide opposing counsel with the courtesy of an email by midnight explaining why "all" the ordered documents were not being produced. The evidentiary hearing was delayed, for a second time, to permit both parties to provide oral argument on the "settlement privilege" which Respondent's counsel alleged applied to the documents that Respondent was withholding and proposing to have the Panel review "in camera." The Panel again ordered the withheld documents to be handed to Claimants' counsel, and not to the Panel for in camera review. The Panel took note of the extreme prejudice Respondent's failure of compliance caused Claimants' counsel in preparing their case and asserting their claims without the withheld

documents which the Panel deemed were highly relevant to the dispute in question, the central figure of which was the terminated employee whose related documents were being withheld. Claimants' counsel repeatedly requested that Respondent be assessed monetary sanctions for its failure of compliance with the Panel's Orders. At the conclusion of the evidentiary hearing, the Panel ordered both parties to submit post-hearing briefs on the issue of the sanctions requested by Claimants against Respondent.

The Panel noted that Rule 12506(b)(2) of the Code related to parties' obligation to "act in good faith when complying with subparagraph (1) of this rule. 'Good faith' means that a party must use its best efforts to produce all documents required or agreed to be produced. If a document cannot be produced in the required time, a party must establish a reasonable timeframe to produce the document." The Panel also took note of Rule 12212 of the Code related to sanctions: "(a) The panel may sanction a party for failure to comply with any provision in the Code, or any order of the panel or single arbitrator authorized to act on behalf of the panel. Unless prohibited by applicable law, sanctions may include, but are not limited to:

- Assessing monetary penalties payable to one or more parties; . . ."

In accordance with the above, after due deliberation and upon consideration of the negative effect that Respondent's noncompliance with the Panel's Orders had on its efforts to achieve a fair arbitration hearing, the Panel hereby orders Respondent to pay monetary sanctions to Claimants in the amount of $3,000,000.00.

4. Other than forum fees which are specified below, the parties shall each bear their own costs and expenses incurred in this matter.

5. Any and all claims for relief not specifically addressed herein, including Claimants' requests for punitive damages and attorneys' fees, are denied.

FEES

Pursuant to the Code, the following fees are assessed:

Filing Fees
FINRA Office of Dispute Resolution assessed a filing fee* for each claim:

Initial Claim Filing Fee	=$ 2,000.00

*The filing fee is made up of a non-refundable and a refundable portion.

Member Fees
Member fees are assessed to each member firm that is a party in these proceedings or to the member firm(s) that employed the associated person(s) at the time of the event(s) giving rise to the dispute. Accordingly, as a party, Respondent is assessed the following:

Member Surcharge	=$ 3,025.00
Member Process Fee	=$ 6,175.00

Discovery-Related Motion Fee
Fees apply for each decision rendered on a discovery-related motion.

Two (2) decisions on discovery-related motions on the papers with one (1) arbitrator @ $200.00/decision	=$ 400.00

Claimants submitted one (1) discovery-related motion
Respondent submitted one (1) discovery-related motion

Total Discovery-Related Motion Fees	=$ 400.00

The Panel has assessed $200.00 of the discovery-related motion fees jointly and severally to Claimants.

The Panel has assessed $200.00 of the discovery-related motion fees to Respondent.

Hearing Session Fees and Assessments
The Panel has assessed hearing session fees for each session conducted. A session is any meeting between the parties and the arbitrator(s), including a pre-hearing conference with the arbitrator(s) that lasts four (4) hours or less. Fees associated with these proceedings are:

One (1) pre-hearing session with a single arbitrator @ $450.00/session			=$ 450.00
Pre-hearing conference:	November 8, 2018	1 session	
One (1) pre-hearing session with the Panel @ $1,400.00/session			=$ 1,400.00
Pre-hearing conference:	December 19, 2017	1 session	
Forty-six (46) hearing sessions with the Panel @ $1,400.00/session			=$64,400.00
Hearing Dates:	January 14, 2019	2 sessions	
	January 15, 2019	2 sessions	
	January 16, 2019	3 sessions	
	January 17, 2019	3 sessions	
	January 18, 2019	3 sessions	
	January 21, 2019	2 sessions	
	January 22, 2019	2 sessions	
	January 23, 2019	3 sessions	
	January 24, 2019	2 sessions	
	March 2, 2019	2 sessions	
	March 3, 2019	2 sessions	
	March 4, 2019	2 sessions	
	March 5, 2019	3 sessions	
	March 6, 2019	1 session	
	April 22, 2019	2 sessions	
	April 23, 2019	3 sessions	

April 24, 2019	3 sessions
April 25, 2019	3 sessions
April 26, 2019	3 sessions

Total Hearing Session Fees =$66,250.00

The Panel has assessed $32,900.00 of the hearing session fees jointly and severally to Claimants.

The Panel has assessed $33,350.00 of the hearing session fees to Respondent.

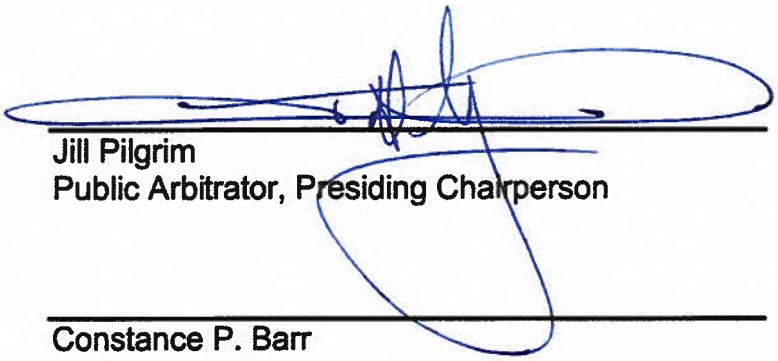
All balances are payable to FINRA Office of Dispute Resolution and are due upon receipt.

ARBITRATION PANEL

Jill Pilgrim	-	Public Arbitrator, Presiding Chairperson
Constance P. Barr	-	Public Arbitrator
Irlanda Ruiz	-	Public Arbitrator

I, the undersigned Arbitrator, do hereby affirm that I am the individual described herein and who executed this instrument which is my award.

Concurring Arbitrators' Signatures



Jill Pilgrim
Public Arbitrator, Presiding Chairperson

7/16/2019
Signature Date

Constance P. Barr
Public Arbitrator

Signature Date

Irlanda Ruiz
Public Arbitrator

Signature Date

JULY 16, 2019

Date of Service (For FINRA Office of Dispute Resolution office use only)

ARBITRATION PANEL

Jill Pilgrim	-	Public Arbitrator, Presiding Chairperson
Constance P. Barr	-	Public Arbitrator
Irlanda Ruiz	-	Public Arbitrator

I, the undersigned Arbitrator, do hereby affirm that I am the individual described herein and who executed this instrument which is my award.

Concurring Arbitrators' Signatures

Jill Pilgrim
Public Arbitrator, Presiding Chairperson

Signature Date

I, Constance P. Barr

Constance P. Barr
Public Arbitrator

7/15/2019
Signature Date

Irlanda Ruiz
Public Arbitrator

Signature Date

JULY 16, 2019

Date of Service (For FINRA Office of Dispute Resolution office use only)

ARBITRATION PANEL

Jill Pilgrim	-	Public Arbitrator, Presiding Chairperson
Constance P. Barr	-	Public Arbitrator
Irlanda Ruiz	-	Public Arbitrator

I, the undersigned Arbitrator, do hereby affirm that I am the individual described herein and who executed this instrument which is my award.

Concurring Arbitrators' Signatures

Jill Pilgrim
Public Arbitrator, Presiding Chairperson — Signature Date

Constance P. Barr
Public Arbitrator — Signature Date

Irlanda Ruiz
Public Arbitrator — July 15, 2019
Signature Date

JULY 16, 2019
Date of Service (For FINRA Office of Dispute Resolution office use only)

Exhibit 2

FINRA
Financial Industry Regulatory Authority

ORDER

Submitted By: Veronica Williams (On behalf of the arbitration panel)
Submitted Date: 11/18/2019 05:08:51 PM EST

Case ID & Parties:
FINRA Office of Dispute Resolution
ORDER

Case Number: 19-00957

In the Matter of the Arbitration Between

Claimant(s)	**VS**	**Respondent(s)**
Robin Fratto		Wells Fargo Advisors Financial Network

PREHEARING CONFERENCE

1. Was a prehearing telephonic conference held in the above captioned matter?
- ● **Yes**
- ○ No

a. Prehearing conference date:
- ● **A prehearing conference was held in the above captioned matter on *09/18/2019* at *10:30 AM Eastern Time Zone***

b. The following arbitrator(s) participated in the hearing:
Chairman: Veronica Williams(Participated ☑)
Panelist: Angela Foster(Participated ☑)
Panelist: Sirena Terr(Participated ☑)

c. The following party representatives participated in the hearing:
Identify Claimant Representatives:

Stuart D. Meissner, Esq.

Identify Respondent Representatives:

Samuel P. Mauch, Esq.

d. Office of Dispute Resolution staff attendee:
- ● **The following FINRA Office of Dispute Resolution Staff person participated in the hearing:**
  Samantha Denny
- ○ Not applicable

ISSUES ADDRESSED

2. Issues addressed: (i.e., name of motion or request, by which party)

- **The following pleadings have been addressed:**

Claimant's Motion to Compel and Imposition of Retroactive Sanctions
Respondent's Opposition to Motion to Compel and Imposition of Retroactive Sanctions
Claimant's Reply to Motion to Compel and Imposition of Retroactive Sanctions
Claimant's Post-Reply to Motion to Compel and Imposition of Retroactive Sanctions

ORDER DECIDED BY

3. Decided by:

- ○ Chairperson
- **Panel**

RULINGS

4. Rulings:

- **After considering the pleadings submitted by the parties (and oral arguments, if prehearing conference held), the Panel/Chairperson rules as follows:**

The Arbitration Panel rejects the Respondent's objections to Claimant's request for documents production. We order that the Respondent provide all documents requested by the Claimant no later than Nov. 22, 2019. Respondent shall affirm in writing that the documents produced constitute all documents that exist, are in Respondent's possession and have been located after a reasonable search. The Claimant's attorney fees for preparing the Motion to Compel and Imposition of Retroactive Sanctions, Claimant's Reply to Motion to Compel and Imposition of Retroactive Sanctions, and Claimant's Post-Reply to Motion to Compel and Imposition of Retroactive Sanctions will be paid by the Respondent. The Respondent will pay all FINRA arbitration fees. Respondent will pay a penalty of $200 per day starting Nov. 12, 2019 through Nov. 22, 2019. If all documents are not delivered to the Claimant's attorney by Nov. 22, 2019 as ordered, the penalty will increase to $400 per day until all documents have been produced and delivered to the Claimant's attorney.

5. Order compliance date:

- **The parties should comply with this order by *11/22/2019***
- ○ Not applicable

ASSESSMENT OF FEES

6. Cost of prehearing conference:

- **If the parties settle this matter with no further hearings, the forum fees for this prehearing conference (or discovery-related motion decided without a prehearing conference) are assessed as follows:**

  _____% to Claimant(s), jointly and severally

  ***100*% to Respondent(s), jointly and severally**

  _____% assessed to _____

  _____% assessed to _____

  _____% assessed to _____

  _____% assessed to _____

  The Claimant's attorney fees for preparing the Motion to Compel and Imposition of Retroactive Sanctions, Claimant's Reply to Motion to Compel and Imposition of Retroactive Sanctions, and Claimant's Post-Reply to Motion to Compel and Imposition of Retroactive Sanctions will be paid by the Respondent. The Respondent will pay all FINRA arbitration fees. Respondent will pay a penalty of $200 per day starting Nov. 12, 2019 through Nov. 22, 2019. If all documents are not delivered to the Claimant.

- ○ Not applicable

ATTACHMENTS

There are no attached documents.

Exhibit 3

Stuart D. Meissner Esq

Meissner Associates
(P)212-764-3100
(F)646-843-4964

1430 Broadway, Suite 1802
New York, N.Y. 10018

October 11, 2019

VIA FINRA PORTAL
Arthur Baumgartner
FINRA Dispute Resolution
One Liberty Plaza
165 Broadway, 27th Floor
New York, New York 10006

Re: Re: FINRA Case Number 19-00957
Robin Fratto vs. Wells Fargo Advisors Financial Network LLC

Dear Mr. Baumgartner:

This firm represents Ms. Fratto in the above matter. Having attempted to resolve the instant issues amicably without assistance of the Panel, we hereby submit this **Motion to Compel and Imposition of Retroactive Sanctions** based on the Respondent's not unexpected scorched earth approach to this case, even refusing to comply with the Code with regard to the Discovery Guidelines which it refuses to comply with. Attached as Exhibit A is Wells Fargo's August 19, 2019 Objections and Responses to the Discovery Guidelines. Exhibit B is Ms. Fratto's September 18, 2019 response to such objection and responses delineating the obstructive nature of such responses and the Respondent's failure to comply with the Code's requirements of all arbitration parties in all customer cases. Finally, Exhibit C contains the Respondent's October 8th, 2019 response to our September 18th, 2019 attempt to resolve the dispute, in which the Respondent for the most part simply maintained their same objections and provided no support for their objections.

A) Relevant Code Discovery Provisions:

The FINRA Code of Arbitration Procedure for Customer Disputes ("The Code") §12506(b) states in relevant part:

(1) Unless the parties agree otherwise..... parties must either:

(A) Produce to all other parties ***all documents in their possession or control*** *that are described in Document Production Lists 1 and 2 ;*

(B) ***Identify and explain the reason that specific documents described in Document Production Lists 1 and 2 cannot be produced*** *within the required time,* ***and state when the documents will be produced,*** *and serve this response on all parties and file this response with the Director; or(C)* ***Object as provided in Rule 12508*** *and serve this response on all parties and file this response with the Director.*

*(2) **A party must act in good faith** when complying with subparagraph (1) of this rule. "Good faith" means that a party must use its **best efforts to produce all documents required** or agreed to be produced. If a document cannot be produced in the required time, a party must establish a reasonable timeframe to produce the document.*

Further with regard to any objections Code §12508 states:

*(a) **If a party objects to producing any document described in Document Production Lists** 1 or 2 or any document or information requested under Rule 12507, **it must specifically identify which document or requested information it is objecting to and why.** Objections must be in writing, and must be served on all other parties. **Parties must produce all applicable listed documents, or other requested documents or information not specified in the objection** by serving the requested documents or information under Rule 12300.*

Finally Code §12505 states:

*The parties must cooperate **to the fullest extent practicable** in the exchange of documents and information to expedite the arbitration.*

B) Respondent's Action

Contrary to the above provisions, and unlike Ms. Fratto who did not object to any single Guideline and has now fully complied with her Guideline production as well as having stated so to the Respondent, the Respondent instead has chosen to engage in a shell/word game of evasive responses and frivolous objections to various presumptively discoverable documents, obstructing Ms. Fratto's ability to prepare tailored document requests, as permitted under the Code.

1) Consistent word games in stating it **"Will Produce Responsive Documents"** – At the panel can see for itself within Exhibit A even where the Respondent agreed to produce the responsive documents it consistently stated it "will produce responsive documents…". Such words are clearly carefully chosen by the Respondent so as to leave the recipient wondering **WHEN** they will produce **ALL** the responsive documents requested and agreed to. The Code makes clear that either they should have produced such documents by now[1] or should have stated exactly when they plan to do so and why the delay. While asserting in its October 8th, 2019 response that "there is no issue with the timeline for production," they make reference to "documents they agreed to produce immediately," yet such response made no reference to such. In fact the word "immediately" does not appear anywhere in their response and now stated that the documents were produced "contemporaneously" with the written responses, yet such is not in accord with their assertion that they "WILL" produce responsive documents. Notably while the Respondent goes on and on about confidentiality, and a red-herring minor delay in our Guideline production, which they were

[1] At this point in time the parties have agreed to and have executed a Confidentiality Agreement so there is no basis to be withholding any documents on such basis any further.

notified of, (Which unlike the Respondent when made was/is complete and was WITHOUT ANY OBJECTIONS), their original responses make references over and over to the fact that they "Will produce Responsive Documents" having NOTHING to do with any issue of confidentiality. Further, the Respondent consistently make reference to "Responsive Documents" that will be produced specifically avoiding stating "ALL RESPONSIVE DOCUEMENTS" documents. Once again the Respondent simply ignored this concern detailed in our correspondence, thus mandating Panel intervention even with regard to this simple issue.

2) Improper Objections

The Respondent has made a mockery of the entirety of the purpose of the Discovery Guidelines. The Discovery Guidelines were included as part of the Code 12506 and 12508 for a reason, and it is not for the Respondent to simply ignore such provisions or modify them to their liking at their whim, otherwise they are useless. To the extent the Respondent takes issue with the relevancy of any one Guideline in any way, the time to express such has long since passed from when FINRA and the SEC sought input from the Industry, Investors and Regulators and confirmed such Guidelines.

In responding to our attempt at resolving their purported concerns or even simply attempting to ascertain what exactly the basis of their objections were the Respondent simply repeated their generic objections which could be utilized in every single customer case having nothing to do with this particular case at hand undermining the very essence of such Guidelines such as they being "unduly burdensome" for Wells Fargo, or that they were somehow "overbroad" for Wells Fargo. FINRA own Discovery Abuses & Sanctions Manual, October 2018, states that such Guideline Documents are "Presumptively Discoverable." **As such FINRA guides that Panels "*should generally assume that a document on the relevant List should be exchanged unless the party in control of the document demonstrates a compelling reason not to produce it.*"** See Exhibit D FINRA Discovery Abuses & Sanctions Manual, October 2018. Rather than providing us with any "compelling reason not to produce" any of the Guideline documents mandated, the Respondent simply repeated their illogical insistence that they are permitted to object at their whim and don't need to provide any reason unique to the instant case, why they should not produce ALL responsive documents to ALL the Guidelines. So as not to be repetitive we hereby incorporate our arguments raised within our letter to the Respondent, Exhibit B attached hereto.

While the Respondent attempts to have us have to explain why the Guideline documents are necessary FINRA Guidance makes clear that it is the party objecting that must provide COMPELLING REASONS why they are not producing all such documents. It seems the Respondent underestimates this Panel's intelligence in making such frivolous arguments such as they should only

have to produce commission runs related to Fratto, when they know full well that there is an issue in this case of the Respondent having taken discretion over the account, and mismarking trades as being "Unsolicited," (the client's idea) as they even assert such in their Answer. The Respondent and their attorney know full well ,for example, a Full Commission Run (List 1 Request 20) which they chose to highlight in their October 8, 2019 response as supposedly being overly broad by including Mr. Kinsman's other clients, will show what the now discharged broker with a record of complaints, was purchasing in other client accounts and if such included the same securities he had marked as "Unsolicited" such would be clear evidence of his mismarking such trades, thus contradicting the Respondent's own Answer in this case, demonstrate consciousness of guilt, as well as the falsification of business records, along with a further failure to supervise such wayward broker which they have now discharged.

C) Sanctions

As the Panel can see for itself the Respondent's response was full over excessive hyperbole whining how they will not ***"roll over and produce documents…simply because the other party demands such"*** and that ***"there are instances where a party must put its foot down and object."*** One would think we were seeking Wells Fargo new CEO's personal tax returns or something similar, rather than simply seeking the presumptively discoverable Discovery Guideline documents that are typically automatically produced in every customer case whether the Respondent is Morgan Stanley, UBS, Citigroup or even the great Wells Fargo . Finra noted panels have faced Discovery Abuse many times before and thus long ago issue a Notice to Members 03-70 (Exhibit E attached hereto) specifically referencing the parties duty to cooperate in discovery and specifically referring the Guidelines. As FINRA noted in such Notice

> *Despite the guidance provided in the Code and the Discovery Guide, NASD continues to receive complaints regarding possible abuses of the discovery process. One measure of the problem is the increasing frequency with which arbitration panels have imposed sanctions for discovery abuse*

The Notice goes on to provide examples of Sanctions Panels have imposed over the years

> *In October 2003, an arbitration panel sanctioned a member $10,000 a day for each day that the firm continued to withhold documents that the panel ordered the firm to produce. Other recent examples of discovery sanctions include:*
>
> - *A panel found that a member firm intentionally concealed documents, delaying the discovery process. The panel assessed the firm over $10,000 in sanctions and $2,500 in attorney's fees.*
> - *A panel awarded the claimant over $7,000 due to a member firm's failure*

to cooperate in the discovery process.

- *A panel awarded the claimant $2,750 in attorney's fees as a sanction for the member's failure to provide discoverable material.*
- *A panel awarded the claimant $3,000 in sanctions for a respondent's failure to provide discoverable material as ordered by the panel.*
- *A panel sanctioned a member $10,000 for failure to produce documents required by the chairperson of the panel.*

Conclusion

1) Documents Ordered - We respectfully request that the Panel Order that the Respondent produce forth with **ALL responsive documents to ALL Guidelines within List 1 Sections 1-22 (All) without exception within ten (10) days of the Order.**

2) We respectfully request that the Panel order the Respondent along with the the documents within #1, **provide the requested affirmation** from the appropriate person in the brokerage firm who has knowledge, a)affirming in writing that the Respondent conducted a good faith search for the requested document; b) describe the extent of the search including, but not limited to, stating the sources searched; and c) state that, based on the search, the Respondent does not have the requested document in its possession, custody, or control.

3) It appears this Respondent, even at this early stage, believes that this Panel and its Chair is a paper tiger for which they have nothing to fear as even with regard to Guideline documents they have chosen to take a scorched earth approach. We have yet to even propound additional discovery requests upon this Respondent, and as such we fear that if the instant abuse is not properly addressed this will happen again and again in this proceeding, continuing to test the resolve of this Panel. We therefore respectfully request that the Panel impose sanctions of a fine of **$200 per day retroactive to the date of their response to our meet and confer letter of October 8th 2019 until they provide the Affirmation in #2 above** which is mandated by the same Guidelines, **In addition to attorney fees in our having to file the instant Motion.** Notably we requested such in our letter of September 18th 2019, but the Respondent similarly deferred providing such until "an appropriate juncture", again in violation of the Code.

In order for Ms. Fratto to have a fair hearing, both in reality and appearance, it is essential that the Panel take charge of this proceeding and not permit the Respondent bank to make a mockery of the FINRA rules and control these proceedings as it appears they believe they can.

Respectfully Submitted,

Stuart David Meissner

Exhibit 4

'That's not me!' What happened when AXA played a recording in an arbitration

By Ann Marsh

June 13, 2019, 3:43 p.m. EDT

It was supposed to be a gotcha moment for AXA Advisors in a $13 million arbitration fight with two former clients. But it turned into a gotcha for the clients when arbitrators found themselves listening to a recording of a fraud taking place.

James and Sandra Fitzpatrick, a retired New York couple who'd saved $20 million from running a large egg farm, claimed to have been taken advantage of by their AXA financial advisor. They accused him and the firm of negligence and other misconduct.

AXA disputed the allegations and its defense relied in part on arguments that the clients and their son and trustee Kerry Fitzpatrick were more savvy investors than they'd let on.

Before a panel of three FINRA arbitrators, AXA's lawyer played what he said was a recording of the son speaking with customer service and demonstrating sophisticated investing know-how. But it wasn't the son on the phone call.

That moment and the underlying case provide an unusual glimpse into how FINRA's arbitrations, which are closed to the public and the media, can make it easier for a financial firm to take one position in private to try to limit damages, while maintaining a different one in public.

"When you're in a neutral, open court," says Remington Gregg, an attorney with the consumer advocacy group Public Citizen, "there is transparency in the proceedings and transparency as relates to the decision. You have neither of those things when it comes to arbitration. ... Companies are able to have two different positions."

In response, the brokerage industry's self-regulator says: "FINRA arbitration strives to provide the fairest and most efficient forum for parties — investors, brokerage firms and individual brokers — to resolve their securities-related disputes. While arbitrators and FINRA staff are bound by confidentiality, the parties and their counsel may share pleadings, documents, transcripts and any other information about their case ... and often do."

Former AXA Advisors clients Sandra and James Fitzpatrick, of Whitesville, New York, say two life insurance and three annuity policies their advisor sold to them were nothing but "commission grabs."

The Fitzpatricks, who live in Whitesville, New York, about 100 miles southeast of Buffalo, had been AXA clients for about 30 years when their longtime advisor retired and, in 2011, the company assigned a successor: Francesco Puccio.

Puccio, 46, who said he was struggling at the time to pay back taxes to the IRS, sold the Fitzpatricks two "unsuitable" life insurance policies, two variable annuities and one fixed-income annuity that were no more than "commission grabs" to bolster his sagging finances, the couple said in an arbitration claim in November 2016. The Fitzpatricks sought damages from AXA for negligence, misrepresentation and breach of fiduciary duty.

The couples' road to arbitration started when their son and daughter saw Puccio's mugshot in the newspaper. He had been convicted in January 2016 of larceny for stealing more than $100,000 from another client, a retired custodian named Shirley Kerwin.

"He did real fine for a while," Kerwin said of Puccio's efforts the first couple of years managing more than $400,000 she and her late husband, a truck driver, had saved for retirement.

'I BROKE THE LAWS'

That was before, she alleges, he put her in a series of unsuitable variable annuities. He then persuaded her to make several loans totaling more than $100,000 to one of his friends. Puccio told her the repayments would provide her with a steady income stream, according to both Kerwin and Puccio. He sold her the policies while was working at AXA and set up the loans after jumping to a new IBD, Cambridge Investment Research.

What he didn't tell her was that he, not the friend, got the money, Puccio acknowledges.

One day, "he came to my house and told me that my money was all gone," Kerwin said. "That was when I hit the floor. ... I asked him, 'Well, where did it go?' "

Puccio told her she had spent it all by giving too much money to her brother, who suffered from lung cancer. "I was actually stunned," says Kerwin, adding that she knew she had not given her brother all of her savings.

Though he disputed details of their conversation, Puccio told *Financial Planning* last month that, "With Shirley, I made a big mistake. I broke the laws."

Kerwin did something that few victims of theft or fraud by their advisors wind up doing: She called the police. Puccio was arrested in July 2015 and, the following January, convicted of second-degree grand larceny.

Sentenced to five years probation, he committed to paying Kerwin $500 a month for five years until March 2021, according to her lawyers who represent her and the Fitzpatricks. His payments are often late, according to court documents, Kerwin and Puccio himself, who offered a variety of explanations as to why. For several years, the money Puccio sent Kerwin was her only source of income beyond a monthly Social Security check, she says.

One month after his arrest, FINRA barred Puccio from the industry for failing to cooperate with its investigation after New York authorities brought charges against him.

It wasn't until the tail end of 2017 that FINRA convened an arbitration panel to resolve the Fitzpatricks' claims against AXA. The case unfolded over nine days of hearings that stretched from February to November 2018.

"I'm going to play for you a recording of a conversation that you had with AXA's customer service," AXA's lead counsel, Joseph Simms, told Kerry Fitzpatrick on the first day of the proceedings, according to a transcript obtained by *Financial Planning*.

Seconds into the recording, Fitzpatrick blurted out, "That's not me!"

It actually was Puccio on the recording, not only impersonating Kerry Fitzpatrick, but providing a gmail account in the name of Fitzpatrick's father, where AXA could send documents.

"That's a fraud, right?" the Fitzpatricks' lawyer Jason Kane asked Puccio later in the hearing.

"If you say it's a fraud, I guess it's a fraud to help the clients, yes," Puccio responded.

Fitzpatrick, in an interview with *Financial Planning*, says, "At no time did I tell Mr. Puccio that it was alright to impersonate me or contact AXA on my behalf." Puccio disputed that in his interview with *Financial Planning*.

QUESTIONED BY STATE POLICE

Puccio had called AXA with his ruse the day before the advisor sold the Fitzpatricks an insurance policy for a large commission, according to the couple's lawyer and documents from the case. Puccio posed as Kerry Fitzpatrick, the couple's lawyers contend, in order to ensure the man's parents had enough money to pay for the new policy he sold them in his new job with Cambridge.

Seven months prior to placing the call, Puccio was questioned by a state trooper while he was visiting Kerwin's house; he was arrested nearly a year later. The Fitzpatricks believe the commission on the new policy allowed Puccio to pay restitution to Kerwin and keep him out of prison. In effect, Puccio robbed Peter to pay Paul, Kane contends. Puccio denies this and maintains the policies he sold to the Fitzpatricks were suitable.

The revelation about Puccio's impersonation of his clients' son and Puccio's criminal status did nothing to dissuade AXA from a wholehearted defense against the Fitzpatricks' arbitration claim. Puccio's treatment of them was "beyond reproach," AXA's lawyer Simms repeatedly told the arbitrators.

"AXA did what it was supposed to do here," Simms said in his closing statement in the arbitration. "It provided reasonable and suitable recommendations. It properly executed the transactions and it properly supervised Mr. Puccio in the process. Yes, Puccio had financial issues. Yes, he received large commissions on these five transactions. Yes, there may have been other choices for the Fitzpatricks. ... Puccio provided practical solutions for them."

In April, the arbitrators came to a different conclusion about AXA's conduct, awarding the Fitzpatricks $3.2 million to recover their losses and legal fees, while denying punitive damages. The couple had requested $13 million. Arbitrators hired by FINRA aren't required to provide explanations for their rulings.

Last month, AXA released a statement that struck a very different tone than the one it had maintained before.

"We do not condone any actions by this individual, which were inconsistent with our policies and values," it says. "The financial professional who was involved with this matter has not been affiliated with the company for more than five years."

After news of the FINRA decision in the Fitzpatricks' case, AXA settled Kerwin's FINRA case two months ago for $130,000, according to BrokerCheck.

In 2014, before his arrest, Puccio resigned from AXA, where he worked for 13 years, to join Cambridge, where his abuses allegedly continued. Cambridge discharged him in 2015 two days after his arrest, according to FINRA BrokerCheck records. Cambridge settled a separate case with the Fitzpatricks more than a year ago for $115,000, according to BrokerCheck. A Cambridge spokeswoman declined to comment.

CLIENTS' WELL-BEING IS AXA'S 'TOP CONCERN'

Kane and his co-counsel Joseph Peiffer say they have detected systemic problems with AXA advisors in upstate New York, referring to five cases against the firm over the past 15 years that led to $24 million in fines. The cases span actions by FINRA, the New York Department of Financial Services and the New York Department of Insurance.

"While [the Fitzpatricks' case] was the work of a financial felon, that felon worked within an atmosphere at AXA that allowed him to do it," Kane says.

AXA refuted point-by-point all the arguments Kane's law firm have lodged against it in an eight-page cease-and-desist letter sent to the firm.

"Mr. Puccio's conduct by no means reflects a 'larger pattern of bad behavior' among AXA Advisors' thousands of associates, nor is the Fitzpatrick case part of any such alleged pattern," the letter says. "AXA Advisors does not 'expose' its clients to individuals with 'multiple red flags,' and it promptly addresses any concerns related to its brokers. Its clients' well-being is AXA Advisors' top concern," the letter adds.

A review of FINRA BrokerCheck records shows that, of 336 brokers in Buffalo, Rochester and Syracuse, the three largest offices in AXA's Empire division in upstate New York, 54 have regulatory disclosures — 16% of AXA's FINRA-registered workforce in the area. Numerous brokers have multiple disclosures, which are all required by FINRA: personal financial problems, including bankruptcy or unsatisfied debts; complaints involving variable annuities; as well as criminal charges or convictions for offenses such as burglary, assault, criminal possession of a loaded firearm and identity theft.

"We have strict hiring and supervisory policies for all financial professionals," an AXA representative says of the disclosures. "If a professional does not meet our high standards of conduct, we take swift action up to and including termination. While BrokerCheck is an important source, it does also contain disclosures that have been proven to be without merit."

In an hour-long interview, Puccio, who says he now works in commercial lending, called one of the attorneys of his former clients "a predator" and said that, aside from Kerwin and the Fitzpatricks, none of his roughly 1,100 clients at AXA complained about him. (There are no other client complaints on his BrokerCheck record.)

As for Kerwin, he says, "I'm very sorry about what happened. I wish I could go back in time." But he also says, "I have a problem with lying."

During his years with AXA, "The fact is, with all the audits that they did in my long career with them, they never found anything wrong." When it came to the Fitzpatricks, he says, a long chain of AXA managers reviewed and approved the policies he sold them.

"If you think it was that bad, then don't sign off on it," Puccio says of AXA. "If I did something wrong, then I should have been stopped."

Ann Marsh Senior Editor, Financial Planning

REPRINT

Arbitration Securities fraud Independent BDs AXA Advisors FINRA

Exhibit 5

Award
FINRA Office of Dispute Resolution

In the Matter of the Arbitration Between:

Claimants
James W. Fitzpatrick
Sandra J. Fitzpatrick
The Fitzpatrick Family Trust

Case Number: 16-03454

vs.

Respondents
AXA Advisors, LLC
Cambridge Investment Research, Inc.

Hearing Site: Buffalo, New York

Nature of the Dispute: Customers vs. Members

This case was decided by an all-public panel.

REPRESENTATION OF PARTIES

For Claimants James W. Fitzpatrick, Sandra J. Fitzpatrick, and The Fitzpatrick Family Trust: Jason Kane, Esq., Adam Wolf, Esq., and Joseph Peiffer, Esq., Peiffer Rosca Wolf Abdullah Carr & Kane, Pittsford, New York.

For Respondent AXA Advisors, LLC ("AXA"): Joseph S. Simms, Esq., Reminger Co., LPA, Cleveland, Ohio.

For Respondent Cambridge Investment Research, Inc. ("Cambridge"): Richard J. Babnick Jr., Esq., Sichenzia Ross Ference Kesner, LLP, New York, New York.

CASE INFORMATION

Statement of Claim filed on or about: November 28, 2016.
Amended Statement of Claim filed on or about: November 20, 2017.
Sandra J. Fitzpatrick signed the Submission Agreement: November 28, 2016.
James W. Fitzpatrick signed the Submission Agreement: November 28, 2016.
The Fitzpatrick Family Trust signed the Submission Agreement: April 22, 2019.

Respondent AXA filed Statement of Answer on or about: February 9, 2017.
Answer to Amended Statement of Claim filed on or about: January 2, 2018.
AXA Advisors, LLC signed the Submission Agreement: February 9, 2017.

Respondent Cambridge filed Statement of Answer on or about: February 1, 2017.
Answer to Amended Statement of Claim filed on or about: January 3, 2018.
Cambridge Investment Research, Inc. signed the Submission Agreement: December 6, 2016.

CASE SUMMARY

Claimants asserted the following causes of action: negligence, violation of FINRA Rule 2111; violation of FINRA Rule 2110; negligent misrepresentation and omission of material facts; and breach of fiduciary duty. The causes of action relate to life insurance policies and variable annuities.

Unless specifically admitted in the Statement of Answer, Respondent AXA denied the allegations made in the Statement of Claim and asserted various affirmative defenses.

Unless specifically admitted in the Statement of Answer, Respondent Cambridge denied the allegations made in the Statement of Claim and asserted various affirmative defenses.

RELIEF REQUESTED

In the Statement of Claim and Amended Statement of Claim, Claimants requested all loss of principal; interest; commissions and fees paid by Claimants; loss of income, non-pecuniary losses; attorneys' fees; costs and other expenses; pre-judgment and post-judgment interest; all other sums Claimants are entitled to at law or equity; and punitive damages.

In the Statement of Answer and Answer to Amended Statement of Claim, Respondent AXA requested Claimants' claims be denied in their entirety and that the Panel award AXA costs; attorneys' fees; assess forum fees against Claimants; include within the award a recommendation for a court order that all reference to this matter in the regulatory records be expunged; and such other and further relief as the Panel deems appropriate.

In the Statement of Answer and Answer to Amended Statement of Claim, Respondent Cambridge requested that the Panel deny Claimants' claims with prejudice and issue such other further relief that the Panel deems just, equitable, and proper.

In their post-hearing brief, Claimants requested $13,228,038.00 plus post-award interest.

OTHER ISSUES CONSIDERED AND DECIDED

The Arbitrators acknowledge that they have each read the pleadings and other materials filed by the parties.

On November 20, 2017, Claimants filed a Motion to Amend the Statement of Claim. Respondents did not oppose the Motion to Amend. By Order dated December 12, 2017, the Panel granted Claimants' Motion to Amend the Statement of Claim.

By correspondence dated January 23, 2018, Claimants notified FINRA Dispute Resolution that they have settled their claims against Respondent Cambridge and dismissed their claims against Respondent Cambridge with prejudice.

The parties present at the hearing have agreed that the Award in this matter may be executed in counterpart copies or that a handwritten, signed Award may be entered.

AWARD

After considering the pleadings, the testimony and evidence presented at the hearing, and the post-hearing submissions, the Panel has decided in full and final resolution of the issues submitted for determination as follows:

1. Respondent AXA is liable for and shall pay to Claimants James W. Fitzpatrick, Sandra J. Fitzpatrick, and The Fitzpatrick Family Trust the sum of $2,224,671.94 in compensatory damages.

2. Respondent AXA is liable for and shall pay to Claimants James W. Fitzpatrick, Sandra J. Fitzpatrick, and The Fitzpatrick Family Trust interest on the above-stated sum at the rate of 9% per annum from 30 days after the date of the award until the award is paid in full.

3. Respondent AXA is liable for and shall pay to Claimants James W. Fitzpatrick, Sandra J. Fitzpatrick, and The Fitzpatrick Family Trust the sum of $67,293.64 in costs.

4. Respondent AXA is liable for and shall pay to Claimants James W. Fitzpatrick, Sandra J. Fitzpatrick, and the Fitzpatrick Family Trust the sum of $889,868.78 in attorneys' fees. The Panel determined it is authorized to award attorneys' fees because both Claimants and Respondent AXA requested attorneys' fees in the pleadings.

5. Respondent AXA's request for specific performance/expungement is denied.

6. Any and all claims for relief not specifically addressed herein, including punitive damages, are denied.

FEES

Pursuant to the Code of Arbitration Procedure, the following fees are assessed:

Filing Fees
FINRA Office of Dispute Resolution assessed a filing fee* for each claim:

Initial Claim Filing Fee	=$ 1,575.00

**The filing fee is made up of a non-refundable and a refundable portion.*

Member Fees
Member fees are assessed to each member firm that is a party in these proceedings or to the member firms that employed the associated person at the time of the events giving rise to the dispute. Accordingly, as parties, Respondents AXA and Cambridge are each assessed the following:

Member Surcharge	=$ 1,900.00
Member Process Fee	=$ 3,750.00

Discovery-Related Motion Fee
Fees apply for each decision rendered on a discovery-related motion.

Three (3) decisions on discovery-related motions on the papers with one (1) arbitrator @ $200.00/decision	=$ 600.00

Claimants submitted one discovery-related motion
Respondent Cambridge submitted two discovery-related motions

Total Discovery-Related Motion Fees	=$ 600.00

The Panel has assessed $400.00 of the discovery-related motion fees jointly and severally to Claimants.
The Panel has assessed $200.00 of the discovery-related motion fees to Respondent Cambridge.

Hearing Session Fees and Assessments
The Panel has assessed hearing session fees for each session conducted. A session is any meeting between the parties and the arbitrators, including a pre-hearing conference with the arbitrators, that lasts four (4) hours or less. Fees associated with these proceedings are:

One (1) pre-hearing session with the Panel @ $1,125.00/session	=$ 1,125.00
Pre-hearing conference: April 17, 2017 1 session	

Seventeen (17) hearing sessions @ $1,125.00/session			=$19,125.00
Hearing Dates:	February 20, 2018	2 sessions	
	February 21, 2018	2 sessions	
	February 22, 2018	2 sessions	
	February 23, 2018	2 sessions	
	September 13, 2018	2 sessions	
	September 14, 2018	2 sessions	
	September 15, 2018	2 sessions	
	September 16, 2018	2 sessions	
	November 1, 2018	1 session	
Total Hearing Session Fees			=$20,250.00

The Panel has assessed the $20,250.00 hearing session fee to Respondent AXA.

All balances are payable to FINRA Office of Dispute Resolution and are due upon receipt.

ARBITRATION PANEL

Krista Gottlieb	-	Public Arbitrator, Presiding Chairperson
Jeffrey M. Bain	-	Public Arbitrator
Thomas E. Webb, Jr.	-	Public Arbitrator

I, the undersigned Arbitrator, do hereby affirm, pursuant to Article 7507 of the Civil Practice Law and Rules, that I am the individual described herein and who executed this instrument which is my award.

Concurring Arbitrators' Signatures

Krista Gottlieb
Public Arbitrator, Presiding Chairperson

4-25-19
Signature Date

Jeffrey M. Bain
Public Arbitrator

Signature Date

Thomas E. Webb, Jr.
Public Arbitrator

Signature Date

April 25, 2019
Date of Service (For FINRA Office of Dispute Resolution office use only)

ARBITRATION PANEL

Krista Gottlieb	-	Public Arbitrator, Presiding Chairperson
Jeffrey M. Bain	-	Public Arbitrator
Thomas E. Webb, Jr.	-	Public Arbitrator

I, the undersigned Arbitrator, do hereby affirm, pursuant to Article 7507 of the Civil Practice Law and Rules, that I am the individual described herein and who executed this instrument which is my award.

Concurring Arbitrators' Signatures

Krista Gottlieb
Public Arbitrator, Presiding Chairperson — Signature Date

Jeffrey M. Bain
Public Arbitrator — April 25, 2019 — Signature Date

Thomas E. Webb, Jr.
Public Arbitrator — Signature Date

April 25, 2019
Date of Service (For FINRA Office of Dispute Resolution office use only)

ARBITRATION PANEL

Krista Gottlieb	-	Public Arbitrator, Presiding Chairperson
Jeffrey M. Bain	-	Public Arbitrator
Thomas E. Webb, Jr.	-	Public Arbitrator

I, the undersigned Arbitrator, do hereby affirm, pursuant to Article 7507 of the Civil Practice Law and Rules, that I am the individual described herein and who executed this instrument which is my award.

Concurring Arbitrators' Signatures

Krista Gottlieb
Public Arbitrator, Presiding Chairperson

Signature Date

Jeffrey M. Bain
Public Arbitrator

Signature Date

Thomas E. Webb, Jr.
Public Arbitrator

4/25/2019
Signature Date

April 25, 2019
Date of Service (For FINRA Office of Dispute Resolution office use only)

Exhibit 6

BEFORE THE FINANCIAL INDUSTRY REGULATORY AUTHORITY

IN THE MATTER OF ARBITRATION BETWEEN:

[redacted]

CLAIMANTS

V. **FINRA CASE NO.** [redacted]

[redacted]

RESPONDENTS

CLAIMANTS' OPPOSITION TO RESPONDENTS' FINRA RULE 12509 SUPPLEMENTAL MOTION TO COMPEL

Claimants respectfully file this Opposition to Respondents' FINRA Rule 12509 Supplemental Motion to Compel, and in support thereof, state as follows:

ARGUMENT

Respondents' Supplemental Motion to Compel is the latest tactic in their ongoing abuse of this arbitration proceeding, and it should be denied. Instead of defending this case, Respondents filed a frivolous counterclaim, made false accusations, withheld documents, manipulated documents, and ignored the Chair's discovery orders. Now, with their Supplemental Motion, Respondents have stooped to a new low – they want to invade the attorney work product doctrine.

"The work product doctrine protects an attorney's thoughts, mental impressions, strategies, and analysis from discovery by opposing counsel." *Hickman v. Taylor*, 329 U.S. 495, 510-11 (1947)[1].

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[1] The Supreme Court in *Hickman* succinctly determined that requests to invade work product are off-limits:

> Proper preparation of a client's case demands that **he assemble information, sift what he considers to be the relevant from the irrelevant facts**, prepare his legal theories and plan his strategy **without undue and needless interference**. That is the historical and the necessary way in which lawyers act within the framework of our system of jurisprudence to promote justice and to protect their clients' interests. This work is reflected, of course, in interviews, statements, memoranda, correspondence, briefs, mental impressions, personal beliefs, and countless other tangible and intangible ways – aptly though roughly termed…as the "Work product of the lawyer."

Hickman, 329 U.S. at 510-11 (emphasis added).

"Not even the most liberal of discovery theories can justify unwarranted intrusions into the files and mental impressions of an attorney." *Id.* at 510. The attorney work product doctrine exists "to promote the adversary system by safeguarding the fruits of an attorney's trial preparations from the discovery attempts of an opponent." *Shields v. Sturm, Ruger & Co.*, 864 F.2d 379, 382 (5th Cir. 1989). It is universally recognized that attorney work product is not discoverable. *See Hickman, supra.*; *see also Hewes v. Langston*, 853 So.2d 1237, 1245 (Miss. 2003).

By seeking Claimants' attorney work product, Respondents are trying to shift their burden of proof. This is a common tactic with frivolous trade secret claims -- a plaintiff will file a complaint for trade secret misappropriation, and then try to get discovery from the defendant without first proving what trade secrets are at issue and how they were misappropriated. Once the plaintiff gets hold of the defendants' sensitive information, the plaintiff will miraculously claim that what is discovered is the plaintiff's own property.

But the discovery at issue here is attorney work product. Claimants' counsel arbitrated this same [redacted] fraud in the [redacted] arbitration, and along with this case, they have developed extensive work product which the law protects from disclosure. Respondents want this work product so they can undermine Claimants' fraud case, and their alleged "counterclaim" is their vehicle to do this. Nonetheless, Respondents are not entitled to this discovery. Instead, they must be held to their own burden of proof which requires them to come forward with their alleged "trade secrets" and show misappropriation. *See* MISSISSIPPI UNIFORM TRADE SECRETS ACT, generally, 75-26-3, *et seq.*

Respondents have never identified the alleged "trade secrets" they contend have been "misappropriated," nor have they proven how filing a Statement of Claim misappropriates anything. And the reason is because there are no "trade secrets" at issue, and filing a Statement of Claim is not a misappropriation.

CONCLUSION

Respondents should not be allowed to invade Claimants' counsels' work product. Claimants respectfully request that this Panel enter an Order denying Respondents' Supplemental Motion to Compel. Claimants also request this Panel assess all fees and costs associated with this Supplemental Motion upon Respondents.

[redacted]

Respectfully submitted:

/s/ Judson M. Lee
Judson M. Lee (MB# 100701)
[redacted]
Attorneys for Claimants

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[redacted]

CERTIFICATE OF SERVICE

I hereby certify that the foregoing was served via electronic mail through the FINRA dr portal to:

[redacted]

/s/ Judson M. Lee
Judson M. Lee

Exhibit 7

FINRA

Office of Dispute Resolution

Version: October 2018

Click on each button below to learn more.

- **Discovery Deadlines**
- **Scheduling the Hearing**
- **Adjournments**
- **Direct Communication**
- **Decisions**

Discovery Deadlines

Arbitrators should take all steps within their authority to help expedite the exchange of documents and the identification of witnesses. During the IPHC, the panel should establish a discovery cut off as close to the IPHC date as possible. FINRA also recommends that the panel set the deadline for the filing of discovery motions no more than three months after the IPHC date.

Scheduling the Hearing

Arbitrators should schedule dates that will expedite the process but still provide a reasonable amount of time for case preparation. FINRA encourages parties and arbitrators to schedule the hearing within six months from the date of the IPHC. FINRA also recommends setting aside extra dates to avoid delay in the arbitration process.

Adjournments

When deciding adjournment requests, arbitrators should be mindful of the age and health of parties or key witnesses. In addition, arbitrators are expected to avoid causing postponements absent a genuine emergency.

Direct Communication

FINRA asks the parties and arbitrators to consider agreeing to direct communication in this matter if all parties are represented by counsel.

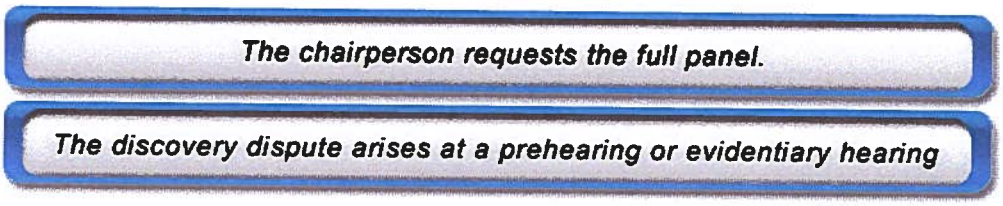
Decisions

Arbitrators should return orders and decisions to FINRA as soon as possible, preferably by email or through the portal (on DR Portal cases). To facilitate prompt return, arbitrators can sign orders and Awards electronically.

FINRA intends for these measures to improve the arbitration process for disputes involving senior or seriously ill parties, while maintaining procedural balance and fairness for all involved parties.

Manage the Discovery Process

Generally the chairperson of the panel will manage the discovery process. In some cases, however, the full panel will resolve discovery issues together. There may be times when you are asked to help facilitate the discovery process. This may occur when:



If you are selected, one of your primary goals is to encourage the parties to be ready for the hearing on the scheduled dates.

The steps you will take will vary by case:

- In some cases, the parties voluntarily exchange documents and information. You will take no action until the hearing.
- In other cases, you will facilitate the discovery process. After gathering the facts involved in a discovery dispute—either through written papers, a prehearing conference, or both—you will decide if and when the parties exchange documents and information.

In this lesson, we will look at situations when you will need to rule on discovery issues to provide all parties with a fair opportunity to prepare their cases.

Specifically, we will review:

- document production lists;
- ruling on requests based on the papers;
- scheduling a prehearing conference; and
- conducting a prehearing conference.

We will begin our review by looking at document exchange under "Using the Document Production Lists" in the Discovery Guide.

Document Production Lists for Use in Customer Arbitrations

The Discovery Guide and Document Production Lists (Lists) supplement the discovery rules 12505-12511 in the Code. The Code and the Discovery Guide work together to streamline the exchange of essential documents among the parties in customer cases without staff or arbitrator intervention.

The Discovery Guide contains two Lists of presumptively discoverable documents: one for firms/associated persons to produce and one for customers to produce. The Discovery Guide, including the Lists, serves as a guide for the parties and the arbitrators. While the parties and arbitrators should consider the documents described in the Lists presumptively discoverable, the parties and the arbitrators retain their flexibility in the discovery process. Arbitrators can: order the production of documents not provided for by the Lists; order that the parties do not have to produce certain documents on the Lists in a particular case; and alter the production schedule described in the 12500 series of rules.

Unless the parties agree otherwise, within 60 days of the date that the answer to the statement of claim is due, the parties must either produce to all parties all documents in their possession or control that are described in the Lists, identify and explain the reasons that specific documents in the Lists cannot be produced within the required time, or object to the production of specific documents. Parties must respond to all other document requests within 60 days from the date a discovery request is received.

Now, let's look at how you will facilitate the discovery process by ruling on the parties' motions and responses, also known as the papers.

Discovery Guide:
http://www.finra.org/arbitration-and-mediation/discovery-guide

12505-12511:
http://www.finra.org/finramanual/rules/r12505

Rule on Requests Based on the Papers

As we discussed in the introduction, the purpose of arbitration is to provide a quick, fair, and relatively inexpensive method of resolving disputes. These objectives can only be reached through proper management by the arbitrators.

At any time, a party may contact FINRA about discovery problems it is encountering. Most discovery requests and motions allege that the opposing party did not produce requested documents and information. Rules 12506 and 12507 of the Code require parties to produce documents or file a written objection within 60 days of receiving a request.

Not every request for documents is proper. It will be your job to deny improper requests and make sure there is compliance with proper requests.

Rule 12503 authorizes the selected arbitrator, usually the chairperson, to act on behalf of the panel with respect to ordering the production of documents.

Under Rule 12503, a party may file a written motion by serving it directly on each party, at the same time and in the same manner. Motions must also be filed with FINRA with additional copies for each arbitrator. Parties have 10 days from receipt of a written motion to respond unless the moving party agrees to an extension or the Director or panel decides otherwise. Parties have 5 days from the receipt of a response to a motion to reply to the response unless the responding party agrees to an extension of time, or the Director or the panel decides otherwise. Written motions must be served at least 20 days before a scheduled hearing, unless the panel decides otherwise.

Occasionally, a party may attempt to contact you directly about a discovery dispute. Do not speak with a party about the case. Refer the caller to FINRA staff. Ex parte communication (arbitrator communication with only one party without the presence of the other parties) is prohibited. We will discuss this important issue later.

Under some circumstances, you can rule on a discovery request based exclusively on the motion and responses submitted without a formal conference. If you are unable to make an informed ruling based solely on the papers, contact FINRA staff and request that a prehearing conference be scheduled with the parties.

You may request a prehearing conference if you determine a discussion with the parties would help you clarify and resolve the issue. A ruling on the papers, however, might be more economical and expeditious. Remember, you can also request more information in writing from the parties prior to making a decision.

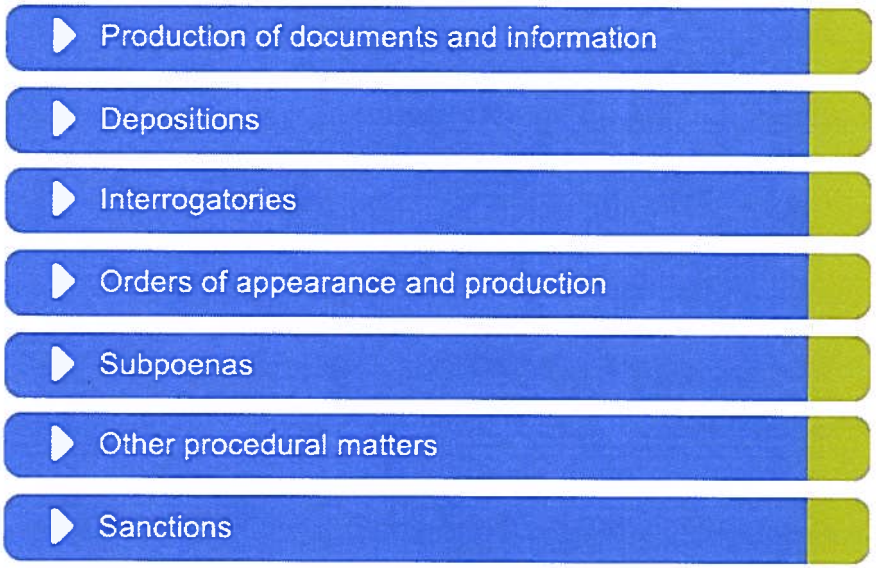
12506:
http://www.finra.org/finramanual/rules/r12506

12507:
http://www.finra.org/finramanual/rules/r12507

12503:
http://www.finra.org/finramanual/rules/r12503

Common Discovery Requests

While discovery disputes occur frequently, the same issues often repeat themselves. Common requests you will see from the parties include:



Our next area of review discusses the process you will use to rule on each of these discovery-related requests.

Production of Documents and Information

Nowhere has the expansion of discovery been more pronounced than in requests for documents. The increase is not surprising because documentation often plays a primary role in the outcome of a case. At the same time, however, parties can use document requests to harass and burden their opponent.

In this section, we will review the issues that arise with document requests and the questions you should ask yourself before ruling on these requests.

As the selected arbitrator, you must decide if a document request is reasonable. Please review the Arbitrator's Guide to assist you with this determination.

Occasionally, you may want to use the expertise of other panel members in making a decision. In this situation, contact FINRA staff and request that the full panel be convened or call the other panel members directly.

To determine whether a document request is reasonable, your first goal will be to determine whether the document is relevant or likely to lead to relevant evidence.

Only after determining that documents are relevant, or likely to lead to relevant evidence, should you consider the cost or burden of production. If a party has demonstrated that the cost or burden of production is disproportionate to the need for the documents, see whether there are alternatives that can lessen the impact, such as narrowing the relevant time frame or scope of the request, or whether other documents can provide the same information.

Confidentiality and Discovery

If a party objects to document production on grounds of privacy or confidentiality, arbitrators or one of the parties may suggest a stipulation between the parties that the documents in question will not be disclosed or used in any manner outside of the arbitration of the particular case, or the arbitrators may issue a confidentiality order. Arbitrators may also want to consider ordering the redaction (removal) of names or other information, or having the parties sign confidentiality agreements.

Ideally, the parties will agree on the form and content of a confidentiality order. In some instances, however, the parties will not agree on what is or is not confidential. When deciding contested requests for confidentiality orders, arbitrators should consider the competing interests of the parties. The party asserting or requesting confidentiality has the burden of establishing that the documents or information in question are entitled to confidential treatment. Arbitrators should not automatically designate all documents as confidential.

When the party requesting confidentiality has met the burden of establishing the need for confidentiality of certain documents or information, arbitrators should strive to accomplish the confidentiality sought in the least restrictive manner possible. In considering questions about confidentiality, arbitrators may consider the following factors:

- **Whether the disclosure would constitute an unwarranted invasion of personal privacy (*e.g.*, an individual's Social Security number, or medical information).**
- **Whether there is a threat of harm attendant to disclosure of the information.**
- **Whether the information contains proprietary confidential business plans and procedures or trade secrets.**
- **Whether the information has previously been published or produced without confidentiality or is already in the public domain.**
- **Whether an excessively broad confidentiality order could be against the public interest or could otherwise impede the interests of justice.**
- **Whether there are legal or ethical issues which might be raised by excessive restrictions on the part.**

Arbitrators shall not issue an order or use a confidentiality agreement to require parties to produce documents otherwise subject to an established privilege, including the attorney-client privilege and the attorney work product doctrine.

Arbitrator's Guide:
http://www.finra.org/arbitration-and-mediation/arbitrators-guide

Test Yourself

Fox Anderson, a customer of EZE Securities, alleged that a number of unauthorized trades of Smart securities were made in his account. As part of a document request, Anderson's representative demanded that EZE produce all order tickets of its clients for the past three years who had purchased Smart securities. Counsel for EZE objected to the request, arguing that the request is not relevant and production is burdensome.

What action would you take?

Question Feedback

You could order EZE to produce the Smart securities order tickets of Claimant Anderson or some other document containing this information. As to the production of other customer order tickets, you might not order their production unless they are shown to be relevant and, if relevant, you may order that EZE redact the other client names to protect privacy interests.

Test Yourself

Assume for the moment that in addition to order tickets of other EZE clients, Mr. Anderson requested the account statements for other customers who had alleged unauthorized trades by the same broker. In response, EZE's counsel objected because account statements are confidential. Assume the documents are relevant or the documents may lead to relevant evidence and outweigh the burden involved.

What steps might you take? Why?

Question Feedback

Because the requested items contain confidential information, you could order EZE to redact customer names from the documents. If more serious proprietary (confidential or private) information is involved, you might ask the parties to sign a confidentiality statement regarding the information.

Production of Documents and Information (continued)

Each document request must be considered on a case-by-case basis. For example, a case involving a broker's failure to execute a trade normally does not require a voluminous exchange of documents. While trade documentation would be relevant, the claimant's financial situation might not be relevant.

Once you issue a ruling, incorporate it into a written order with a deadline for compliance. Your written ruling should be submitted to FINRA for service upon the parties.

Test Yourself

Assume that respondent's counsel requested any telephone notes made by the customer relating to the transactions in dispute. According to the customer's response, the notes could not be located. What steps might you take?

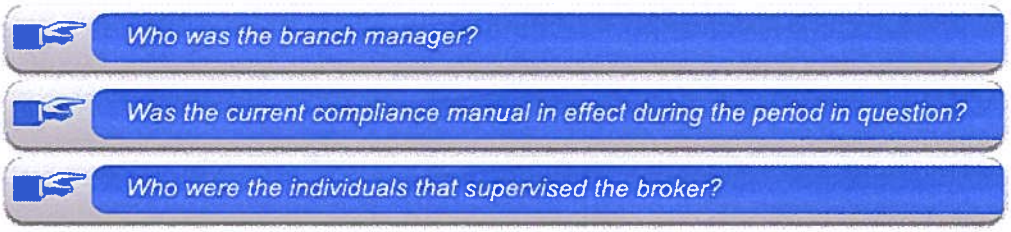
Question Feedback

You could order the customer to conduct a search and either produce the document or sign an affidavit stating his or her efforts to locate the documents and that the documents could not be located or no longer exist.

Production of Documents and Information (continued)

In addition to requests for documents, parties may request the production of information. Information requests are a form of interrogatory, but are more limited in scope, number, and specificity.

In general, requests for information assist the discovery process. Proper requests for information may include the following:



Questions that ask for opinions or conclusions, rather than seeking information on facts or events, may be improper. For example, a question asked of a witness such as, "What is your understanding of this document?" should generally be left for the hearing.

Limiting the scope of requests for documents and information to the facts of a case keeps the discovery process moving. Identifying issues under contention focuses the parties and prevents unnecessary requests that slow down the process.

Requests for documents and information are just one area in which a dispute may arise during discovery. Another request is to depose a party or witness. We will look at this type of request next.

Depositions

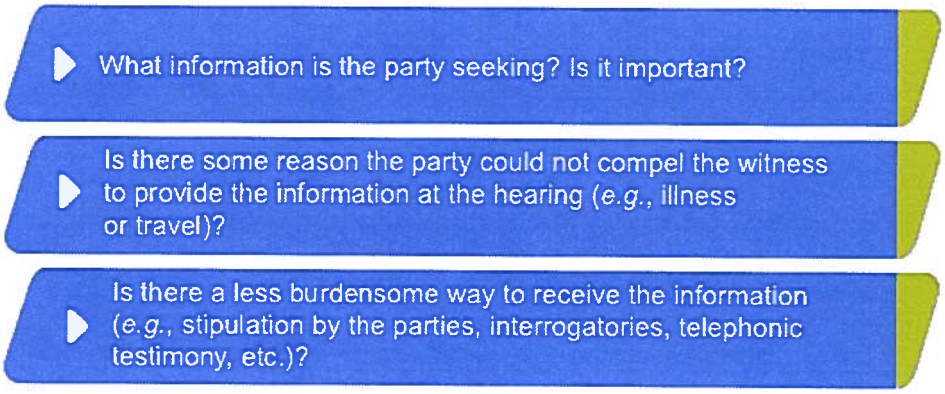
The goal of arbitration is the speedy and inexpensive resolution of a controversy; therefore, depositions are not generally part of the arbitration process. A deposition is the testimony of a witness taken upon oral question or written interrogatories. Depositions are conducted under oath outside of the court room (or arbitration hearing) and are reduced to writing (transcript), authenticated and intended to be used in preparation for hearing.

Depositions are strongly discouraged in arbitration, pursuant to FINRA Rule 12510. However, under Rule 12510, upon motion of a party, arbitrators may permit depositions, but only under very limited circumstances, including:

- to preserve the testimony of ill or dying witnesses;
- to accommodate essential witnesses who are unable or unwilling to travel long distances for a hearing and may not otherwise be required to participate in the hearing;
- to expedite large or complex cases; and
- if the panel determines that extraordinary circumstances exist.

Generally, witnesses may only be compelled to attend a deposition or hearing if it is held within the county in which: they reside, are employed, transact business, or in another convenient location. Ask the parties to provide the applicable state or local laws for your case.

Even when these situations occur, however, you must balance the need for the testimony against the expense and burden inherent in taking a deposition (*e.g.*, travel expenses, attorneys' fees, transcript costs, etc.). Before you rule on a request, you will want to know:



FINRA Rule 12510:
http://www.finra.org/finramanual/rules/r12510

Test Yourself

Prior to a hearing, the respondent's attorney files a motion requesting that you order the deposition of the claimant's wife. Do you have the authority to grant this request? If so, what provides this authority?

Question Feedback

The selected arbitrator has the authority to issue rulings, including an order for deposition, which will expedite arbitration proceedings under Rule 12503 of the Code.

With respect to the request to depose the claimant's wife, you would want further information to determine whether you should grant the order.

You would want to ask the following questions:

- What information is the respondent seeking? Is it relevant or likely to lead to relevant evidence?
- Is there a reason such as illness or distance that prevents the claimant's wife from testifying at the hearing?
- Is there a less burdensome alternative for the party to secure the information?

12503:
http://www.finra.org/finramanual/rules/r12503

Depositions (continued)

Depositions often play an important role in courtroom litigation. You have greater discretion in finding a less expensive alternative, though, because arbitrators are not strictly bound by the rules of evidence.

Another discovery mechanism is interrogatories. We will review this information device next.

Interrogatories

Interrogatories are written questions from one party to another. While less burdensome than depositions, interrogatories can be used to harass an opponent through the sheer volume of the requests.

Many state and federal jurisdictions have adopted limits on the number of interrogatories a party may serve on an opponent during discovery.

While requests for information promote efficient discovery, parties should ask more formal questions at the arbitration hearing itself. For example, asking where a registered person worked might lead to further discovery with respect to those firms. It is a proper request for information. However, asking about the conversations the registered person had with a supervisor may be improper during discovery and could be asked at the hearing.

Test Yourself

In a request for information, the respondent's counsel asks "Who was the broker that handled the transactions for the claimant?" Is this a proper discovery question? Why or why not?

Question Feedback

It is a proper question because it is likely to lead to additional discoverable evidence.

Test Yourself

Counsel for the respondent's next request is, "State how the claimant was introduced to the broker." Is this a proper discovery question? Why or why not?

Question Feedback

No. This question would be more proper at a hearing. There may be times, though, when you will determine that certain interrogatories would streamline a case and would be appropriate.

Orders of Appearance and Production

Rule 12513 permits an arbitrator to order the appearance of any person employed or associated with any member of FINRA—even nonparties—or the production of any documents in the possession or control of such persons. In most instances, arbitrators should issue orders, instead of issuing subpoenas, when industry parties seek the appearance of witnesses or the production of documents from non-party firms or their employees or associated persons.

In general, the process used to order an appearance of a witness or production of documents is the following:

- The requesting party drafts an order and sends it to FINRA staff with copies to all parties to the arbitration.
- The order of appearance or production of documents is treated like a motion under Rule 12503. The responding party(s) must submit a response within 10 days of receipt of the motion, unless the moving party agrees to an extension or the Director or panel determines otherwise. Parties have 5

days from the receipt of a response to a motion to reply to the response unless the responding party agrees to an extension of time, or the Director or the panel decides otherwise. Once FINRA either receives all the responses or the deadline to respond has passed, FINRA staff will forward the request and the responses to the arbitrator for signature.

- The arbitrator promptly rules on the order and returns it to FINRA.
- FINRA returns the signed order of appearance or production of documents to the requesting party who is responsible for serving it on the person named therein, as well as providing copies to all parties to the arbitration.

Unless the panel directs otherwise, the party requesting the appearance of witnesses by or the production of documents from non-parties under this rule shall pay reasonable costs of appearances and/or production.

You will analyze an order of appearance in a manner similar to a request for production of documents. When you receive a request for an order of appearance or production, balance the likelihood of the testimony or documents leading to relevant evidence against the burden to the individual who must appear.

12513:
http://www.finra.org/finramanual/rules/r12513

12503:
http://www.finra.org/finramanual/rules/r12503

Subpoenas

At times, important testimony and documents are not under the control of a brokerage firm or its employees. For such cases, Rule 12512 allows arbitrators to issue subpoenas. Under Rule 12512, only arbitrators are permitted to issue subpoenas for both parties and non-parties, whether for discovery or for appearance at a hearing. Although Rule 12512 authorizes the use of subpoenas, it also states that "to the fullest extent possible, parties should produce documents and make witnesses available to each other without the use of subpoenas."

Parties may make written motions requesting the arbitrator to issue a subpoena to a party or a non-party:

Parties will send their requests for issuance of a subpoena to FINRA and to all parties at the same time and in the same manner. The request must be in the form of a written motion and must include a draft subpoena.

If another party objects to the scope or propriety of the subpoena, that party must–within 10 calendar days of service of the motion–file written objections with FINRA, with an additional copy for the arbitrator, and must serve copies on all other parties at the same time and in the same manner as on FINRA.

The party that requested the subpoena may respond to the objection within 10 calendar days of receipt of the objections.

Once FINRA receives either all of the responses or the deadline to respond has passed, staff will forward the subpoena and the responses to the selected arbitrator for ruling.

After considering timely objections, the arbitrator responsible for deciding discovery-related motions will rule promptly on the issuance and scope of the subpoena.

Arbitrators will use their discretion to determine whether or not to issue a subpoena, and whether or not to limit the scope of the subpoena before it is issued.

After the requesting party receives subpoenaed documents from a non-party, the requesting party must notify all other parties within five calendar days of receipt. If another party requests copies of documents that were received in response to a non-party subpoena, the party that requested the documents must provide the copies within 10 calendar days.

These same principles apply equally when arbitrators are reviewing challenges to subpoenas issued to third parties.

Concerns about confidentiality and privilege might also be raised regarding subpoenas issued to non-parties. Pursuant to Rule 12512, a non-party may file an objection to a subpoena served upon the non-party. The arbitrator may set up a conference call with a non-party and the parties to discuss the non-party's objection to the subpoena. Staff advises the non-party and the parties of the arbitrator's decision. Non-parties also may ask the arbitrators to resolve questions concerning who pays the costs incurred as a result of producing subpoenaed documents.

Unlike orders of appearance for FINRA members, subpoenas may only be issued within geographic limits set by local or state law. For example, in some jurisdictions, you cannot compel the attendance of a witness living or working more than 40 miles from the hearing location.

Third-Party Subpoenas to Regulatory Authorities—Documents with Personal Confidential Information (PCI)

Third-party subpoenas to regulatory authorities present unique situations. These subpoenas often seek documents that may contain personal confidential information (PCI) about customers who are not parties to the arbitration. PCI includes Social Security numbers, brokerage, bank or other financial account numbers and taxpayer identification numbers. Regulatory authorities may have difficulty complying with such subpoenas because of the presence of PCI and may object to the subpoenas.

If a regulatory authority objects to a subpoena because the responsive documents contain PCI, arbitrators may be asked to resolve the dispute. Arbitrators may, in no particular order:

- issue protective orders to limit the use of PCI;
- suggest parties enter into confidentiality agreements;
- require a party to redact PCI; or
- modify the scope of the subpoena.

Let's review examples of requests for orders of appearance and subpoenas.

12512:
http://www.finra.org/finramanual/rules/r12512

Test Yourself

During a prehearing conference, Jack Donaldson, counsel for the claimant, informs you that he will be requesting orders of appearance for eight of the Respondent Tal Jones Securities' registered persons. Respondent objects. What steps might you take? Why?

Question Feedback

You would ask the claimant's counsel why eight witnesses are necessary and determine whether the testimony of the witnesses is cumulative, that is, only adding to or corroborating other testimony.

You could ask whether the respondent would produce the registered persons without an order. According to Rule 12512 of the Code, parties should cooperate in producing witnesses. You could direct Tal Jones' counsel to make the witnesses available.

Test Yourself

Assume that Tal Jones Securities' counsel replied that he would make seven of the eight registered persons available, but that the other individual moved 500 miles away to a neighboring state where he works for another FINRA brokerage firm. What questions might you ask? Why?

Question Feedback

Initially, you would want to know what information the claimant sought from the witness and whether his testimony was necessary. If the information was necessary, ask counsel whether there was a less burdensome way to obtain it, such as telephonic testimony or stipulations of fact.

If you determine the testimony is more critical than the burden of appearing at the hearing, order his appearance pursuant to Rule 12513.

Test Yourself

If the individual was not employed in the securities industry, could you subpoena him or her to appear? Why or why not?

Question Feedback

It is doubtful a witness in another state could be compelled to travel 500 miles to a hearing. If the claimant's counsel requests a subpoena, ask her to provide the statutory authority behind the request.

Subpoenas (continued)

While issues involving subpoenas and orders of appearance are becoming more common, you can limit disagreements by emphasizing to the parties that you expect them to produce documents and make available witnesses who are under their control. Problems still may occur, however, most parties want to cooperate with an arbitrator and will attempt to comply with your request.

Now, let's look at other procedural issues related to discovery.

Other Procedural Matters

If you are the arbitrator selected to facilitate discovery, particularly in large or complex cases, you can do so by ruling on procedural matters. These matters may include:

- stipulations of uncontested facts;
- requiring advance identification of exhibits;
- exchange of witness lists;
- estimating the length of a case; and
- establishing a discovery schedule.

As the selected arbitrator, you may establish rules that can expedite the arbitration proceedings. Normally, you will only make such determinations following a prehearing conference with the parties.

If a pro se party (a party representing himself or herself and appearing without legal representation) is involved, you might become more involved in the discovery process to help move the case along. For example, you might provide specific dates for document requests, responses, and any replies to those requests. However, you must always remain impartial and never become an advocate for any party.

As you have seen, there are a number of gray areas in the discovery process. While ruling on each motion based solely on the papers submitted is desirable, it is not always possible. Hearing the parties may increase your understanding of the key issues of the dispute.

Before we review how to conduct a prehearing conference on issues requiring additional information or clarification, let's review sanctions.

Discovery Sanctions

While Rule 12513 of the Code authorizes the selected arbitrator to direct an appearance, Rules 12212 and 12511 provide the full panel with the authority to enforce orders. Failure to cooperate in the exchange of documents and information as required under the Code may result in sanctions. The panel may issue sanctions against any party in accordance with Rule 12212(a) for:

- failing to comply with the discovery provision of the Code, unless the panel determines that there is substantial justification for the failure to comply; or
- frivolously objecting to the production of requested documents or information.

12513:
http://www.finra.org/finramanual/rules/r12513

12212:
http://www.finra.org/finramanual/rules/r12212

12511:
http://www.finra.org/finramanual/rules/r12511

Sanctions

Under Rule 12212, the panel may sanction a party for failure to comply with any provision in the Code, or any order of the panel or single arbitrator authorized to act on behalf of the panel. Unless prohibited by law, sanctions may include, but are not limited to:

- assessing monetary penalties payable to one or more parties;
- precluding a party from presenting evidence;
- making an adverse inference against the party;
- assessing postponement and/or forum fees;
- assessing attorneys' fees, costs and expenses;
- initiating a disciplinary referral; and
- dismissing with prejudice a claim, defense, or proceeding (see Rule 12513).

If assessing monetary penalties, remember to instruct parties to make them payable to one or more parties. Monetary penalties should not be made payable to FINRA as FINRA is not a party to the arbitration. Awards containing monetary sanctions payable to FINRA are inappropriate.

Arbitrators may also consider these sanctions to address a respondent's failure to sign and submit a Submission Agreement (SA), absent a specific jurisdictional challenge.

Pursuant to Rule 12302, claimants must submit the SA when filing the Statement of Claim; FINRA will not serve the claim until the claimant submits the signed SA. According to Rule 12303, Respondents must file a signed and dated SA within 45 days of receipt of the Statement of Claim.

To ensure parties submit the required SA, the IPHC Script guides arbitrators to remind the parties of their requirement to sign and submit the SA. After the arbitrators acknowledge all pleadings, the script provides that any party who has filed a SA or otherwise objected to jurisdiction must submit it within 30 days or may be subject to sanctions.

As stated in *Notice to Members* 04-11, a party's failure to sign and submit the SA may cause confusion, lead to ancillary litigation, and undermine the enforceability of arbitration awards. For example, Section 13 of the Federal Arbitration Act (FAA) requires that a motion to confirm an arbitration award must include the parties' agreement to arbitrate. Although the claimant may be able to demonstrate that the respondent that failed to execute an SA was nonetheless required to arbitrate pursuant to FINRA rules, failure to execute the SA can unnecessarily hinder the ability of a claimant to seek confirmation of an award pursuant to Section 13 of the FAA.

Occasionally, you will need clarification from the parties before ruling on a request. You may have FINRA coordinate a telephonic conference with the parties to discuss any outstanding issues. Next we will learn how to prepare and conduct a prehearing conference.

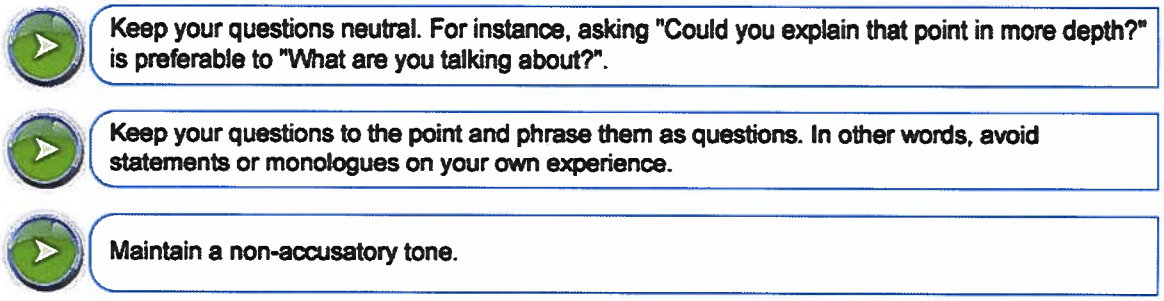
12212:
http://www.finra.org/finramanual/rules/r12212

12513:
http://www.finra.org/finramanual/rules/r12513

12302:
http://www.finra.org/finramanual/rules/r12302

12303:
http://www.finra.org/finramanual/rules/r12303

Notice to Members:
http://www.finra.org/Industry/Regulation/Notices/2004/P003272



If you think that documents not submitted by parties—such as charts, briefs or summaries of legal points, or information already presented—will greatly enhance your ability to decide the case, consider requesting them.

However, there are two potential risks in requesting additional documents at this stage. Asking for additional evidence can be tricky because:

- you may give the impression that you are putting on a party's case for him or her; and
- such documents may catch one or both parties off-guard. If either or both parties appear surprised or ill-prepared, allow them sufficient time to respond.

Now let's see how you will perform another important task of deciding whether to admit evidence.

Rule on the Admissibility of Evidence

While the rules of evidence used in a court may provide guidance, arbitrators are not bound by them (see Rule 12604 of the Code). This does not mean, however, that the panel should accept everything offered into evidence. In fact, the opposing party will probably object to at least some of the evidence introduced.

Because arbitration is less formal than the judicial process, the panel is not bound by the rules of evidence used in court. Arbitrators will decide for themselves whether to admit evidence and how much weight to give it.

12604:
http://www.finra.org/finramanual/rules/r12604

Now let's review how the panel will rule on the:

Click on each button below to learn more.

- **Weight and Relevance of the Evidence**
- **Form and Timing of Questioning**
- **Failure to Comply With the 20-Day Exchange**

We will start with weight and relevance of evidence.

As the parties introduce exhibits, mark each in the order it is introduced.

Weight and Relevance of the Evidence

Just as it was during discovery, relevance is a key factor to consider when deciding whether to admit evidence. When determining relevance, decide how the evidence relates to the issue at hand.

The main question you should ask is: "How much will this document or testimony help prove or disprove the claimant's case (or the respondent's defense)?" Obviously, the parties will try to convince you of their answer to this question.

Another factor that may come up during evidentiary disputes is whether the document or testimony is duplicative or cumulative. If you sense that this is the case, consider whether alternative evidence would serve the same function as the item in question.

Test Yourself

During a hearing on whether a publishing house's penny stock was a suitable investment for the claimant, the respondent submits a copy of a sports magazine containing an article authored by the claimant. When the claimant objects that this exhibit has nothing to do with the disputed transaction, the respondent says it is intended to document the claimant's knowledge of the publishing industry.

How would you rule? Why?

Question Feedback

Because the relevance of this exhibit appears peripheral, you would probably sustain the objection. Authoring an article in one magazine does not mean the claimant has in-depth knowledge of the publishing industry or knowledge regarding the stock offerings of a publishing house.

Weight and Relevance of the Evidence (continued)

Admissibility and Reliability of the Evidence

In addition to determining if evidence is relevant, also consider the form in which it is offered. The reliability of the evidence may also be considered. For example, if a party offers a copy of a financial blog on the Internet, you may determine that it is not sufficiently reliable to establish the facts stated. An official public record, on the other hand, generally has higher indicia of reliability.

A party may object to the admissibility of evidence on the grounds that it is prejudicial. In such a situation, you must determine whether any prejudice outweighs the "probative value" of the evidence (the degree of relevance and usefulness of the evidence in determining the facts of the case). If you decide the value of the evidence is greater than the prejudice, it should be admitted; if you decide that the prejudicial effect is greater than the value of the evidence, it should not be admitted.

Form and Timing of Questioning

Even after you have decided that a witness's testimony is relevant, the panel will probably have to rule on objections as to how that testimony is elicited.

To expedite the hearing, the chairperson may, with the panel's permission, rule on the panel's behalf on evidentiary and procedural objections. However, if an objection is unusual or has the potential to materially impact the case, then the entire panel should discuss it in executive session before ruling.

Here are a few testimony-related issues the panel may be asked to rule on:

- leading questions;
- argumentative questions;
- repetitive questions that have already been asked and answered;
- misquoting the witness;
- questions with insufficient foundation;
- questions that assume facts not yet in evidence;
- questions too complex or convoluted to answer;
- abusive questioning;
- witness questioning counsel;
- rambling testimony with no question; and
- non-responsive answers.

Upholding an objection to the timing or the form of a question does not mean the question may not be asked, just that it be asked at a different time or in a different manner.

The chairperson should be careful that the panel's rulings are consistent and even-handed as to all parties. Fairness is the ultimate objective in this proceeding.

Now let's look at another issue: failure to produce evidence during discovery.

Failure to Comply With the 20-Day Exchange

Earlier, you learned that during discovery, parties sometimes indicate that they cannot produce a document because it no longer exists (or never did). When a party makes such a claim, the chairperson or selected arbitrator may direct the party to state in a sworn, written statement called an affidavit that it doesn't exist.

Rule 12514 requires parties to provide each party with copies of all documents and other materials in their possession or control that they intend to use at the hearing that have not already been produced, at least 20 days before the first scheduled hearing date. The idea behind the 20-day rule is not to penalize parties who produce documents late, but to maintain a level playing field by giving the other side ample opportunity to digest the documents.

Documents not exchanged or witnesses not identified may be barred from the hearing, unless the panel determines that good cause exists for the failure to produce the document or identify the witness. Good cause includes the need to use documents or call witnesses for rebuttal or impeachment purposes based on developments during the hearing. Documents and lists of witnesses in defense of a claim are not considered rebuttal or impeachment information and, therefore, must be exchanged by the parties.

Failure to produce documents under the 20-day rule can present issues for the panel, especially in long, antagonistic hearings. Here are some issues to consider:

- If the document was exchanged, how late was the exchange?

- How long did the party hold on to the document before exchanging it?
- Is the complaining party prejudiced in any way? If so, how can the prejudice be remedied?
- Was the document exchanged late for reasons beyond the producing party's control?

Another violation of the 20-day rule occurs when items prepared by a third party—such as expert documents—are produced late. In such cases, determine if the parties exchanged documents as soon as possible.

Nothing slows down a case as much as late exchange or non-exchange of evidence. Barring circumstances beyond the party's control, such behavior is a violation of the Code—not to mention unfair.

The panel may handle this issue proactively by giving the parties one last chance to exchange documents and identify witnesses before excluding them. For example, the chairperson might make the following statement on the record:

The panel is concerned over the failure of the parties to comply with Rule 12514 of the Code, but would like to allow the parties one last chance to exchange documents and identify witnesses under this section. Any further violations of Rule 12514 may result in exclusion of the document or witness.

Now, let's look at a few examples.

12514:
http://www.finra.org/finramanual/rules/r12514

Test Yourself

In an employment case, the respondent repeatedly presents excerpts of the firm's employee handbook on respondent's direct examination. The handbook outlines behavior a broker-dealer must follow. Claimant objects that she was never furnished copies of the handbook during the course of document production. After numerous arguments, the chairperson calls an executive session to discuss the problem.

What might you recommend? Why?

Question Feedback

When faced with a situation such as this one, the panel might consider asking the parties to address whether:

- the document should have been produced either during the course of discovery or as part of the 20-day identification of documents and witnesses;
- the document is rebuttal material (although in this example its use on direct examination suggests otherwise);
- the significance of the document to be produced;
- the extensiveness of the document to be produced; and
- the panel has previously allowed both sides to offer documents that had not previously been produced.

If the submitting party has no good reason why the document was not previously provided, the panel should consider excluding it. Withholding documents contrary to FINRA rules wastes the time of the parties and the panel and causes undue surprise and prejudice to the party against whom the document is produced.

On the other hand, the panel may decide not to exclude the document. If the panel so decides, it should take sufficient steps to reduce any prejudice to the party objecting to the document. Such steps may

include:

- time to review the document;
- the opportunity to re-call witnesses whose testimony regarding the document might be relevant; and
- sanctions against the party who did not timely produce the document.

Test Yourself

During a hearing, the claimant alleges that options were unsuitable for him. In his statement of claim, he maintains he has never traded options before. During cross-examination, the respondent asks the claimant to identify other broker-dealers with which he had accounts over the last 10 years. When the claimant names three other firms, the respondent turns to the panel and says the claimant had stated earlier that he never had an account before. The respondent requests an adjournment to allow her to obtain and review monthly account statements from the other three firms. The claimant objects to this delay.

How would you handle this situation? Why?

Question Feedback

Discuss the matter with the panel in an executive session. You may grant the motion so the respondent can obtain and review copies of the account statements. The claimant may or may not have had experience trading options; in any case, the statements are relevant to the claimant's financial experience and sophistication. You may consider assessing costs of the postponement in your final award.

Facilitate Testimony by Telephone or Affidavit

Live testimony is most common and preferred, but sometimes parties agree to testimony by telephone. This may occur because a party or a witness may be unable to physically appear at the hearing or cannot be subpoenaed or ordered to appear. In such a situation, the parties may agree that the witness be allowed to testify by telephone conference. Ordinarily, this agreement is made before the evidentiary hearing. Where parties agree, arbitrators should allow testimony by telephone.

Click on each button below to learn more.

- **Telephonic Testimony**
- **Disagree on Telephonic Testimony**

Telephonic Testimony

If allowing telephonic testimony—either by agreement of the parties or by ruling of the panel—the chairperson should:

- swear in or affirm the witness as usual, but modify the oath to have the witness confirm that she is who she claims to be. If you have doubts, consider having a notary present at the witness's location;
- have the party calling the witness initiate the call;
- identify yourself and tell the witness who else is listening to the testimony;
- do all the same things you would do if the witness were present: explain the testimony process,

obtain a vocal introduction for the record, and caution the witness not to discuss the case with other witnesses;
- make sure the parties have advised the witness what documents—such as order tickets, letters, written supervisory procedures—will be referred to during testimony. Through the parties, confirm that the witness has all, and only, those documents that the parties will reference during questioning; and
- confirm with the witness that he or she is alone in a private room. By preventing disruptions of the testimony, you protect both the accuracy and efficiency of the testimony.

Disagree on Telephonic Testimony

If parties disagree about telephonic testimony, consider the following:

- the witness' reason for not attending in person;
- whether the person is a less critical witness whose testimony will be short;
- whether the witness will comment on documentary evidence not in his or her possession—and any difficulty involved in relaying those documents;
- whether credibility is an issue. If so, consider whether you can judge the witness' credibility over the phone; and
- whether a video conference is available and can remedy any of the issues presented.

As an alternative to telephonic testimony, a party may wish to submit evidence in an affidavit.

Affidavits are allowed in cases filed pursuant to FINRA Rule 12800 (Simplified Arbitration) because it is the best method available for parties to use to present sworn testimony. (Simplified Arbitration cases are those that are decided on the papers submitted to a single arbitrator without a live hearing.)

In contrast, affidavits are infrequently submitted in an evidentiary hearing for anything other than ministerial matters, like authenticating third-party records. To consider a request to submit an affidavit in an evidentiary hearing, the panel should meet in an executive session to discuss why the witness cannot attend the hearing (or at least testify by telephone), and whether to admit such testimony.

12800:
http://www.finra.org/finramanual/rules/r12800

Test Yourself

Do you see any potential problem when testimony is admitted by affidavit? How do you think the panel might address such problems?

Question Feedback

While formal rules of evidence do not apply to arbitration, testimony by affidavit from a witness who could testify in person or by telephone prevents one party from cross-examining that witness. After all, the opposing party cannot cross-examine an affidavit.

Affidavits are infrequently submitted in an evidentiary hearing for anything other than ministerial matters, like authenticating third-party records. If the panel, however, decides to admit an affidavit, the chairperson may state that its weight as evidence may be diminished, because the opposing party will not have a chance to challenge the truth of the statements it contains.

MIXED MEDIA FOR A SUCCESSFUL PRESENTATION

Hugh Berkson & Sam Edwards[1]

Introduction

There is a substantial body of scientific research devoted to the subject of how people learn, and whether they learn better via visual or auditoria media. It should come as no surprise to most legal tacticians, but the consensus among those who have conducted the research is that people: (1) process visual information more quickly than they do auditory information; (2) focus on color graphics more than they do black and white ones; (3) retain information gleaned from visuals longer than they do from oral presentations; and, (4) respond best to a mix of oral and visual presentation of information.

While this is hopefully not new information for most seasoned litigators, gaining a better understanding of *why* these things are true should help a trial lawyer use mixed media to the best advantage for his or her clients and cases.

Visual vs Oral Presentations

Those who have researched the subject of whether visual or oral presentations are more compelling weigh in favor of visual ones. Why would that be the case? First, there is a long history of humans using visual images. We have used pictures to record our experiences for 250 centuries, pictograms and ideograms for the next 20 centuries, and words for only the remaining 15 centuries.[2] Second, the majority of information we perceive is visual. In fact, approximately 90% of information the brain receives is non-verbal.[3] This tilt of information is not accidental, but rather hard wired into our systems in such a way that humans process visuals more quickly than they do text –60,000 times faster.[4] And, third, Biology explains this huge disparity in learning as well our natural inclination towards visual information. In the human body, 40% of nerve fibers are linked to the retina.[5] Additionally, the part of the brain used to process words is small in

[1] Hugh Berkson is a principal with McCarthy, Lebit, Crystal & Liffman Co., LPA in Cleveland. He is a past-president of PIABA and has served on PIABA's board of directors since 2011. Sam Edwards is a partner with Shepherd Smith Edwards & Kantas in Houston. He is the current President of PIABA and has served on its board of directors since 2013?

[2] Dewan, Pauline, *Words Versus Pictures: Leveraging the Research on Visual Communication*, Partnership Vol. 10, No. 1 (2015); available at: https://journal.lib.uoguelph.ca/index.php/perj/article/view/3137.

[3] www.pixelo.net/visuals-vs-text-content-format-better/ (March 21, 2018).

[4] Gillet, Rachel, *Why We're More Likely To Remember Content With Images And Video*, Fast Company (Sept. 18, 2014; available at https://www.fastcompany.com/3035856/why-were-more-likely-to-remember-content-with-images-and-video-infogr (Referencing a 3M study).

[5] Jandhyala, Dana, *Visual Learning: 6 Reasons Why Visuals Are The Most Powerful Aspect of eLearning*, (Dec 8, 2017); available at: https://elearningindustry.com/visual-learning-6-reasons-visuals-powerful-aspect-elearning.

comparison to the part that processes visual images.[6] Humans can therefore: see images that last for 13 milliseconds; gain the sense of a visual scene in 1/10 of a second; and register 36,000 visual messages per hour.[7]

Not only do we process visual information much faster that auditory, we also remember it much better. People remember up to 80% of what the visual information they receive, i.e. pictures and graphs, compared to approximately 20% of what they only read.[8] One scientific study found that people had significantly better short-term recall of words they saw, rather than the words they heard, and that they enjoyed much better recall of short words compared with longer words.[9] That said, not all pictures are created equal, and neither are all words. Studies show that decorative images are not remembered as well as informative ones. So, in making presentation materials, making it "pretty" is not as important as making it informative. Additionally, concrete words are remembered better than abstract ones.[10] So, the prose you choose as a part of your presentation needs to be clear and unequivocal rather than poetic and interesting if it is to be remembered beyond the actual presentation.

As a result, it should come as no surprise that 65% of people are visual learners.[11] Drilling down further, it might surprise some that women tend to be more visually oriented than men.[12] Women are also more likely to face adverse consequences from learning style mismatches than are men.[13] Obviously, litigators want everyone to understand and remember their message. Knowing that presenting the message in a format half the population (or more) is not inclined to find compelling or recall should serve as a powerful motivator to ensure that trial attorneys spend as much time on the format of the presentation as the information in it.

Most importantly, as with most things in life, combining together makes it better. That means, people who tie images to words enjoy better recall.[14] Consider, for example, a study in which a number of second-year dance students were taught two dance phrases. Some were taught by presenting a video clip, and some were taught through verbal instruction. Each was recorded as they performed the material. They were then presented complementary information using the other modality and recorded again. Finally, they were recorded again 10 days later. While

[6] Kouyoumdjian, Haig, *Learning Through Visuals*, Psychology Today (Jul. 20, 2012); available at: https://www.psychologytoday.com/us/blog/get-psyched/201207/learning-through-visuals.

[7] Jandhyala*, Supra.*

[8] www.pixelo.net/visuals-vs-text-content-format-better/ (March 21, 2018).

[9] Hilton, Elizaeth, *Differences in Visuan and Auditory Short-Term Memory*, IU South Bend Undergraduate Research Journal, Vol 4 (2001); available at: https://scholarworks.iu.edu/journals/index.php/iusburj/article/view/19810.

[10] *Id.*

[11] Bradford, Wiliam C., *Researching the Visual Learner: Teaching Property Through Art*, The Law Teacher, Vol. 11 (Sep. 10, 2004); available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=587201.

[12] *Id.*

[13] *Id.*

[14] Kouyoumdjian, *Supra*.

observation produced a better result than did verbal instruction alone, completeness scores showed that recall was generally better after the second learning step, compared to the first alone.

The reason this combined approach is thought to be that the brain's architecture implies a perceptual parity between the senses – audition and vision. Cross-sensory integration occurs completely and early in the perceptual stream.[15] Put into English, words have a single code in the brain while visuals have two (visual and verbal – the word tied to the picture). Thus, given the two codes associated with the visual, the odds of recall are increased to a significant degree.[16]

> Communicating with both graphics and text is well suited to the way our minds work. Reed points out that "our cognitive abilities to comprehend, remember, reason, solve problems, and make decisions depend on a rich combination of words and images." Language itself rests on a foundation of visual thinking, and metaphoric language in particular is inextricably linked with visual images. Metaphors underlie abstract thinking "by mapping them onto concrete ides." In the unconscious mind, the verbal and visual are also inextricably linked. If we have different ways of communicating, it makes little sense to rely on only one.[17]

The overwhelming research therefore supports that the most effective presentation will include both a visual and an audible component, will rely primarily on shorter words, and will use concrete words more frequently than abstract ones. While all of these concepts seem intuitive to the seasoned litigator, it does not hurt to know *why* these concepts are true *how* best to incorporate them into a compelling presentation.

Caveats and Tips

There are a few things to keep in mind as an attorney contemplates using visual aids during the course of a legal presentation. First and foremost, a visual aid works only when the viewer can see it clearly. Small, cluttered text and images convey little to the person across the room suffering from poor visual acuity. The presenter is asked to keep the following in mind as the visual presentation is developed:

1. Use sans-serif fonts – they present better on screens and projectors. The ten most popular sans-serif fonts are: Apercu, Futura, Proxima Nova, Avenir, Brandon Grotesque, GT America, GT Walsheim, Circular, Gotham and Graphik.[18] The resolution inherent in video monitors and projectors does not do well with the small flourishes serif fonts feature on each character.
2. Do not litter graphs with unnecessary data or images. Plot only what is important. Furthermore, never use the "3D" charting options available in excel. The 3D effect only serves to confuse the image and force the viewer to re-imagine the chart in 2D to better compare the height of the various bars or positions of the various plot

[15] Bläsing, Bettina E., Coogan, Jenny, BLondi, Josè, and Schlack, Thomas, *Watching or Listening: How Visual and Verbal Information Contribute to Learning a Complex Dance Phrase*, Frontiers in Psychology (Nov. 30, 2018), available at: https://www.frontiersin.org/articles/10.3389/fpsyg.2018.02371/full.

[16] Dewan, *Supra.*

[17] *Id.* (citations omitted).

[18] https://www.typewolf.com/top-10-sans-serif-fonts

points/lines. A compelling chart also lacks unnecessary elements like outlines, gridlines, or backgrounds. The focus should be on the data alone.

3. Use the right chart for the right data. The following concepts help with choosing the correct type of chart:
    a. Bar charts are best for showing comparisons of categorical data; and,
    b. Line charts are best for tracking changes over time with continuous data.
4. Use the best layout for the chart you're using. The following concepts help:
    a. You are likely better off avoiding a legend and instead labeling each line, next to the terminus of that line on a line chart. The viewer therefore does not have to continue to move the eye from the bottom to the line to figure out the chart's meaning.
        i. Naturally, there are exceptions. High density charts, like scatterplots, get cluttered quickly when using labels.
        ii. If there are few categories, such as in bubble charts comparing two categories, a legend works better.
    b. Use descriptive titles. For example, rather than the title "Peterson Account Value," consider the tile "Excessive Trading Causes Peterson Losses." While it's possible the title could be considered as a dreaded example of "Telling not showing," the fact is that the chart itself will validate the title, making the entire image more compelling to the viewer.
    c. Use bright contrasting colors for important elements of the chart and soft muted colors to push less important elements into the background.
    d. Keep aspect ratios in mind when sizing the chart. Narrowing the width of a line chart will serve to make each increase or decrease in amplitude more dramatic.

An outstanding primer for effective charts, including examples proving each point, was prepared by Midori Nediger in 2018 and is readily available on the Web.[19]

Knowing your technology is also a vitally important component to effective presentations. If the presenting attorney decides to use a computer or tablet to assist with the visual elements of the presentation, they need to know how to use both the hardware and the software or at least make sure there is someone present to help who is intimately familiar with the hardware and software being used. A series of avoidable tech mishaps will derail even the best presentation. Spend the time necessary so using the hardware and software becomes second nature.

Finally, there is a persistent thought that a plaintiff's (or claimant's) lawyer shouldn't use high-tech presentation methods for fear of creating the wrong image in the fact-finders' minds. The concern is the feeling that the factfinder my believe the victim clearly has a lot of money – how else could they afford a lawyer with all that fancy technology? Fortunately, those fears are (mostly) misplaced. First, presentation technology has become fairly commonplace. There's no more "razzle dazzle" effect. Second, it is easy to defuse those concerns by addressing them at the outset. Years ago, one of the authors of this paper, Hugh Berkson, was representing a large insurance company defending a bad-faith claim. Plaintiff's counsel was a defense lawyer who decided to change sides for this one case. Plaintiff was a court reporter and used her connections to bring a technology team into the courtroom to run the exhibits, computer, and projector. Mr. Berkson brought his associate to do the same. During the course of the opening statement, Mr. Berkson told the jury that he too would be using the computer and projector to display graphics and exhibits through the course of the trial. He introduced his tech team: his associate.

[19] Nediger, Midori, *10 Do's and Don'ts of Infographic and Chart Design* (May 14, 2018); available at: https://venngage.com/blog/chart-design/.

Mr. Berkson explained to the jury that he taught his associate everything he knew about the software and hardware and it was almost certain there would be tech hiccups along the way. Mr. Berkson asked the jury to blame him for those problems, since he was the one who trained his associate. Job complete – Mr. Berkson had completely undercut the whole "massive insurance company with infinite resources who won't care one bit about the result of the trial." To answer the question that's surely coming, yes, Mr. Berkson did get a jury award that was less than 1/20th of the Plaintiff's last settlement demand.

Conclusion

The goal of any trial or arbitration presentation is to convince the factfinder. Most litigators have learned through trial-and-error and anecdotal experiences. A survey of literature on the subject of learning styles reveals that litigators' gut instincts are correct: visual aids make a huge difference in the quality of a presentation. In fact, it is nearly certain that the factfinders will remember more, and will find more convincing, material they perceive through a visual medium. But, even then, the combination of auditory and visual messages is more compelling and easier to remember than either auditory or visual messages standing alone. A high-quality and compelling presentation will: (1) use simple images; (2) use short words; and, (3) focus on concrete rather than abstract words. Such a presentation will be more likely to be remembered, and more likely to be believed, than one that is not so structured.

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[2] Dewan, Pauline, *Words Versus Pictures: Leveraging the Research on Visual Communication*, Partnership Vol. 10, No. 1 (2015); available at: https://journal.lib.uoguelph.ca/index.php/perj/article/view/3137.

[3] www.pixelo.net/visuals-vs-text-content-format-better/ (March 21, 2018).

[4] Gillet, Rachel, *Why We're More Likely To Remember Content With Images And Video*, Fast Company (Sept. 18, 2014; available at https://www.fastcompany.com/3035856/why-were-more-likely-to-remember-content-with-images-and-video-infogr (Referencing a 3M study).

[5] Jandhyala, Dana, *Visual Learning: 6 Reasons Why Visuals Are The Most Powerful Aspect of eLearning*, (Dec 8, 2017); available at: https://elearningindustry.com/visual-learning-6-reasons-visuals-powerful-aspect-elearning.

comparison to the part that processes visual images.[6] Humans can therefore: see images that last for 13 milliseconds; gain the sense of a visual scene in 1/10 of a second; and register 36,000 visual messages per hour.[7]

Not only do we process visual information much faster that auditory, we also remember it much better. People remember up to 80% of what the visual information they receive, i.e. pictures and graphs, compared to approximately 20% of what they only read.[8] One scientific study found that people had significantly better short-term recall of words they saw, rather than the words they heard, and that they enjoyed much better recall of short words compared with longer words.[9] That said, not all pictures are created equal, and neither are all words. Studies show that decorative images are not remembered as well as informative ones. So, in making presentation materials, making it "pretty" is not as important as making it informative. Additionally, concrete words are remembered better than abstract ones.[10] So, the prose you choose as a part of your presentation needs to be clear and unequivocal rather than poetic and interesting if it is to be remembered beyond the actual presentation.

As a result, it should come as no surprise that 65% of people are visual learners.[11] Drilling down further, it might surprise some that women tend to be more visually oriented than men.[12] Women are also more likely to face adverse consequences from learning style mismatches than are men.[13] Obviously, litigators want everyone to understand and remember their message. Knowing that presenting the message in a format half the population (or more) is not inclined to find compelling or recall should serve as a powerful motivator to ensure that trial attorneys spend as much time on the format of the presentation as the information in it.

Most importantly, as with most things in life, combining together makes it better. That means, people who tie images to words enjoy better recall.[14] Consider, for example, a study in which a number of second-year dance students were taught two dance phrases. Some were taught by presenting a video clip, and some were taught through verbal instruction. Each was recorded as they performed the material. They were then presented complementary information using the other modality and recorded again. Finally, they were recorded again 10 days later. While

[6] Kouyoumdjian, Haig, *Learning Through Visuals*, Psychology Today (Jul. 20, 2012); available at: https://www.psychologytoday.com/us/blog/get-psyched/201207/learning-through-visuals.

[7] Jandhyala*, Supra.*

[8] www.pixelo.net/visuals-vs-text-content-format-better/ (March 21, 2018).

[9] Hilton, Elizaeth, *Differences in Visuan and Auditory Short-Term Memory*, IU South Bend Undergraduate Research Journal, Vol 4 (2001); available at: https://scholarworks.iu.edu/journals/index.php/iusburj/article/view/19810.

[10] *Id.*

[11] Bradford, Wiliam C., *Researching the Visual Learner: Teaching Property Through Art*, The Law Teacher, Vol. 11 (Sep. 10, 2004); available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=587201.

[12] *Id.*

[13] *Id.*

[14] Kouyoumdjian, *Supra*.

observation produced a better result than did verbal instruction alone, completeness scores showed that recall was generally better after the second learning step, compared to the first alone.

The reason this combined approach is thought to be that the brain's architecture implies a perceptual parity between the senses – audition and vision. Cross-sensory integration occurs completely and early in the perceptual stream.[15] Put into English, words have a single code in the brain while visuals have two (visual and verbal – the word tied to the picture). Thus, given the two codes associated with the visual, the odds of recall are increased to a significant degree.[16]

> Communicating with both graphics and text is well suited to the way our minds work. Reed points out that "our cognitive abilities to comprehend, remember, reason, solve problems, and make decisions depend on a rich combination of words and images." Language itself rests on a foundation of visual thinking, and metaphoric language in particular is inextricably linked with visual images. Metaphors underlie abstract thinking "by mapping them onto concrete ides." In the unconscious mind, the verbal and visual are also inextricably linked. If we have different ways of communicating, it makes little sense to rely on only one.[17]

The overwhelming research therefore supports that the most effective presentation will include both a visual and an audible component, will rely primarily on shorter words, and will use concrete words more frequently than abstract ones. While all of these concepts seem intuitive to the seasoned litigator, it does not hurt to know *why* these concepts are true *how* best to incorporate them into a compelling presentation.

Caveats and Tips

There are a few things to keep in mind as an attorney contemplates using visual aids during the course of a legal presentation. First and foremost, a visual aid works only when the viewer can see it clearly. Small, cluttered text and images convey little to the person across the room suffering from poor visual acuity. The presenter is asked to keep the following in mind as the visual presentation is developed:

1. Use sans-serif fonts – they present better on screens and projectors. The ten most popular sans-serif fonts are: Apercu, Futura, Proxima Nova, Avenir, Brandon Grotesque, GT America, GT Walsheim, Circular, Gotham and Graphik.[18] The resolution inherent in video monitors and projectors does not do well with the small flourishes serif fonts feature on each character.
2. Do not litter graphs with unnecessary data or images. Plot only what is important. Furthermore, never use the "3D" charting options available in excel. The 3D effect only serves to confuse the image and force the viewer to re-imagine the chart in 2D to better compare the height of the various bars or positions of the various plot

[15] Bläsing, Bettina E., Coogan, Jenny, BLondi, Josè, and Schlack, Thomas, *Watching or Listening: How Visual and Verbal Information Contribute to Learning a Complex Dance Phrase*, Frontiers in Psychology (Nov. 30, 2018), available at: https://www.frontiersin.org/articles/10.3389/fpsyg.2018.02371/full.

[16] Dewan, *Supra.*

[17] *Id.* (citations omitted).

[18] https://www.typewolf.com/top-10-sans-serif-fonts

points/lines. A compelling chart also lacks unnecessary elements like outlines, gridlines, or backgrounds. The focus should be on the data alone.

3. Use the right chart for the right data. The following concepts help with choosing the correct type of chart:
    a. Bar charts are best for showing comparisons of categorical data; and,
    b. Line charts are best for tracking changes over time with continuous data.
4. Use the best layout for the chart you're using. The following concepts help:
    a. You are likely better off avoiding a legend and instead labeling each line, next to the terminus of that line on a line chart. The viewer therefore does not have to continue to move the eye from the bottom to the line to figure out the chart's meaning.
        i. Naturally, there are exceptions. High density charts, like scatterplots, get cluttered quickly when using labels.
        ii. If there are few categories, such as in bubble charts comparing two categories, a legend works better.
    b. Use descriptive titles. For example, rather than the title "Peterson Account Value," consider the tile "Excessive Trading Causes Peterson Losses." While it's possible the title could be considered as a dreaded example of "Telling not showing," the fact is that the chart itself will validate the title, making the entire image more compelling to the viewer.
    c. Use bright contrasting colors for important elements of the chart and soft muted colors to push less important elements into the background.
    d. Keep aspect ratios in mind when sizing the chart. Narrowing the width of a line chart will serve to make each increase or decrease in amplitude more dramatic.

An outstanding primer for effective charts, including examples proving each point, was prepared by Midori Nediger in 2018 and is readily available on the Web.[19]

Knowing your technology is also a vitally important component to effective presentations. If the presenting attorney decides to use a computer or tablet to assist with the visual elements of the presentation, they need to know how to use both the hardware and the software or at least make sure there is someone present to help who is intimately familiar with the hardware and software being used. A series of avoidable tech mishaps will derail even the best presentation. Spend the time necessary so using the hardware and software becomes second nature.

Finally, there is a persistent thought that a plaintiff's (or claimant's) lawyer shouldn't use high-tech presentation methods for fear of creating the wrong image in the fact-finders' minds. The concern is the feeling that the factfinder my believe the victim clearly has a lot of money – how else could they afford a lawyer with all that fancy technology? Fortunately, those fears are (mostly) misplaced. First, presentation technology has become fairly commonplace. There's no more "razzle dazzle" effect. Second, it is easy to defuse those concerns by addressing them at the outset. Years ago, one of the authors of this paper, Hugh Berkson, was representing a large insurance company defending a bad-faith claim. Plaintiff's counsel was a defense lawyer who decided to change sides for this one case. Plaintiff was a court reporter and used her connections to bring a technology team into the courtroom to run the exhibits, computer, and projector. Mr. Berkson brought his associate to do the same. During the course of the opening statement, Mr. Berkson told the jury that he too would be using the computer and projector to display graphics and exhibits through the course of the trial. He introduced his tech team: his associate.

[19] Nediger, Midori, *10 Do's and Don'ts of Infographic and Chart Design* (May 14, 2018); available at: https://venngage.com/blog/chart-design/.

Mr. Berkson explained to the jury that he taught his associate everything he knew about the software and hardware and it was almost certain there would be tech hiccups along the way. Mr. Berkson asked the jury to blame him for those problems, since he was the one who trained his associate. Job complete – Mr. Berkson had completely undercut the whole "massive insurance company with infinite resources who won't care one bit about the result of the trial." To answer the question that's surely coming, yes, Mr. Berkson did get a jury award that was less than 1/20th of the Plaintiff's last settlement demand.

Conclusion

The goal of any trial or arbitration presentation is to convince the factfinder. Most litigators have learned through trial-and-error and anecdotal experiences. A survey of literature on the subject of learning styles reveals that litigators' gut instincts are correct: visual aids make a huge difference in the quality of a presentation. In fact, it is nearly certain that the factfinders will remember more, and will find more convincing, material they perceive through a visual medium. But, even then, the combination of auditory and visual messages is more compelling and easier to remember than either auditory or visual messages standing alone. A high-quality and compelling presentation will: (1) use simple images; (2) use short words; and, (3) focus on concrete rather than abstract words. Such a presentation will be more likely to be remembered, and more likely to be believed, than one that is not so structured.

AN OVERVIEW OF THE REGULATION BEST INTEREST RULE PACKAGE

Christine Lazaro

On June 5, 2019, the SEC adopted the Regulation Best Interest Rule Package. The package consists of Regulation Best Interest: The Broker-Dealer Standard of Conduct;[1] Form CRS Relationship Summary and Amendments to Form ADV;[2] Commission Interpretation Regarding Standard of Conduct for Investment Advisers;[3] and Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser.[4] This article will summarize each of the releases.

I. Regulation Best Interest

a. General Obligation

Regulation Best Interest requires that brokerage firms and their brokers must act in the best interests of their retail customers when making recommendations of securities or investment strategies.[5] The brokerage firm and the broker may not place their own interests ahead of the customers' interests.[6]

For purposes of this standard, the term "recommendation" has the same meaning it currently has under FINRA rules.[7] It is a fact-based determination. The SEC recognizes that factors to consider are "whether the communication 'reasonably could be viewed as a 'call to action'' and 'reasonably would influence an investor to trade a particular security or group of securities.'"[8]

The SEC provides some guidance as to what would not be considered a recommendation, including communications such as general financial and investment information; descriptive

[1] Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318 (July 12, 2019) (to be codified at 17 C.F.R. pt. 240).

[2] Form CRS Relationship Summary; Amendments to Form ADV, 84 Fed. Reg. 33,492 (July 12, 2019) (to be codified at 17 C.F.R. pts. 200, 240, 249, 275, and 279).

[3] Commission Interpretation Regarding Standard of Conduct for Investment Advisers, 84 Fed. Reg. 33,669 (July 12, 2019).

[4] Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion From the Definition of Investment Adviser, 84 Fed. Reg. 33,681 (July 12, 2019).

[5] 17 C.F.R. §240.15l-1(a)(1) (2019).

[6] *Id.*

[7] 84 Fed. Reg. 33,318, 33,337.

[8] *Id.* at 33,335.

information about an employer-sponsored retirement plan; certain asset allocation models; and interactive investment materials.[9]

Recommendations include advice about the type of securities account to open, as well as advice to roll over or transfer assets from one account to another.[10] Additionally, a broker may be deemed to have made an implicit hold recommendation, triggering the obligations of the Rule, if the broker has agreed to perform periodic account monitoring.[11]

Brokerage firms and brokers owe this obligation to "retail customers." The SEC defines retail customer to focus on natural persons and their legal representatives, seeking advice for personal, family, or household purposes.[12]

b. Component Obligations

Regulation Best Interest is comprised of four components: (i) the Disclosure Obligation; (ii) the Care Obligation; (iii) the Conflict of Interest Obligation; and (iv) the Compliance Obligation.[13]

i. Disclosure Obligation

The Disclosure Obligation requires that a broker or brokerage firm make full and fair disclosure in writing of "material facts relating to the scope and terms of the relationship" with the customer; and "material facts relating to such conflicts of interest that are associated with the recommendation."[14] "Materiality" has the same meaning the Supreme Court articulated in *Basic v. Levinson*.[15,16]

Material facts related to the scope of the relationship explicitly include the following types of information: (i) the capacity in which the broker is acting (as a broker-dealer or investment adviser); (ii) fees and costs associated with the transactions and the accounts more generally; and (iii) the type and scope of the services the brokerage firm will offer, including any limitations on those services.[17]

Regardless of whether the firm and individual is dually-registered, both still have to disclose the capacity in which they are acting. If the firm or individual is not dually-registered but uses the

[9] *Id.* at 33,337 – 33,338.

[10] *Id.* at 33,338.

[11] *Id.* at 33,340.

[12] *Id.* at 33,343.

[13] 17 C.F.R. §240.15l-1(a)(2) (2019).

[14] 84 Fed. Reg. at 33,347.

[15] *Id.*

[16] *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988).

[17] 84 Fed. Reg. at 33,349.

term “advisor” or “adviser”, they will likely be in violation of this obligation because their disclosure about capacity will not be accurate.[18]

With respect to fees and costs, the SEC expects that brokerage firms will build on the disclosure of fees and costs which are set forth in Form CRS (to be discussed in further detail below).[19] The obligation does not require that the brokerage firm provide “individualized” costs and fees, but rather may provide standardized or hypothetical amounts or percentage ranges.[20] Brokerage firms may also satisfy this part of their disclosure obligations by providing mandated disclosure documents, such as prospectuses, and trade confirmations.[21]

With respect to the type of services the brokerage firm offers, the firm must disclose whether it monitors transactions and strategies.[22] As part of this disclosure, the brokerage firm must be specific as to the frequency and duration of the services offered.[23] The brokerage firm may rely on information disclosed in the Form CRS (as will be discussed below), but will likely need to expand on that information to meet this disclosure obligation.[24] However, the brokerage firm may rely on other documents, including account agreements, to make these disclosures.[25] As part of this disclosure, brokerage firms must also disclosure whether they have any account minimums.[26] The brokerage firm must also disclose any limitations on its offerings.[27] Limitations include for example, if the brokerage firm only offers proprietary products.[28] Additionally, if the brokerage firm is dually registered but the broker is not, the broker must disclose that he cannot offer advisory services.[29]

The conflicts of interest disclosure obligation should summarize how the brokerage firm and the brokers are compensated for their recommendations as well as the conflicts that the

[18] *Id.* at 33,352.

[19] *Id.* at 33,354.

[20] *Id.* at 33,355.

[21] *Id.*

[22] *Id.* at 33,356.

[23] *Id.*

[24] *Id.* at 33,357.

[25] *Id.*

[26] *Id.* at 33,358.

[27] *Id.* at 33,357.

[28] *Id.*

[29] *Id.*

compensation arrangements create.[30] These conflicts need not be disclosed on a recommendation by recommendation basis.[31]

The disclosure obligation does require that the disclosures be made in writing, however, the SEC recognizes that it may be necessary to supplement, clarify, or update written disclosures with oral disclosures.[32] However, if the brokerage firm does supplement the written disclosures, the brokerage firm must keep a record of the fact that an oral disclosure was provided.[33]

ii. Care Obligation

The Care Obligation in many ways mirrors the FINRA Suitability Rule. It requires that the broker, when making a recommendation, exercise "reasonable diligence, care, and skill to:"

> (A) Understand the potential risks, rewards, and costs associated with the recommendation, and have a reasonable basis to believe that the recommendation could be in the best interest of at least some retail customers;
> (B) Have a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile and the potential risks, rewards, and costs associated with the recommendation and does not place the financial or other interest of the broker, dealer, or such natural person ahead of the interest of the retail customer; and
> (C) Have a reasonable basis to believe that a series of recommended transactions, even if in the retail customer's best interest when viewed in isolation, is not excessive and is in the retail customer's best interest when taken together in light of the retail customer's investment profile and does not place the financial or other interest of the broker, dealer, or such natural person making the series of recommendations ahead of the interest of the retail customer.[34]

The first prong is similar to the "reasonable basis" obligation under the FINRA Suitability Rule.[35] As a threshold issue, the broker must understand the security or investment strategy recommended before being capable of determining whether the recommendation is in the best interest of a particular customer.[36] The SEC sets forth factors the broker or brokerage firm should consider when investigating the security or investment strategy: "the security's or investment strategy's investment objectives, characteristics (including any special or unusual features), liquidity, volatility, and likely performance in a variety of market and economic conditions; the

[30] *Id.* at 33,363.

[31] *Id.*

[32] *Id.* at 33,368.

[33] *Id.*

[34] 17 C.F.R. §240.15l-1(a)(2)(ii) (2019).

[35] *See* FINRA Rule 2111.05(a).

[36] 84 Fed. Reg. at 33,375 – 33,376.

expected return of the security or investment strategy; as well as any financial incentives to recommend the security or investment strategy."[37]

The SEC has included "costs" as a factor in evaluating securities or strategies because it recognizes that cost will always be a relevant factor.[38] "Costs" includes both costs associated with purchasing a security, as well as future costs associated with exchanging or selling a security.[39] However, the SEC cautions that cost is not a dispositive factor. The Rule does not require that a broker recommend the lowest cost option.[40]

The second prong incorporates the "customer specific" prong of the FINRA Suitability Rule,[41] but enhances it by replacing "suitable" with a best interest standard.[42] In sum, the broker must determine that a recommendation is in the customer's best interest based on that customer's investment profile. The customer's investment profile includes "age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance," and any other information that may be disclosed.[43] This is the same information that firms must currently consider as part of the investor's profile under the FINRA Suitability Rule.[44] If a customer does not provide the information, the SEC cautions that a firm may not have sufficient information to make a best interest determination.[45]

In evaluating whether a recommendation is in the customer's best interest, the broker should consider reasonably available alternatives offered by the broker's firm.[46] The broker need not recommend the "best" of all possible alternatives.[47] The Rule also does not require that the broker be familiar with every product available by the brokerage firm.[48] The scope of the reasonably available alternatives that are considered with respect to any particular recommendation will depend on several factors, including, the broker's customer base; the products available to the broker to recommend; and specific limitations on the available products, including that products may only be available in certain geographical locations or to particular types of accounts.[49]

[37] *Id.* at 33,376.

[38] *Id.* at 33,373.

[39] *Id.*

[40] *Id.*

[41] *See* FINRA Rule 2111.05(b).

[42] 84 Fed. Reg. at 33,377.

[43] 17 C.F.R. §240.15l-1(b)(3) (2019).

[44] *See* FINRA Rule 2111(a).

[45] 84 Fed. Reg. at 33,379.

[46] *Id.* at 33,381.

[47] *Id.*

[48] *Id.*

[49] *Id.* at 33,382.

For dually registered brokers, the options with respect to account type must be considered as reasonably available alternatives.[50] If the broker may only offer brokerage accounts, the broker must consider the customer's objectives before recommending a brokerage account.[51] For example, if the customer is requesting that the broker have unlimited discretion, a brokerage account would not be appropriate.[52]

When recommending a roll over, the broker must consider a number of factors, including, "fees and expenses; level of service available; available investment options; ability to take penalty-free withdrawals; application of required minimum distributions; protection from creditors and legal judgments; holdings of employer stock; and any special features of the existing account."[53] A broker may not just consider whether the roll over may offer additional options beyond the customer's current plan.

The final component is similar to the "quantitative suitability" requirement,[54] except that the "control" element has been eliminated.[55] This component is intended to prevent trading that is so excessive that a positive return is virtually impossible.[56]

iii. Conflict of Interest Obligation

The Conflict of Interest Obligation requires a firm to adopt policies and procedures designed to identify and, at a minimum, disclose all conflicts associated with a recommendation.[57] The obligation further requires that a brokerage firm mitigate or eliminate certain types of conflicts.[58] With respect to the content of the policies and procedures, the SEC contemplates that brokerage firms will have flexibility to design policies and procedures that are risk-based rather than requiring a detailed review of each recommendation.[59] The SEC suggests certain components a brokerage firm should consider when adopting policies and procedures including:

> [P]olicies and procedures outlining how the firm identifies conflicts, identifying such conflicts and specifying how the broker-dealer intends to address each conflict; robust compliance and monitoring systems; processes to escalate identified instances of noncompliance for remediation; procedures that designate responsibility to business line personnel for supervision of functions and persons,

[50] *Id.* at 33,383.

[51] *Id.*

[52] *Id.*

[53] *Id.*

[54] *See* FINRA Rule 2111.05(c).

[55] 84 Fed. Reg. at 33,384.

[56] *Id.*

[57] *Id.* at 33,385.

[58] *Id.*

[59] *Id.* at 33,386.

> including determination of compensation; processes for escalating conflicts of interest; processes for periodic review and testing of the adequacy and effectiveness of policies and procedures; and training on policies and procedures.[60]

Under this obligation, the brokerage firm has a duty to, at a minimum, disclose all conflicts of interest.[61] Disclosure must be full and fair; if it is not possible to fully and fairly disclose a conflict, it must be mitigated such that full and fair disclosure is possible.[62]

Brokerage firms have a duty to identify and mitigate conflicts of interest that create an incentive for the broker to place the interests of the broker or the firm ahead of the interests of the customer.[63] The SEC has chosen to primarily limit the duty to mitigate to broker-level conflicts, allowing the brokerage firms to generally deal with firm-level conflicts through disclosure.[64] The requirement to identify and mitigate broker-level conflicts applies only to incentives provided to the broker, either by the firm or third parties that are within the control of or associated with the firm.[65] Accordingly, the requirement does not create an obligation with respect to private securities transactions.[66] The SEC does provide examples of conflicts that must be mitigated: (i) compensation from the brokerage firm or third parties, including fees and other charges associated with the service or recommendation provided; (ii) employment incentives, including those tied to asset accumulation, special awards, variable compensation, and compensation tied to performance reviews; and (iii) commissions, sales charges, or other fees whether paid by the customer, the brokerage firm, or a third party.[67]

Mitigation measures should be based on the nature and significance of the incentive, as well as other factors related to the brokerage firm's business model, such as the size of the firm, the types of customers, and the complexity of the security product or strategy.[68]
The SEC provides a list of best practices for brokerage firms developing policies and procedures for mitigation methods:

- Avoiding compensation thresholds that disproportionately increase compensation through incremental increases in sales;
- Minimizing compensation incentives for employees to favor one type of account over another; or to favor one type of product over another, proprietary or preferred provider

[60] *Id.* at *note* 688.

[61] *Id.* at 33,388.

[62] *Id.*

[63] *Id.* at 33,390.

[64] *Id.*

[65] *Id.* at 33,391.

[66] *Id.* at *note* 744.

[67] *Id.* at 33,391.

[68] *Id.*

products, or comparable products sold on a principal basis, for example, by establishing differential compensation based on neutral factors;
- Eliminating compensation incentives within comparable product lines by, for example, capping the credit that an associated person may receive across mutual funds or other comparable products across providers;
- Implementing supervisory procedures to monitor recommendations that are: near compensation thresholds; near thresholds for firm recognition; involve higher compensating products, proprietary products or transactions in a principal capacity; or, involve the roll over or transfer of assets from one type of account to another (such as recommendations to roll over or transfer assets in an ERISA account to an IRA) or from one product class to another;
- Adjusting compensation for brokers who fail to adequately manage conflicts of interest; and
- Limiting the types of retail customer to whom a product, transaction or strategy may be recommended.[69]

If a brokerage firm materially limits its securities offerings or investment strategies, the brokerage firm must prevent such limitations from causing the firm to put its interests ahead of the customers'.[70] The SEC considers that recommending only proprietary products, products with revenue sharing arrangements, or a specific asset class would be material limitations.[71] The SEC recommends that brokerage firms offering limited menus consider establishing a "product review process" which includes evaluating the use of preferred lists; restrictions on the customers to whom a product may be sold; requiring brokers selling certain products to have minimum knowledge requirements; as well as period product reviews to further evaluate conflicts.[72]

Certain practices are completely prohibited pursuant to this obligation. Brokerage firms must eliminate "sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited time."[73] Non-cash compensation includes merchandise, gifts and prizes, travel expenses, meals and lodging.[74] This obligation is not intended to eliminate all incentives, only those that create high-pressure situations to sell specific securities within a limited period of time.[75] It likely will not capture contests or other incentives tied to total products sold or asset accumulation and growth.[76] Brokerage firms may also continue to hold annual conferences, so long as attendance is not premised on the sale of specific securities within a limited period of time.[77]

[69] *Id.* at 33,392.

[70] *Id.* at 33,393.

[71] *Id.*

[72] *Id.* at 33,394.

[73] 17 C.F.R. §240.15l-1(a)(2)(iii)(D) (2019).

[74] 84 Fed. Reg. at 33,396.

[75] *Id.*

[76] *Id.*

[77] *Id.*

iv. Compliance Obligation

The Compliance Obligation is an overarching requirement to adopt policies and procedures that are reasonably designed to achieve compliance with the Rule as a whole.[78] The Rule does not specify which policies and procedures must be adopted. The SEC expects brokerage firms to design policies and procedures that "prevent violations from occurring, detect violations that have occurred, and to correct promptly any violations that have occurred."[79] Brokerage firms are expected to tailor their policies and procedures to account for the "scope, size, and risks associated with the operations of the firm and the type of business in which the firm engages."[80]

II. Form CRS Relationship Summary

In addition to adopting a new standard of conduct for brokers and brokerage firms, the SEC also adopted a new disclosure obligation for both brokerage firms and investment advisers.[81] The SEC will require that both brokerage firms and investment advisers create and deliver a relationship summary to prospective and existing customers. This section will describe the relationship summary and the firms' delivery obligations.

a. Presentation and Format

The SEC allows firms to use a mix of prescribed wording along with firm-authored wording in drafting the relationship summary.[82] For example, firms will be able to describe their services, investment offerings, fee, and conflicts of interest.[83] However, firms will be required to use prescribed headings, conversation starters, and statement describing their standard of conduct when providing investment advice.[84]

The SEC requires that headings be in the form of prescribed questions, in a set order.[85] The relationship summary may not exceed four pages for a dual registrant that includes both its brokerage and advisory services in a single summary.[86] Otherwise, the relationship summary may not exceed two pages for brokerage firms and investment advisers that are describing one of their services.[87]

[78] *Id.* at 33,397.

[79] *Id.*

[80] *Id.*

[81] 84 Fed. Reg. 33,492.

[82] *Id.* at 33,502.

[83] *Id.*

[84] *Id.*

[85] *Id.* at 33,504.

[86] *Id.* at 33,505.

[87] *Id.*

The SEC is encouraging the use of graphics to facilitate comprehension, including using charts, graphs, tables, text colors, and graphical cues such as dual-column charts.[88] Additionally, firms may include QR codes and hyperlinks to facilitate layered disclosure.[89] However, a firm may not satisfy its disclosure obligations of the relationship summary through the use of "incorporation by reference."[90]

b. Content

i. Introduction

Firms are required to open the relationship summary with a standardized introduction that includes (i) the name of the firm and whether it is a brokerage firm or investment adviser; (ii) a statement that brokerage and advisory services and fees differ; and (iii) a statement that research tools are available at Investor.gov/CRS.[91]

ii. Relationships and Services

Following the introduction, firms must summarize the relationships and services they offer under the heading, "What investment services and advice can you provide me?"[92] Additionally, firms must include any material limitations on the services they offer to investors.[93] In the description of services, firms must address (i) monitoring; (ii) investment authority; (iii) limited investment offerings; and (iv) account minimums and other requirements.[94]

With respect to monitoring, firms must explain whether they monitor an investor's accounts, including the frequency of the monitoring and any limitations on the monitoring.[95] If an investment adviser accepts discretionary authority, the firm must describe how the authority will be exercised.[96] For example, if the firm requires investor input before exercising discretion in certain circumstance, the firm must explain that.[97] Both investment advisers and brokerage firms that offer non-discretionary services must explain that the investor is the ultimate decision maker.[98] If a firm has a limited menu of offerings, such as only proprietary products or a specific asset class,

[88] *Id.* at 33,507.

[89] *Id.*

[90] *Id.* at 33,508.

[91] *Id.* at 33,513.

[92] *Id.* at 33,515.

[93] *Id.* at 33,516.

[94] *Id.* at 33,517.

[95] *Id.* at 33,518.

[96] *Id.* at 33,519.

[97] *Id.*

[98] *Id.*

the firm must explain those limitations.[99] Firms must also disclose whether there are minimums to open an account or place a trade, or if there is a tiered fee schedule.[100]

In the relationship and services section of the form, firms must also provide additional information which further explains the firms' services.[101] This section should provide the information about services that would be available in an investment adviser's Form ADV, Part 2A brochure, or that a brokerage firm otherwise has to provide under Reg. BI.[102] This section of the disclosure may be layered, providing hyperlinks or other ways of directing the investor to the source of the information.[103]

The relationship and services section will also contain three conversation starters.[104] The first conversation starter will be tailored to the nature of the firm's business. For firms that are not dual registrants, the firm will include, "Given my financial situation, should I choose a brokerage service? Why or why not?" or "Given my financial situation, should I choose an investment advisory service? Why or why not?"[105] Dual registrants will include, "Given my financial situation, should I choose an investment advisory service? Should I choose a brokerage service? Should I choose both types of services? Why or why not?"[106]

Additionally, firms will also include the following two questions: (i) "How will you choose investments to recommend to me?;" and (ii) "What is your relevant experience, including your licenses, education and other qualifications? What do these qualifications mean?"[107]

iii. Summary of Fees, Costs, Conflicts, and Standards of Conduct

Firms will begin the discussion of fees, costs, conflicts, and standards of conduct with the heading, "What fees will I pay?"[108] In this section, the firm must summarize the principal costs and fees that investors will incur, including how frequently they are assessed and what conflicts of interest the fees may create.[109] Additionally, firms must describe other fees and costs associated with their services or investments, whether paid directly or indirectly.[110] The SEC provides some

[99] *Id.* at 33,520.

[100] *Id.* at 33,521.

[101] *Id.*

[102] *Id.*

[103] *Id.*

[104] *Id.*

[105] *Id.*

[106] *Id.*

[107] *Id.*

[108] *Id.* at 33,524.

[109] *Id.*

[110] *Id.*

examples of the other fees and costs that may need to be disclosed, including: custodial fees; account maintenance fees; fees related to mutual funds and variable annuities; distribution fees; platform fees; and shareholder servicing fees.[111]

Finally, firms are required to include the following statement: "You will pay fees and costs whether you make or lose money on your investments. Fees and costs will reduce any amount of money you make on your investment over time. Please make sure you understand what fees and costs you are paying."[112]

Firms must also include a conversation starter about fees: "Help me understand how these fees and costs might affect my investments. If I give you $10,000 to invest, how much will go to fees and costs, and how much will be invested for me?"[113]

Following the fees and costs discussion, firms must discuss the standard of conduct that applies, using prescribed language.[114] Additionally, this section must include a summary of certain firm-level conflicts.[115]

The disclosure that firms have to make will vary based on whether it is [a broker making a recommendation], [an investment adviser], or [a dual registrant]:

> [***When we provide you with a recommendation,***] [***When we act as your investment adviser,***] [***When we provide you with a recommendation as your broker-dealer or act as your investment adviser,***] we have to act in your best interest and not put our interest ahead of yours. At the same time, the way we make money creates some conflicts with your interests. You should understand and ask us about these conflicts because they can affect the [recommendations] [investment advice] [recommendations and investment advice] we provide you. Here are some examples to help you understand what this means.[116]

Following the prescribed wording, the firms must summarize the following ways the firm makes money which involve conflicts: (i) from proprietary products; (ii) from third-party payments; (iii) by revenue sharing; and (iv) by principal trading.[117] If the firm does not have any of these conflicts, it must describe one material conflict of interest that will affect retail investors.[118]

[111] *Id.*

[112] *Id.* at 33,527.

[113] *Id.* at 33,528.

[114] *Id.* at 33,530.

[115] *Id.* at 33,529.

[116] *Id.* at 33,532 – 33,533, *notes* 507 – 509.

[117] *Id.* at 33,533.

[118] *Id.*

In this section, firms must include the following conversation starter: "How might your conflicts of interest affect me, and how will you address them?"[119] Finally, firms must include the heading, "How do your financial professionals make money?" and include a description of how their financial professionals are compensated, including both cash and non-cash compensation, as well as the conflicts that the payments create.[120]

iv. Disciplinary History

The relationship summary will also include a section about whether the firm or its financial professionals have any disciplinary history, as well as where an investor may find additional information.[121] This section will begin with the following question: "Do you or your financial professionals have legal or disciplinary history?" Firms will have to answer yes if they have any of a number of disclosable events as set forth in the instructions.[122] For example, firms will have to answer yes if a broker has any items disclosed pursuant to question 14 A though M on the Form U4.[123]

This section must also include the following conversation starter: "As a financial professional, do you have any disciplinary history? For what type of conduct?"[124]

v. Additional Information

The final section of the relationship summary will state where the investor can find additional information.[125] This section will also include the following conversation starters: "Who is my primary contact person? Is he or she a representative of an investment adviser or a broker-dealer? Who can I talk to if I have concerns about how this person is treating me?"[126] Finally, this section must include a phone number where investors can request up-to-date information as well as a copy of the relationship summary.[127]

[119] *Id.* at 33,535.

[120] *Id.* at 33,536.

[121] *Id.*

[122] *Id.* at 33,537 – 33,538.

[123] *Id.* at 33,538.

[124] *Id.* at 33,539.

[125] *Id.*

[126] *Id.* at 33,540.

[127] *Id.*

c. Filing, Delivery, and Updating Requirements

Firms must file the relationship summary with the SEC; and the SEC will make the forms publicly available through the website, Investor.gov.[128] Additionally, firms must make the forms available on their own websites.[129]

Firms may deliver the relationship summary electronically, so long as the firm complies with the SEC's rules regarding electronic delivery.[130] Essentially, the firm must make the investor aware that the form is available electronically; the access to the information must be comparable to that which would have been provided in paper form; and the firm must maintain evidence of delivery.[131] Brokerage firms must deliver the relationship summary before or at the earliest of: (i) a recommendation as to account type, a securities transaction, or an investment strategy; (ii) placing an order; or (iii) opening a brokerage account.[132] Investment advisers must deliver the relationship summary before or at the time of entering into an investment advisory contract with an investor.[133]

After the initial delivery of the form, firms must re-deliver the relationship summary whenever: (i) an account is opened that is different than the investor's existing account(s); (ii) there is a recommendation to roll over assets; or (iii) there is a recommendation for a new service or product that would not be held in an existing account.[134] This last item contemplates recommendations for investments such as direct-sold mutual funds or insurance products.[135]

Finally, firms must update the relationship summary within 30 days whenever the relationship summary becomes materially inaccurate.[136] At that time, the revised relationship summary must be filed with the SEC and posted to the firm's website.[137] Firms will have 60 days to deliver the revised relationship summary to existing clients.[138] When delivering the revised relationship summary, firms must highlight any changes by either marking the revised text or including a summary of the changes.[139]

[128] *Id.* at 33,545.

[129] *Id.*

[130] *Id.* at 33,546.

[131] *Id.* at 33,547.

[132] *Id.* at 33,550.

[133] *Id.* at 33,551.

[134] *Id.* at 33,552.

[135] *Id.*

[136] *Id.* at 33,554.

[137] *Id.*

[138] *Id.*

[139] *Id.*

III. Investment Adviser Interpretation

As part of the Regulation Best Interest Rule package, the SEC issued an interpretation of the investment adviser standard of conduct.[140] The SEC recognized that the investment adviser's fiduciary duty follows the contours of the relationship with the client.[141] Further, an investment adviser can shape that relationship by agreement, so long as there is full and fair disclosure, and informed consent by the client.[142] The specific duties an investment adviser owes a client will depend on the services the adviser has agreed to perform for the client.[143] However, an investment adviser cannot have a client waive the fiduciary duty.[144]

a. Duty of Care

An investment adviser's fiduciary duty includes a duty of care. This duty includes: (i) the duty to provide advice that is in the best interest of the client; (ii) the duty to seek best execution of a client's transactions where the adviser has the duty to select the broker-dealer that will execute the client's trades; and (iii) the duty to provide advice and monitoring over the course of the relationship.[145]

The duty to provide advice that is in the best interest of the client is a duty to provide advice that is suitable for the client.[146] To be able to satisfy this duty, the investment adviser must make a reasonable inquiry into the client's financial situation, financial sophistication, investment experience, and financial goals, among other things.[147] Further, the investment adviser must determine that the client can and is willing to tolerate the risks of any recommended investment, and that the potential benefits of the investment recommendation justify the risks.[148]

Next, the investment adviser must conduct a reasonable investigation into the investment being recommended.[149] As part of the investigation, the investment adviser must consider a number of factors relating to the investment, including the cost associated with the investment advice; as well as the investment product's or strategy's investment objectives, characteristics, liquidity, risks and potential benefits, volatility, likely performance in a variety of market and economic conditions,

[140] 84 Fed. Reg. 33,669.

[141] *Id.* at 33,671.

[142] *Id.*

[143] *Id.*

[144] *Id.* at 33,672.

[145] *Id.* at 33,672.

[146] *Id.*

[147] *Id.* at 33,673.

[148] *Id.*

[149] *Id.* at 33,674.

time horizon, and cost of exit.[150] This duty applies to advice about investment strategy, engaging a sub-adviser, and account type.[151] Accordingly, advice to open a particular type of account (brokerage or investment advisory) as well as advice about rolling over assets would trigger this duty.[152]

In seeking best execution, an investment adviser must try to execute trades such that the costs or proceeds from each transaction are the most favorable for the client.[153]
The duty to monitor means the investment adviser must monitor a client's account at a frequency that is in the best interest of the client.[154] However, if the investment adviser has been engaged for a limited duration, the investment adviser is unlikely to have a duty to monitor.[155]

b. Duty of Loyalty

In simple terms, an investment adviser has a duty of loyalty, which prohibits the investment adviser from subordinating its clients' interests to its own.[156] As part of this duty, the investment adviser must make full and fair disclosure of any material facts relating to the advisory relationship.[157]

Additionally, the investment adviser must eliminate or at least expose through full and fair disclosure all conflict of interest which might incline an adviser to render advice that is not disinterested.[158] For disclosure to be full and fair, the disclosure must be specific enough so that the client can understand the material fact or the conflict of interest and be able to make an informed decision as to whether to provide consent.[159]

As part of its disclosure, an investment adviser may not state that the adviser "may" have a conflict if the conflict actually exists; however, "may" could be appropriate if the conflict does not currently exist but might reasonably present itself in the future.[160] In other words, disclosure will not be full and fair if the adviser states that a conflict "may" exist if the conflict already does exist.

[150] *Id.*

[151] *Id.*

[152] *Id.*

[153] *Id.*

[154] *Id.* at 33,675.

[155] *Id.*

[156] *Id.*

[157] *Id.*

[158] *Id.* at 33,676.

[159] *Id.*

[160] *Id.*

Investment advisers do not have to determine whether the client actually understood the disclosure made.[161] The investment adviser merely has to put the client into the position to be able to understand the disclosure.[162] However, if the investment adviser actually knows, or reasonably should know, that the client does not understand the disclosure, the adviser cannot accept the client's consent.[163]

If the conflict is of a nature and to an extent that it would be difficult to be able to fully explain the conflict in a way that it could be understood by a client, the investment adviser must eliminate or mitigate the conflict.[164]

IV. Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser

In the last item of the Regulation Best Interest Rule package, the SEC provided an interpretation of the "solely incidental" prong of the broker-dealer exclusion from the definition of "investment adviser."[165] In this interpretation, the SEC clarified that if a broker exercises unlimited discretion, such conduct would not be "solely incidental" to the business of the broker-dealer, and accordingly, the brokerage firm would meet the definition of "investment adviser."[166] However, discretion that is limited in scope would not necessarily turn a brokerage firm into an investment adviser.[167]

With respect to monitoring a customer's account, if the monitoring is at specific intervals for the purpose of determining whether to provide a buy, sell, or hold recommendation, such conduct would be considered "solely incidental" to the broker-dealer's primary business of effecting securities transactions.[168] It would not turn the brokerage relationship into an advisory relationship.

[161] *Id.* at 33,677.

[162] *Id.*

[163] *Id.*

[164] *Id.*

[165] 84 Fed. Reg. 33,681.

[166] *Id.* at 33,686.

[167] *Id.*

[168] *Id.* at 33,687.

REGULATION BEST INTEREST RESOURCES

Regulations

Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318 (July 12, 2019): https://www.govinfo.gov/content/pkg/FR-2019-07-12/pdf/2019-12164.pdf

Form CRS Relationship Summary; Amendments to Form ADV, 84 Fed. Reg. 33,492 (July 12, 2019): https://www.govinfo.gov/content/pkg/FR-2019-07-12/pdf/2019-12376.pdf

Commission Interpretation Regarding Standard of Conduct for Investment Advisers, 84 Fed. Reg. 33,669 (July 12, 2019): https://www.govinfo.gov/content/pkg/FR-2019-07-12/pdf/2019-12208.pdf

Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion From the Definition of Investment Adviser, 84 Fed. Reg. 33,681 (July 12, 2019): https://www.govinfo.gov/content/pkg/FR-2019-07-12/pdf/2019-12209.pdf

FINRA

Key Topic: SEC Regulation Best Interest: https://www.finra.org/rules-guidance/key-topics/regulation-best-interest#overview

SEC

A Small Entity Compliance Guide: https://www.sec.gov/info/smallbus/secg/regulation-best-interest

Frequently Asked Questions on Regulation Best Interest: https://www.sec.gov/tm/faq-regulation-best-interest

Frequently Asked Questions on Form CRS: https://www.sec.gov/investment/form-crs-faq

Reg BI and Form CRS Firm Checklist

Compliance Date is June 30, 2020

FINRA is providing this checklist to help members assess their obligations under the SEC's Regulation Best Interest (Reg BI) and Form CRS Relationship Summary (Form CRS). This checklist explains key differences between FINRA rules and Reg BI and Form CRS. The checklist is not a substitute for any rule. Only the rule can provide definitive information regarding its requirements. Interpretive questions should be directed to the SEC, at *IABDQuestions@sec.gov*. You should carefully review the SEC's new rules and interpretations, related *Federal Register* notices and the SEC's Small Entity Compliance Guides, which provide important information on the new obligations.[1]

REG BI

1 Do you have procedures and training in place to assess recommendations using a **best interest** standard?

Status ○ Completed ✔

Securities recommendations must be in the retail customer's best interest. The firm and the associated person (AP) may not place their interests ahead of the retail customer's. This is a change from FINRA's suitability standard, which does not have an explicit best interest requirement. The best interest standard is an overarching obligation, which is satisfied only if you comply with four component obligations: Care, Disclosure, Conflict of Interest and Compliance.

2 Do you apply a best interest standard to recommendations of **types of accounts**?

Status ○ Completed ✔

Unlike FINRA's suitability rule, the best interest standard explicitly applies to recommendations of types of accounts. A broker-dealer (BD) or AP must have a reasonable basis to believe that a recommendation of a securities account type (*e.g.,* brokerage or advisory, or among the types of accounts offered by the firm, including IRAs) is in the retail customer's best interest at the time of the recommendation and does not place the financial or other interest of the BD or AP ahead of the interest of the retail customer.

In general, when considering recommendations of types of accounts, you should consider: (a) services and products provided in the account; (b) projected cost of the account; (c) alternative account types available; (d) services the retail customer requests; and (e) the retail customer's investment profile.

With regard to IRAs, in addition to the factors above, you should consider: (a) fees and expenses; (b) level of services available; (c) ability to take penalty-free withdrawals; (d) application of required minimum distributions; (e) protections from creditors and legal judgments; (f) holdings of employer stock; and (g) any special features of the existing account.

1 The SEC's *Federal Register* notices for *Reg BI, Form CRS, Interpretation of Solely Incidental and Interpretation of Investment Advisers' Obligations* are available at *https://www.sec.gov/rules/final.shtml*. The SEC's *Regulation Best Interest, A Small Entity Compliance Guide* is available at *https://www.sec.gov/info/smallbus/secg/regulation-best-interest*, and *Form CRS Relationship Summary; Amendments to Form ADV, A Small Entity Compliance Guide* is available at *https://www.sec.gov/info/smallbus/secg/form-crs-relationship-summary*.

3 If you agree to provide **account monitoring**, do you apply the best interest standard to both explicit and **implicit hold recommendations**?

Status
Completed ✔

Reg BI imposes no duty to monitor a customer's account following a recommendation. However, if you agree to perform account monitoring services, you are taking on an obligation to review and make recommendations regarding the account (*e.g.*, to buy, sell or hold) on the specified, periodic basis that you have agreed to with the retail customer. In such circumstances, Reg BI would apply even where you remain silent (*i.e.*, an implicit hold recommendation).

For example, if you agree to monitor a retail customer's account on a quarterly basis, the quarterly review and resulting recommendation will be subject to Reg BI, including an implicit recommendation to hold if you are silent as to the securities in the account. In addition, if you agree to monitor the customer's account, you are required to disclose the terms of such account monitoring services (including the scope and frequency of such services) pursuant to the Disclosure Obligation. IA registration requirements also might apply if a BD agrees to conduct ongoing monitoring in a manner not reasonably related to providing buy, sell or hold recommendations.

Importantly, you may voluntarily, and without any agreement with your customer, review the holdings in your retail customer's account for the purposes of determining whether to provide a recommendation to the customer. This voluntary review is not considered to be "account monitoring," and would not create an implied agreement with the customer to monitor the account.

4 Do you consider the elements of **care, skill** and **costs** when making recommendations to retail customers?

Status
Completed ✔

Reg BI incorporates FINRA's reasonable-basis (*i.e.* knowing the product and having a reasonable basis to believe it is appropriate for at least some investors) and customer-specific (*i.e.* knowing the customer and having a reasonable basis to believe a particular recommendation is appropriate for a specific customer based on that customer's investment profile) suitability obligations with important enhancements.

Care, skill and costs (in addition to applying a best interest standard) are new express elements for consideration when making recommendations to retail customers.

Cost must *always* be considered when making a recommendation. Moreover, consideration of cost includes not only the cost of purchase, but also any costs that may apply to the future sale or exchange of the security, such as deferred sales charges or liquidation costs. However, while cost must always be considered, it is not dispositive, and its inclusion in the rule text is not intended to limit or foreclose a recommendation of a more costly product if there is a reasonable basis to believe that product is in the best interest of a particular retail customer.

5 Do you guard against **excessive trading**, irrespective of whether the BD or AP "**controls**" the account?

Status
Completed ✔

Reg BI incorporates FINRA's quantitative suitability obligation (that a series of recommended transactions are appropriate and not excessive). However, in a change from FINRA's quantitative suitability obligation, Reg BI applies the best interest standard to a series of recommended transactions, irrespective of whether the BD exercises actual or de facto control over a customer's account.

6 Do you consider **reasonably available alternatives** to the recommendation?

Status Completed ✔

You should consider reasonably available alternatives, if any, offered by your BD in determining whether you have a reasonable basis for making the recommendation. An evaluation of reasonably available alternatives does not require an evaluation of every possible alternative (including those offered outside the firm) nor require BDs to recommend one "best" product.

A BD should have a reasonable process for establishing and understanding the scope of such "reasonably available alternatives" that would be considered by particular APs or groups of APs (*e.g.*, groups that specialize in particular product lines) in fulfilling the reasonable diligence, care and skill requirements under the Care Obligation.

7 Do you consider how to ensure that **high-risk** or **complex products** are in a retail customer's best interest?

Status Completed ✔

Although not a rule requirement, BDs should consider, as a best practice, applying heightened scrutiny as to whether high-risk or complex investments, such as inverse and leveraged ETFs, are in a retail customer's best interest.

8 Prior to or at the time of the recommendation, do you provide retail customers with full and fair written disclosure of all material facts relating to the scope and terms of the relationship with the retail customer, including:

Status Completed ✔

○ The capacity in which you are acting (BD or IA)?

A standalone BD generally may satisfy this requirement by delivering the Form CRS to the retail customer.

For BDs who are dually registered, and APs who are either dually registered or who are not dually registered but only offer BD services through a firm that is dually registered, providing Form CRS will not be sufficient to disclose their capacity, and they must disclose if they are acting as a BD when making a recommendation.

In addition, an AP of a dual registrant who does not offer investment advisory services must disclose that fact as a material limitation. Similarly, an AP registered in a limited capacity (*e.g.*, a Series 6) must disclose that limitation (*i.e.*, she cannot recommend all available products).

○ Material fees and costs that apply to the retail customer's transactions, holdings, and accounts?

This should build upon the fees and costs disclosure in Form CRS, with more particularity, such as whether fees are deducted from the customer's account per transaction or quarterly. This obligation would not require individualized disclosure for each retail customer. Rather, the use of standardized numerical or other non-individualized disclosure (*e.g.*, reasonable dollar or percentage ranges) is permissible.

○ **The type and scope of services – whether or not the BD will monitor the retail customer's account and, if so, the scope and frequency of those services?**

Although Form CRS may disclose that the firm provides account monitoring services, Reg BI requires disclosure about whether or not account monitoring would occur for the particular retail customer and the scope and frequency of those services.

○ **Any requirements for retail customers to open or maintain an account or establish a relationship (*e.g.*, minimum account size)?**

This would include any requirements for retail customers to open or maintain an account, or to avoid additional fees when a threshold is crossed, such as a low account balance.

○ **Any material limitations on the securities or investment strategies involving securities that may be recommended to the customer?**

Material limitations include recommending only proprietary products or a specific asset class; products with third-party arrangements (revenue sharing, mutual fund service fees); products from a select group of issuers; the fact that IPOs are available only to certain clients; and that an AP of a dually registered firm does not offer investment advisory services or is registered in a limited capacity (*e.g.*, Series 6).

○ **The general basis for the recommendation (*i.e.*, what might commonly be described as the firm's investment approach, philosophy, or strategy)?**

This may be standardized or a summary; however, the disclosure should also address circumstances when a standardized basis does not apply, and how the BD will notify the customer when that is the case.

As a best practice, firms should encourage APs to discuss the basis for any particular recommendation with their retail customers and the associated risks, particularly when the recommendation is significant to the customer (*e.g.*, the decision to roll over a 401(k) into an IRA).

○ **Risks associated with the recommendation?**

Standardized disclosure is permitted.

9 At or prior to making a recommendation, do you make full and fair written disclosure of all material facts relating to conflicts of interest?

○ Status Completed ✔

Material facts regarding conflicts of interest include, for example: conflicts associated with proprietary products, payments from third parties and compensation arrangements. BDs must disclose all material facts relating to conflicts of interest associated with the recommendation. This does not require that information regarding conflicts be disclosed on a recommendation-by-recommendation basis. Standardized written disclosure of this information may be made, provided that it sufficiently identifies the material facts relating to conflicts of interest associated with a particular recommendation.

10	Do you ensure that you do not use the term "advisor" or "adviser" unless you are a registered investment adviser, a registered municipal advisor, a registered commodity trading advisor or an advisor to a special entity?

Status Completed ✔

Use of the terms "advisor" or "adviser" in a name or title by: (a) a BD that is not also an RIA; or (b) a financial professional that is not a supervised person of an RIA, would presumptively violate Reg BI. Exceptions would include a BD/AP that acts on behalf of a municipal advisor or commodity trading advisor, or an advisor to a special entity. In addition, an RR of a dually registered BD may use firm materials when the BD/IA firm has the term "advisor" or "adviser" in its title.

11	Do APs supplement written disclosures with subsequent oral disclosure?

Status Completed ✔

Oral disclosure of a material fact may be required to supplement, clarify or update written disclosure made previously. BDs must maintain a record that oral disclosure was provided to the retail customer (but not the substance of the disclosure).

Although not required by Reg BI, the SEC encourages, as a best practice, following oral disclosures with timely, written disclosure summarizing the information conveyed orally.

12	Do you have policies and procedures to **identify** and **address** the firm's conflicts of interest?

Status Completed ✔

Firms must have written policies and procedures reasonably designed to identify and, at a minimum, disclose or eliminate all conflicts of interest associated with recommendations covered by Reg BI.

A conflict of interest is an interest that might incline a BD or AP – consciously or unconsciously – to make a recommendation that is not disinterested.

13	Do you have policies and procedures to **identify** and **mitigate** the AP's conflicts?

Status Completed ✔

Conflicts that create an incentive for the AP to place the BD's or AP's interest ahead of the retail customer's interest must be mitigated.

Mitigation measures will depend on the nature and significance of the incentives and a variety of factors related to a BD's business model, such as its size and retail customer base, and the complexity of the security or investment strategy that is being recommended.

14	Do you have policies and procedures to **identify** and **disclose** material limitations on products recommended?

Status Completed ✔

Material limitations include, for example, recommending only proprietary products or a specific asset class; products with third-party arrangements; products from a select group of issuers; or making IPOs available only to certain clients.

15

Do you have policies and procedures to **prevent** material limitations from causing the BD or AP to make recommendations that place the BD's or AP's interest ahead of the retail customer's interest?

Status
Completed ✔

Policies and procedures to prevent harm from material limitations could consist of establishing product review processes for products that may be recommended, including establishing procedures for identifying and mitigating the conflicts of interests associated with the product, or declining to recommend a product where you cannot effectively mitigate the conflict, and identifying which retail customers would qualify for recommendations from the product menu.

As part of this process, firms may consider: evaluating the use of "preferred lists"; restricting the retail customers to whom a product may be sold; prescribing minimum knowledge requirements for APs who may recommend certain products; and conducting periodic product reviews to identify potential conflicts of interest, whether the measures addressing conflicts are working as intended, and to modify the mitigation measures or product selection accordingly.

16

Do you have policies and procedures to **identify** and **eliminate** sales contests, bonuses, non-cash compensation and quotas based on the sale of specific securities or specific types of securities within a limited time?

Status
Completed ✔

Reg BI bans these practices. This requirement does not apply to compensation practices based on, for example, total products sold, or asset growth or accumulation, and customer satisfaction.

This requirement would not prevent a BD from offering only proprietary products, placing material limitations on the menu of products, or incentivizing the sale of such products through its compensation practices, so long as the incentive is not based on the sale of specific securities or types of securities within a limited period of time.

The requirement also is not intended to prohibit: training or education meetings, provided that these meetings are not based on the sale of specific securities or types of securities within a limited period of time; or receipt of certain employee benefits by statutory employees, as these benefits would not be considered to be non-cash compensation for purposes of Reg BI.

17

Have you updated your policies and procedures to ensure **compliance** with Reg BI?

Status
Completed ✔

Reg BI's Compliance Obligation requires that BDs establish, maintain and enforce written policies and procedures reasonably designed to achieve compliance with Reg BI.

In addition to the required policies and procedures, depending on the BD's size and complexity, a reasonably designed compliance program generally would also include: controls, remediation of non-compliance, training, and periodic review and testing.

Firms may be able to satisfy the Compliance Obligation by adjusting their current systems of supervision and compliance, rather than creating new ones.

18 Have you updated your policies and procedures and systems to ensure Reg BI's **recordkeeping** obligations are satisfied?

Status Completed ✔

SEA Rules 17a-3(a)(35) and 17a-4(e)(5) codify the recordkeeping requirements associated with Reg BI.

Current recordkeeping practices will not fully satisfy Reg BI. For example, BDs must provide retail customers with additional disclosures that require records. Firms may use a risk-based approach to documenting compliance with Reg BI.

19 Have you implemented **training** to ensure that APs are aware of Reg BI's requirements?

Status Completed ✔

The SEC noted that training generally is an important vehicle to communicate firm culture, specific requirements of a firm's code of conduct and its conflicts management framework.

20 Have you aligned your policies and procedures to the **definitions** in Reg BI?

Status Completed ✔

Retail Customer

Reg BI only applies to recommendations to "retail customers." Reg BI defines a "retail customer" as a natural person, or the **legal representative** of such person, who: (a) receives a **recommendation** for any securities transaction or **investment strategy** from a BD or AP; and (b) **uses** the recommendation primarily for **personal, family or household purposes**.

Legal Representative

"Legal representative" includes the non-professional legal representatives of such a natural person, *e.g.*, a non-professional trustee that represents the assets of a natural person. Reg BI would not apply when the legal representative is acting in a professional capacity as a regulated financial services industry professional retained to exercise independent professional judgment. Therefore, recommendations to registered IAs and BDs or corporate fiduciaries would not trigger Reg BI. On the other hand, recommendations to non-professional trustees, executors, conservators and persons holding power of attorney that represent natural persons are covered.

Recommendation

The final rule release for Reg BI states that this is keyed off of the guidance for FINRA's suitability rule.

Investment Strategy

The final rule release for Reg BI states that this is keyed off of the guidance for the FINRA's suitability rule; however, this will include recommendations of types of accounts.

Receives and Uses

The SEC has stated that "use" means when, as a result of the recommendation:

- the retail customer opens a brokerage account with the BD, regardless of whether the BD receives compensation;
- the retail customer has an existing account with the BD and receives a recommendation from the BD, regardless of whether the BD receives or will receive compensation, directly or indirectly, as a result of the recommendation; or
- the BD receives or will receive compensation, directly or indirectly, as a result of that recommendation, even if that retail customer does not have an account at the firm.

Personal, Family, or Household Purposes

The phrase "primarily for personal, family, or household purposes" covers any recommendation to a natural person for his or her account, other than recommendations to a natural person seeking these services for commercial or business purposes. Reg BI would not cover, for example, an employee seeking services for an employer or an individual seeking services for a small business or on behalf of another non-natural person entity, such as a charitable trust.

Conflict of Interest

A conflict of interest is an interest that might incline a BD or AP – consciously or unconsciously – to make a recommendation that is not disinterested.

Full and Fair

Sufficient information to enable a retail customer to make an informed decision with regard to a recommendation.

FORM CRS

1 Have you developed a two-page (four for dual registrants) **relationship summary known as Form CRS**?

Status: ○ Completed ✔

This applies to both IAs and BDs. Firms must write their relationship summaries in plain language, taking into consideration retail investors' level of financial experience. Firms are encouraged, but not required, to use electronic and graphical formatting.

2 Does your **relationship summary** include:

Status: ○ Completed ✔

○ **An introduction to the firm?**

This must include: (a) the name of the BD or IA, and whether the firm is registered with the SEC as a BD, IA or both; (b) an indication that BD and IA services and fees differ and that it is important for the retail investor to understand the differences; and (c) a statement that free and simple tools are available to research firms and financial professionals on the SEC's investment education website (Investor.gov/sec), which provides educational materials about BDs, IAs and investors.

○ **A description of services and advice that can be provided?**

The relationship summary must describe all relationships and services offered to retail investors, even if the investor at issue does not qualify for or is not being offered a particular service currently.

○ **A description of fees and costs, applicable standard of conduct, and examples of how the firm makes money and conflicts of interest?**

Firms must summarize the principal fees and costs that retail investors incur with respect to their BD and IA accounts, and the conflicts they create.

○ **Relevant disciplinary history?**

The relationship summary must include a separate section about whether a firm and its financial professionals have reportable disciplinary history and where investors can conduct further research on these events.

○ **How additional information may be obtained?**

Firms must state where retail investors can find additional information about their BD and IA services.

○ **Prescribed "conversation starters" for investors to ask?**

If a required disclosure or conversation starter is inapplicable to your business, or specific wording required by the Form's instructions is inaccurate, you may omit or modify that disclosure or conversation starter.

FORM CRS

3	Do you have a process in place to **file** the Form CRS?
○ Status Completed ✔	Firms must file the relationship summary through Web CRD® (dual registrants will be required to file their relationship summaries using both IARD™ and Web CRD®).
4	Do you have a process in place to **update** the Form CRS?
○ Status Completed ✔	Firms must update Form CRS and file it within 30 days whenever any information becomes materially inaccurate. Firms must communicate any changes in the updated relationship summary to retail investors who are existing clients or customers within 60 days after the updates are required to be made and without charge. Firms can make the communication by delivering the amended relationship summary or by communicating the information through another disclosure that is delivered to the retail investor. Form CRS General Instruction 8 sets forth requirements for updating the relationship summary, including filing and delivering an exhibit that highlights changes to an updated relationship summary.
5	Are you **delivering** Form CRS to each **new or prospective customer** who is a retail investor before or at the earliest of:
○ Status Completed ✔	(a) a recommendation of an account type, a securities transaction or an investment strategy involving securities; (b) placing an order for the retail customer; or (c) the opening of a brokerage account for the retail customer? If included in a packet of information, the relationship summary must be placed first. If the relationship summary is delivered electronically, it must be presented prominently in the electronic medium, for example, as a direct link or in the body of an email or message, and must be easily accessible for retail investors.
6	Do you have a process in place to **deliver** the relationship summary to **existing retail customers**?
○ Status Completed ✔	Firms must deliver the relationship summary to existing retail investor customers before or at the time firms open a new account that is different from the retail investor's existing account. In addition, firms must deliver the relationship summary when they recommend that the retail investor roll over assets from a retirement account, or when they recommend or provide a new service or investment outside of a formal account (*e.g.*, variable annuities or a first-time purchase of a direct-sold mutual fund through a "check and application" process). With respect to existing customers, firms should deliver the relationship summary in a manner consistent with the firm's existing arrangement with that customer and with the SEC's electronic delivery guidance. Firms must initially deliver the relationship summary to each existing retail investor customer within 30 days after the date by which they are first required to electronically file the relationship summary with the SEC.

FORM CRS

7	Are you posting the relationship summary on your **public website**?

Status
Completed ✔

Firms must post the current version of the relationship summary prominently on your public website, if you have one. The instructions set forth requirements, including design requirements, for a relationship summary that is posted on your website.

8	Have you adjusted your **recordkeeping procedures** to reflect the relationship summary?

Status
Completed ✔

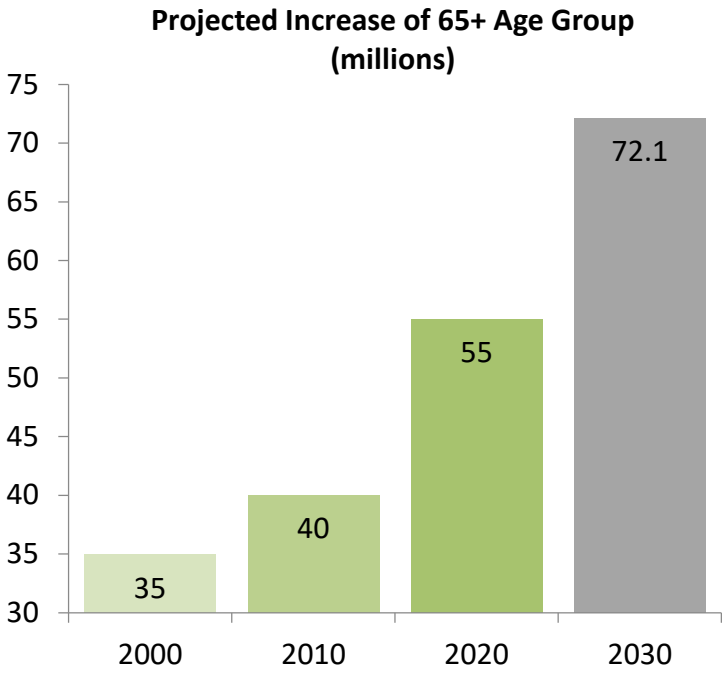
BDs must make and keep current a record of the date that each relationship summary was provided to each retail investor, including any relationship summary that was provided before such retail investor opens an account.

BDs must maintain and preserve, in an easily accessible place, the following records until at least six years after such record or relationship summary is created: (a) all records of the dates that each relationship summary was provided to each retail investor, including any relationship summary that was provided before such retail investor opens an account, as well as (b) a copy of each relationship summary.

The Importance of Protecting a Growing Senior Population

10,000…

10,000 Americans will turn 65 every day Through 2030.



- Currently, Americans over the age of 50 account for **77%** of all financial assets in the United States (and more than half of them utilize financial advisors)
- By 2030…
  - Seniors aged 65+ will account for **18%** of the nation's population

Life expectancies are on the rise and cases of reported elder abuse are increasing. ***This is not a problem that is going away.***

The Fraud Concern

Familiar Faces

- Unfortunately, more than half of all senior financial exploitation is perpetrated by **friends, family members, or caregivers**. This exploitation can be wide-ranging, is often the most difficult to prevent, and is the most under-reported form of senior financial exploitation. A victim of such exploitation may even seek to cover-up such abuse out of feelings of guilt, shame, or loyalty.

- A Metlife study found that seniors lose at least **$2.9 billion** each year to **financial exploitation in media-reported cases***

- The National Adult Protective Services Association estimates that only **1 in 44 cases of financial abuse are ever reported to the authorities**

*The Metlife Study of Elder Financial Abuse, June 2011

Financial Exploitation Is…

- Third party fraud
- Family member exploitation
  - Inheritance Impatience
- Red flags of exploitation
- Red flags of cognitive impairment

Non-financial Consequences

- Psychological
  - Loss of independence/security
  - Relationship disruptions
  - Fearful, depressed, suicidal
  - Change of plans for future
- Health
  - Unable to afford medications
  - Hospitalization
  - Mortality
- Secondary Victims
  - Financial support
  - Loss of wealth transfer
  - Costs to society

New Tools in the Toolbox

- New FINRA Rules (Feb. 2018)
  - Rule 2165 – Hold on Disbursements
  - Rule 4512 – Trusted Contact Form

TRUSTED CONTACT

SENIOR INVESTORS

Trusted Contact Authorization Form

- To be used in certain circumstances:
  - If customer cannot be reached
  - If firm has concerns about health status or well being of customer
  - If firm believes customer may be a victim of fraud/exploitation.
- Allows firms to share information

Trusted Contact Authorization Form

Lincoln Financial Network

Account Number(s):

By my signature below, I authorize Lincoln Financial Network ("LFN") and its affiliates to share my nonpublic personal information* held by LFN to the named Authorized Individual identified below.

I authorize this information to be shared with the Authorized Individual at the discretion of LFN. This authorization includes, but is not limited to, any of the undersigned client's information regarding securities, insurance, bank related, financial planning or other financial products or services offered by or through LFN or any financial information the undersigned may have provided to LFN.

I understand that LFN may contact the named Authorized Individual if there are questions/concerns about my whereabouts or health status (i.e., if LFN becomes concerned that I might no longer be able to handle my financial affairs) or in the event that LFN becomes concerned that I may be a victim of fraud or exploitation.

LFN suggests that the named Authorized Individual not be someone authorized to transact business on the account or who is already otherwise able to receive the information described above.

Name of Trusted Contact Person:	Evening Phone:	Relationship:
Daytime Phone:		Email:
Street Address:		City and State:

Check here if this Trusted Contact Authorization supersedes a previous Contact Authorization:

I understand that there is no requirement that LFN reach out to my contact person and that I may withdraw this Trusted Contact Authorization at any time by notifying LFN in writing at the address shown on my account statement. By signing below, I and my heirs, hold LFN harmless if we either act, or fail to act, on your stated preferences based upon our own best judgement.

Client Signature

Printed Name

Date

DRAFT

* "Nonpublic personal information" includes, but is not limited to: financial account information and balances, recommendation for purchase of a security or insurance product, and, as defined in Title V of the Federal Financial Services Modernization Act of 1999 as amended, or as defined by any other federal or state law, personally identifiable financial information-(i) provided by a consumer to a financial institution, (ii) resulting from any transaction with the consumer or any service performed for the consumer, or (iii) otherwise obtained by the financial institution.

Lincoln Financial Network is the marketing name for the retail sales and financial planning affiliates, Lincoln Financial Securities Corporation and Lincoln Financial Advisors Corporation, both dually registered broker-dealer and investment adviser entities.

LFN11673

Page 1 of 1
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More Tools in the Toolbox

- Senior Safe Act of 2017
  - Provides broader protections for firms that report suspicions of elder financial exploitation to State and Federal regulators and investigators

- New NAPSA Financial Information Request Form

FINRA & FINRA Foundation

Research:

- Exposed to Scams: What Separates Victims from Non-Victims? (October 2019)
- Understanding and Combating Investment Fraud (October 2017)
- Findings from a Pilot Study to Measure Financial Fraud in the United States (February 2017)

FINRA Securities Helpline for Seniors

- Toll-free 844-57-HELPS (844-574-3577)

Useful Websites

- SIFMA: www.sifma.org/seniorinvestors
- Department of Justice: www.elderjustice.gov
- NAPSA APS Database: www.napsa-now.org
- WISER: www.wiserwomen.org
- FINRA: www.finra.org/rules-guidance/key-topics/senior-investors
- NASAA Securities Administrator Reporting: www.serveourseniors.org/connect
- National Resource Center on LGBT Aging: https://www.lgbtagingcenter.org/

AARP'S BANKSAFE™ INITIATIVE

Think. Do. Disrupt.

Jilenne Gunther, MSW, JD
Director of BankSafe

AARP® Real Possibilities

1 THINK

What is the problem?

---

2 DO

How can we get ahead of the problem?

---

3 DISRUPT

How can we work together to outsmart the perpetrators?

1 THINK

What is the problem?

“The illegal or improper use of an Older Americans funds, property, or assets”

The Problem Affects Everyone

Victims

$120,000

(Older Americans 50+)

Caregivers

$36,000

Financial Institutions

$1 billion

Why Does This Matter?

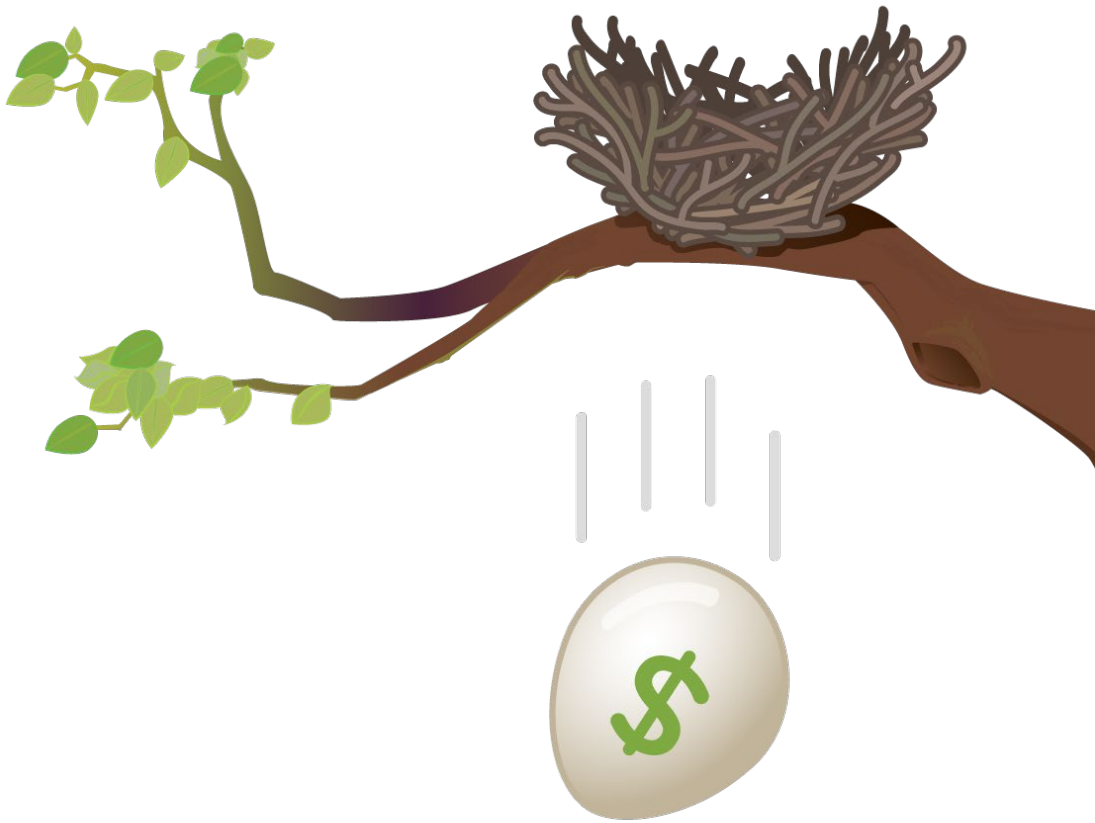
RETIREMENT SAVINGS LOST:

Average Victim Loses

$120,000

Average Retirement Savings at 50

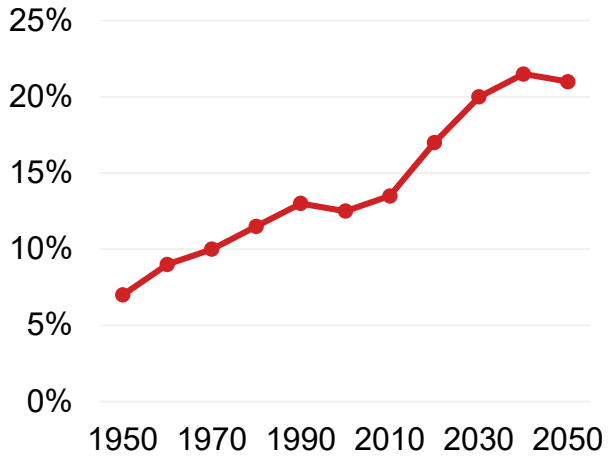
$108,000



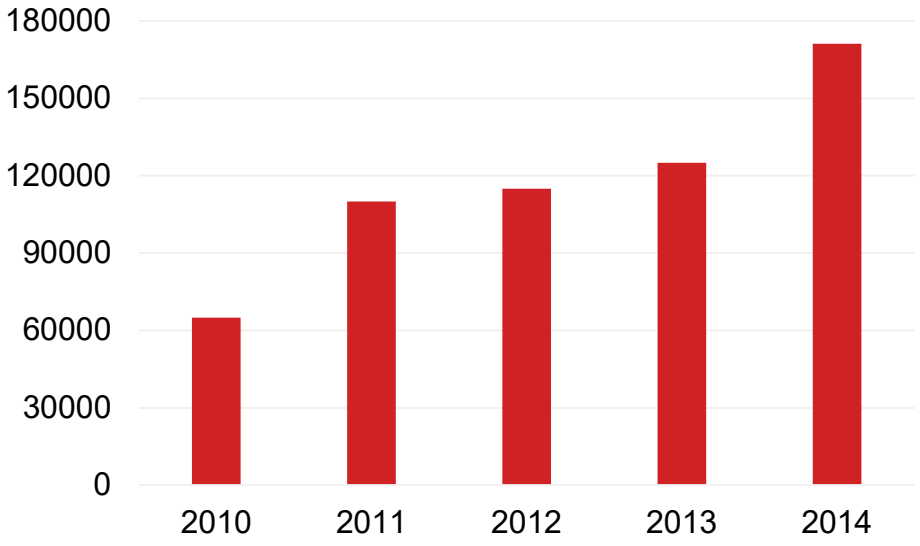
AARP Real Possibilities

The Problem is Only Going to Get Worse

People age 65 and older as a percentage of the U.S. population



Increase in complaints by people age 60 and over[1]



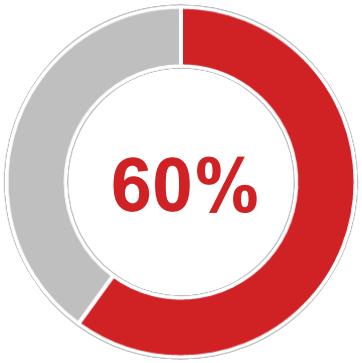
Sources: Census Bureau; Federal Trade Commission (fraud complaints)
1. 1950 excludes Alaska and Hawaii. 2. Figures are for complaints by consumers who reported their age.

AARP Real Possibilities

What is the Risk?

$18 Trillion in Assets will move between the generations in the next 20 years.

How Does Exploitation Happen?



of the amount taken comes from accounts at financial institutions.

Consumer Insights

41%

41% of consumers better trusted their financial institution based on how it handled an exploitation situation.

4 out of 5 older consumers prefer establishing accounts at a credit union with at least one exploitation-prevention service.

85% prefer their financial institution's employees to be highly trained to detect and prevent exploitation. More than discounts.

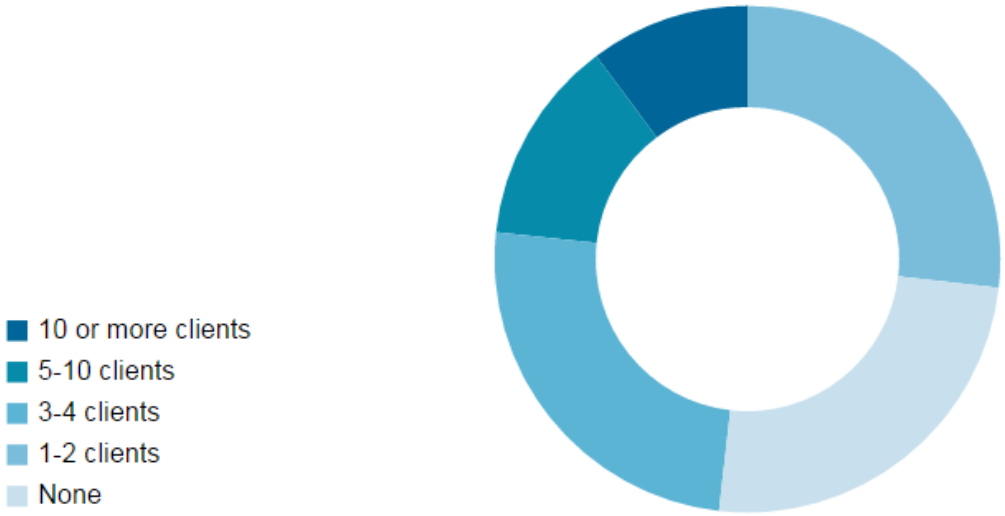
AARP Real Possibilities

Advisors are on the Frontline in this Battle

AARP Real Possibilities

Advisors are on the Frontline in this Battle

How many of your clients have shown signs of diminished mental capacity?

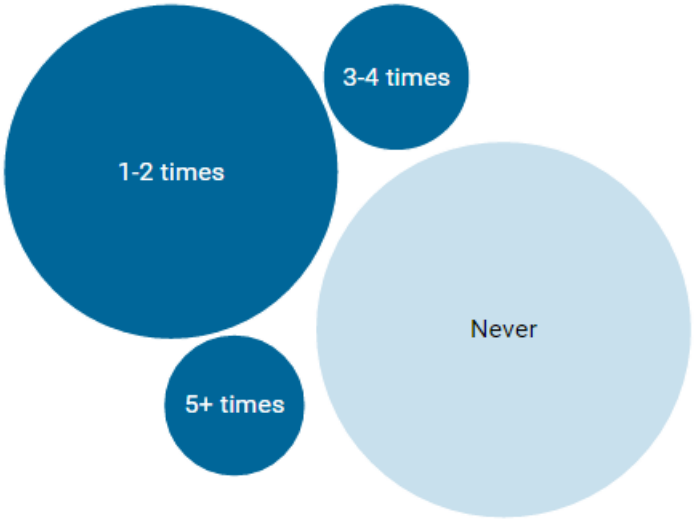


AARP Real Possibilities

Reference: Idzelis, C. Advisors on the Frontlines in Battle Against Financial Abuse of the Elderly. Investment News.

Advisors are on the Frontline in this Battle

How many times in your career have you seen or suspected financial abuse of an elderly client?

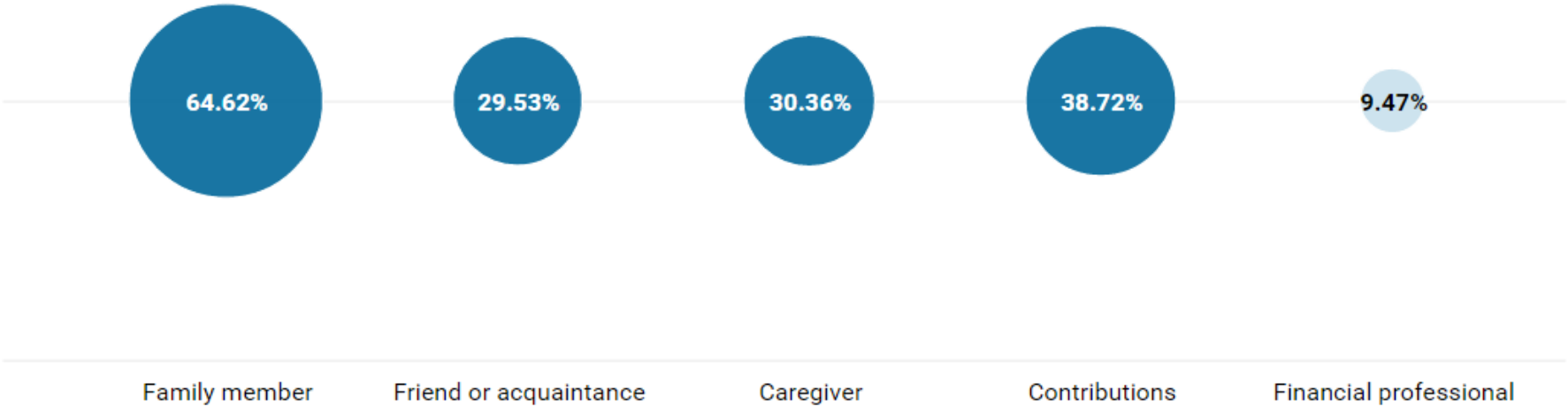


Reference: Idzelis, C. Advisors on the Frontlines in Battle Against Financial Abuse of the Elderly. Investment News.

Advisors are on the Frontline in this Battle

Who was the suspected perpetrator?

Asked of all participants who responded they "have seen or suspected financial abuse"



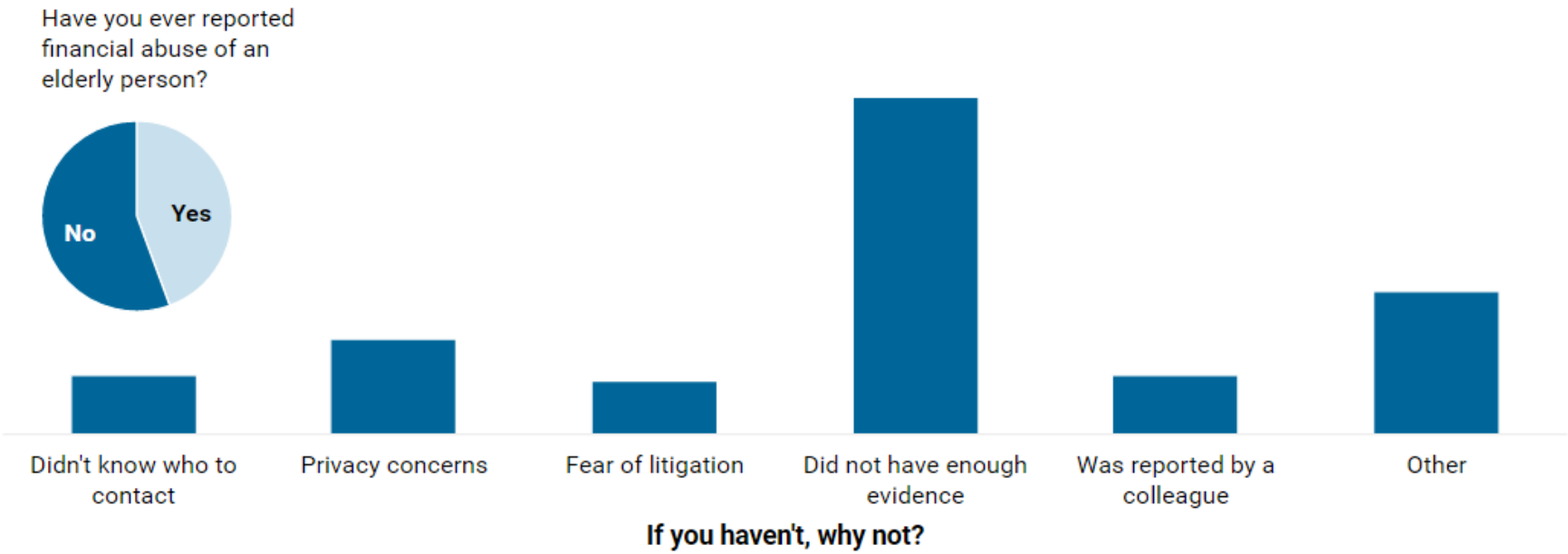
AARP Real Possibilities

Reference: Idzelis, C. Advisors on the Frontlines in Battle Against Financial Abuse of the Elderly. Investment News.

Risk of Not Providing Internal Training

Those who have reported financial abuse of an elderly person — and those who haven't

Asked of all participants who responded they "have seen or suspected financial abuse"



Reference: Idzelis, C. Advisors on the Frontlines in Battle Against Financial Abuse of the Elderly. Investment News.

Advisors Interest in Internal Training

83%

of advisors would like **mandatory training.** Yet only 33% are required to take such training.

2 DO

How can we get ahead of the problem?

How Can We Work Together to Outsmart the Perpetrators?

TRAINING & EDUCATION

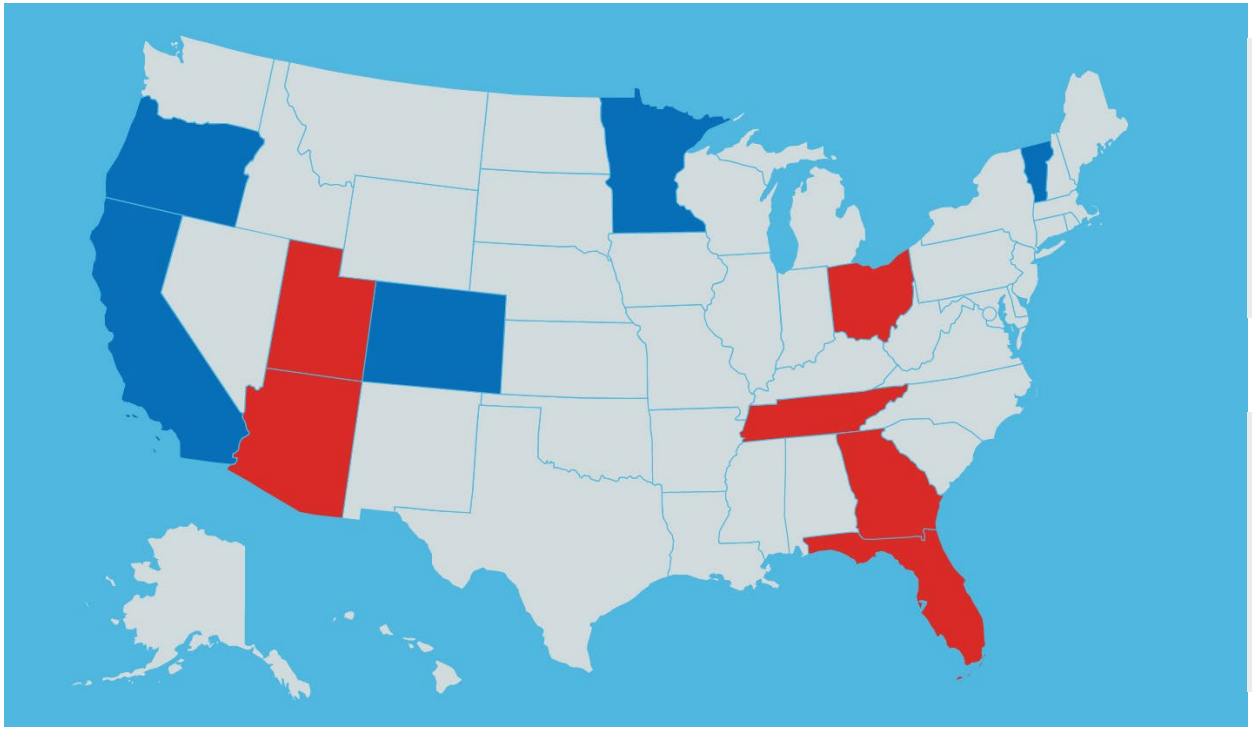
How Do We Get Ahead of the Problem?

Real action before the money leaves the account…

Senior Safe Act

- Senior Safe Act became federal law in 2018.
- Senior Safe Act provides immunity from liability when reporting exploitation in good faith for those satisfying its requirements.

The Bank*Safe* Pilot Program

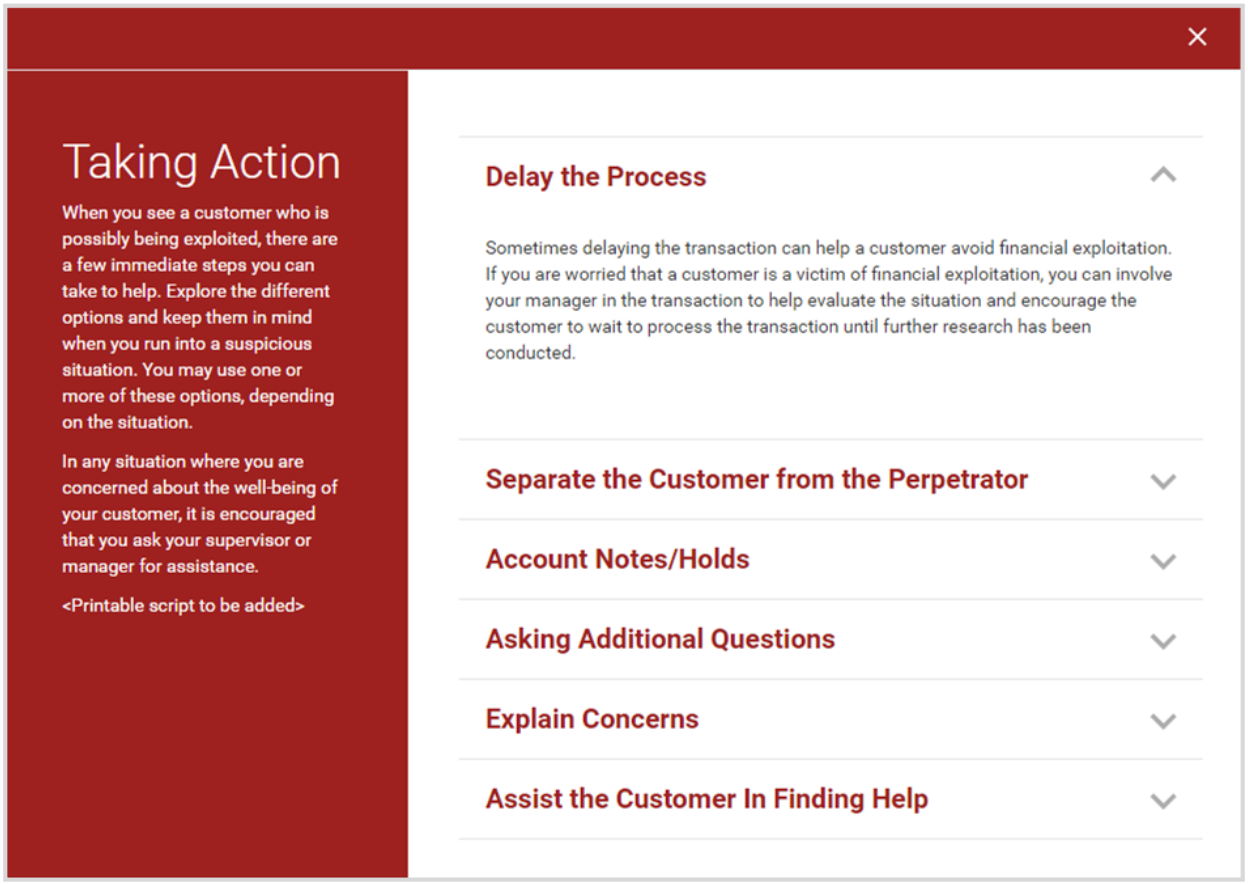


Developed and Reviewed by **200+** Financial Experts

Tested by **2,000** Financial Industry Employees

AARP Real Possibilities

Action Steps



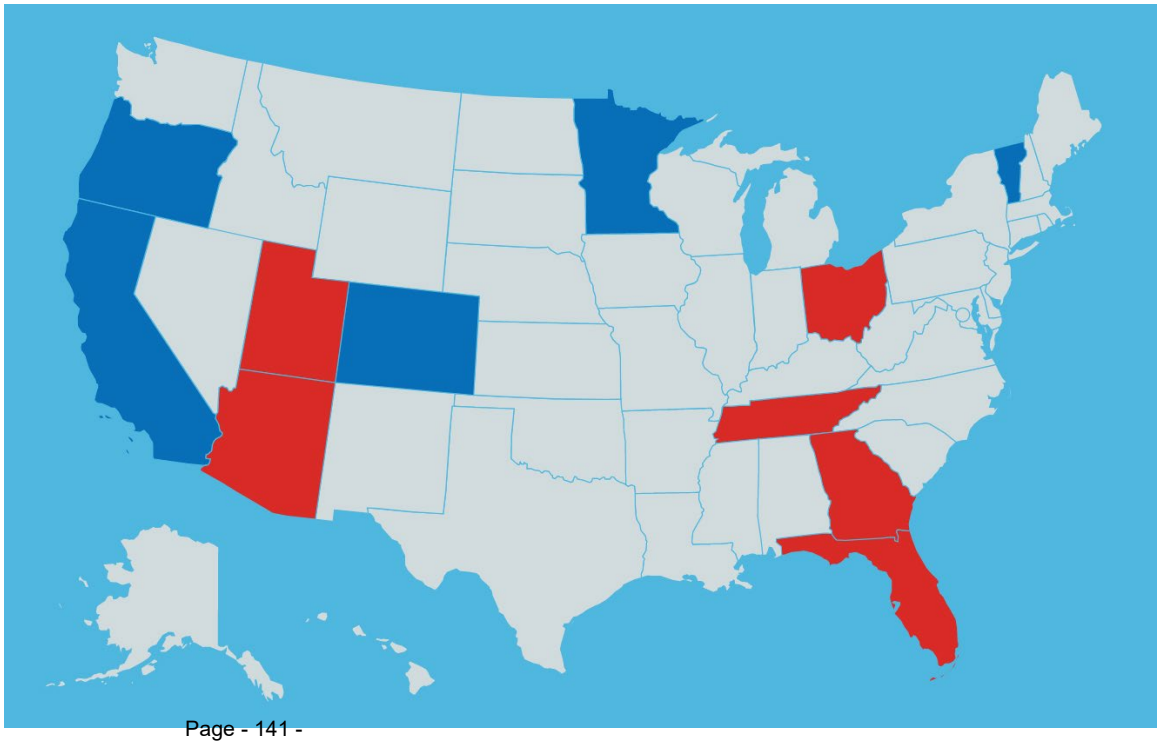
Bank*Safe* Research

6 **month research study prior to national launch**

11 **states involved in the research**

VIRGINIA TECH™

Research partner Virginia Tech Center for Gerontology



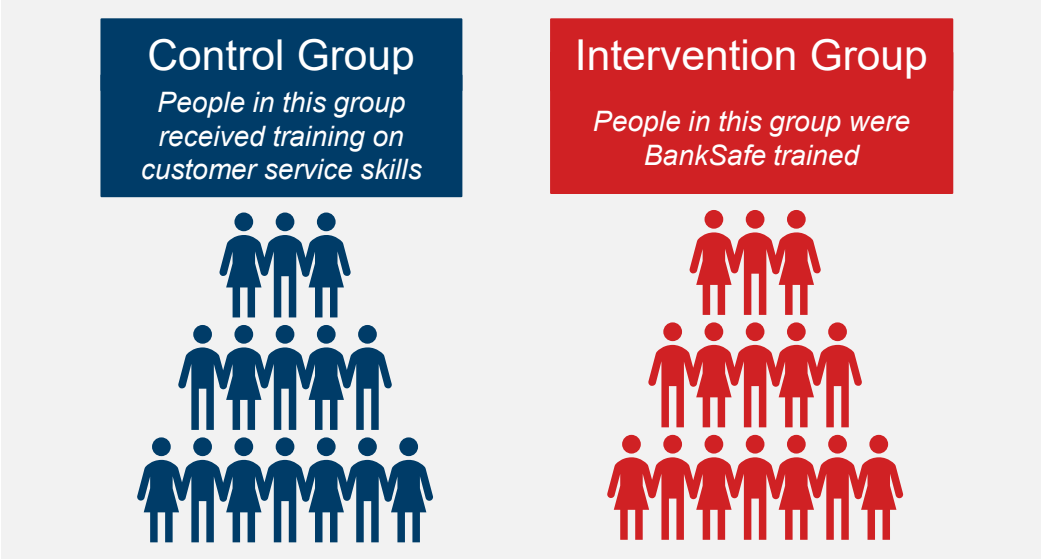
AARP® Real Possibilities

Research Sample

1,816 **completed the Bank*Safe* training**

1,042 in the Bank*Safe* trained group
774 in the control group

Scientific random process to assign control group vs. intervention group



AARP Real Possibilities

Majority of sample in both the intervention and control group had taken a financial exploitation course within the last year

1

KNOWLEDGE

Did the Bank*Safe* Training Increase Knowledge?

2

CONFIDENCE

Did the Bank*Safe* Training Increase Confidence?

3

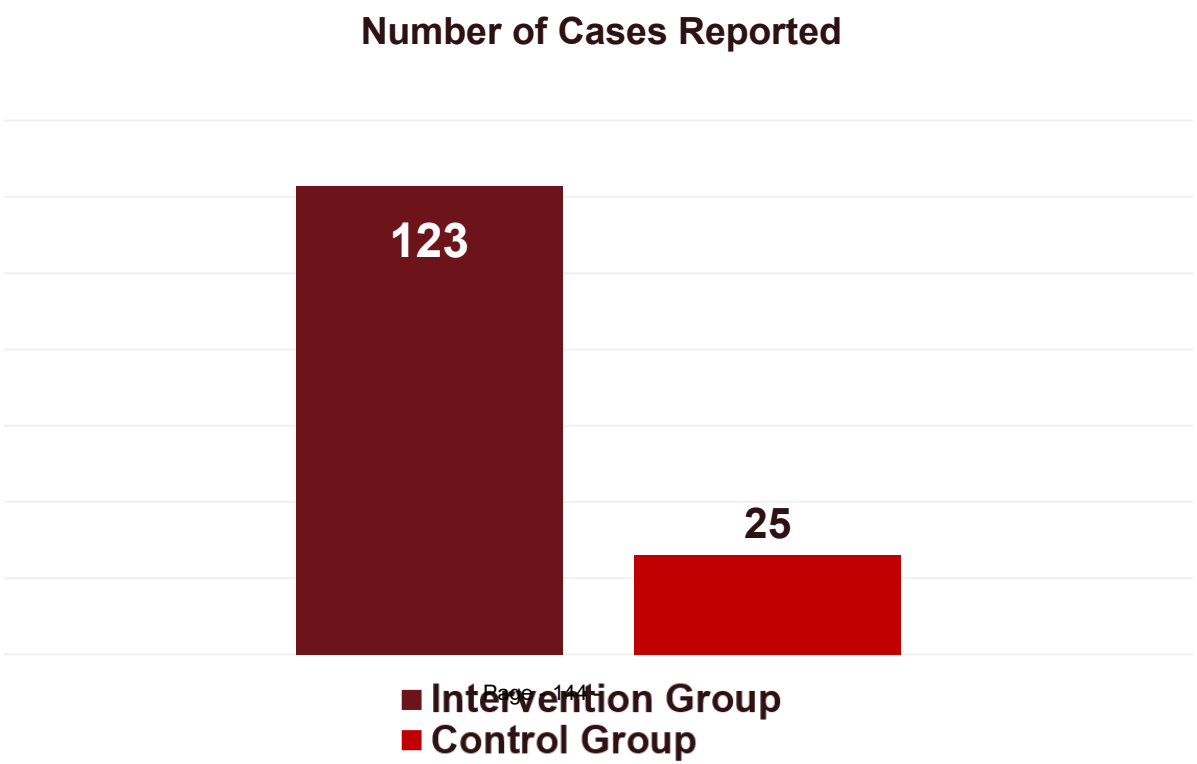
SAVE MONEY

Did the Bank*Safe* Training Group Save Consumers' Money?

AARP Bank*Safe* Trained Group Reported Exploitation at a Significantly Higher Rate

4x

The Bank*Safe* trained group reported exploitation at a rate 4 times higher than the control group.

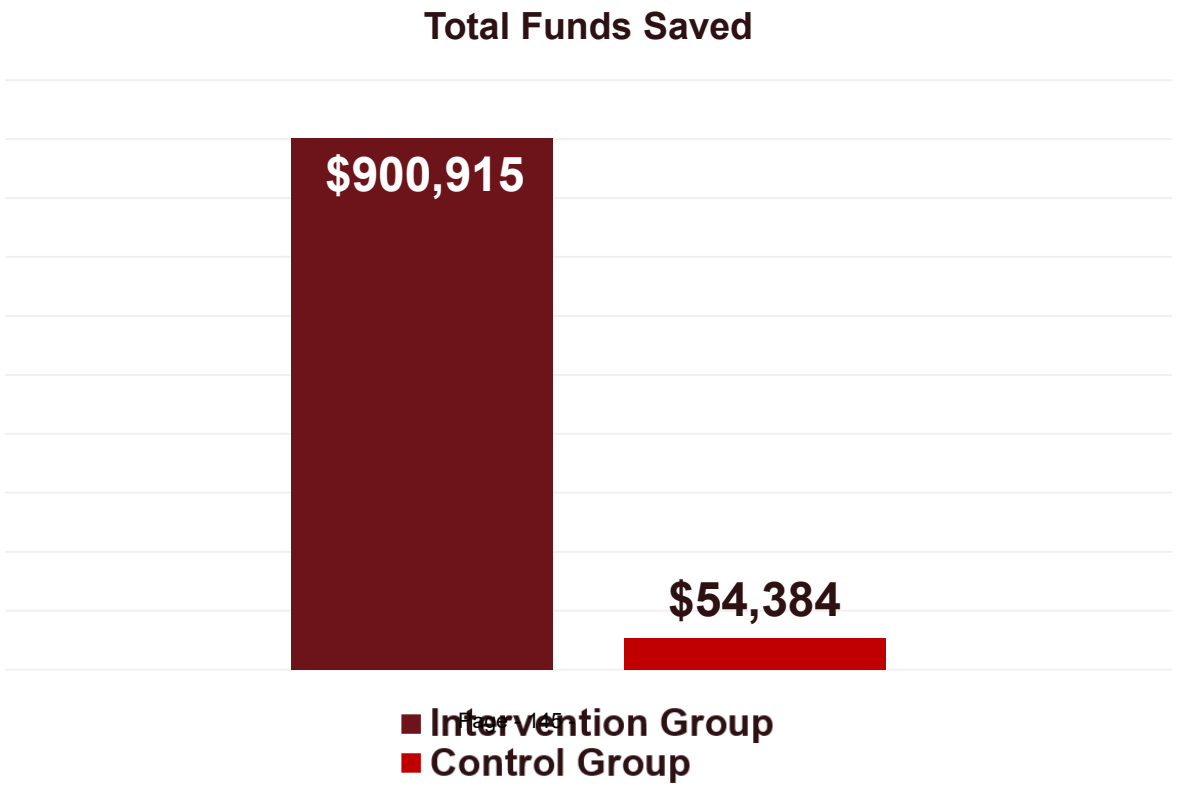


AARP Real Possibilities

The AARP Bank*Safe* Trained Group Saved a Significant Amount of Money

16x

The Bank*Safe* trained group saved just under $1 million, which is 16 times more than the control group.

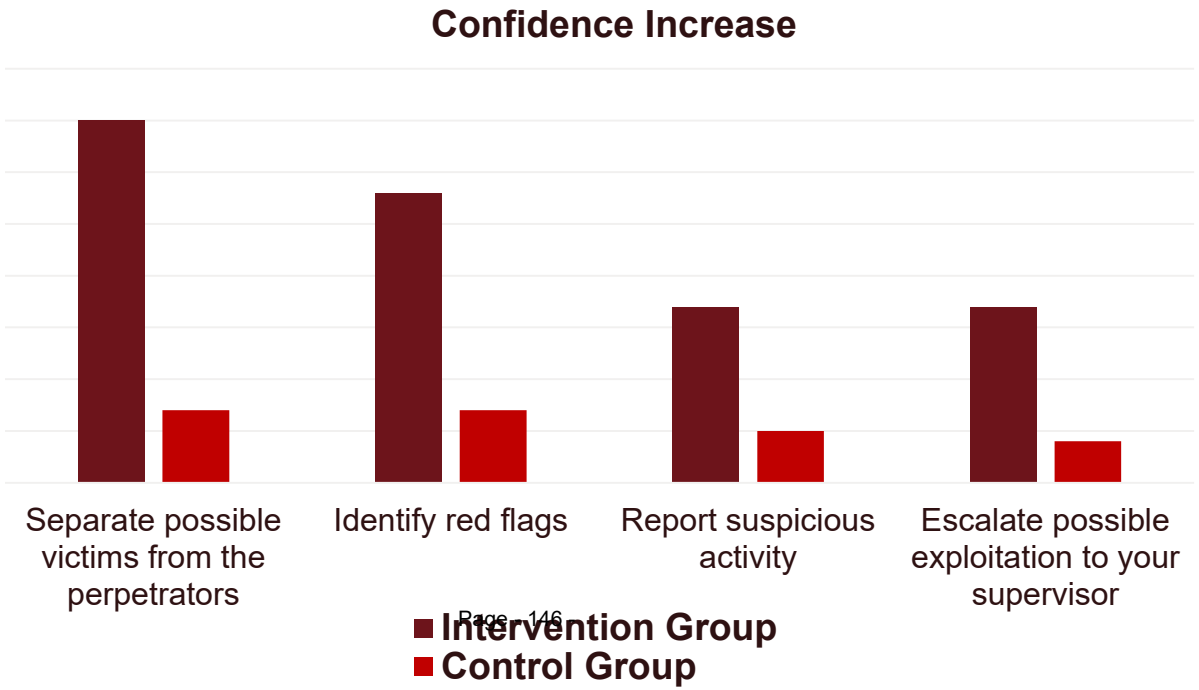


AARP Real Possibilities

The AARP Bank*Safe* Training Increases Confidence

4x

After the training, Bank*Safe* learners reported having four times as much confidence in recognizing, preventing, and reporting cases of exploitation than before the training compared to the control group.

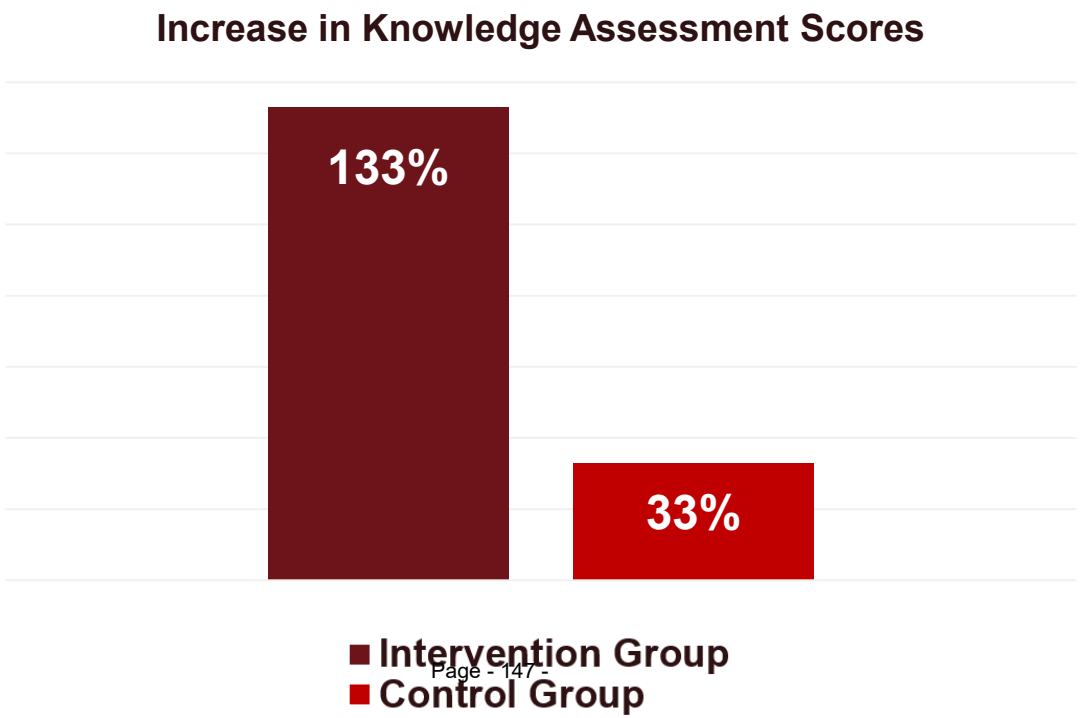


AARP Real Possibilities

The AARP Bank*Safe* Training Increases Knowledge

133%

Post-test scores improved 133% among those who had gone through the Bank*Safe* training, indicating a significant increase in knowledge of financial exploitation.

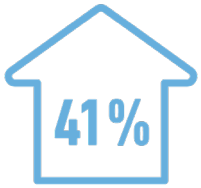


AARP Real Possibilities

Training Benefits

Saves Money

Two banks saved a total of more than $3 million in funds when they trained their frontlines on preventing exploitation.



Establishes Trust

41% increase in customer trust when financial institutions resolve an exploitation situation.

Meets Regulatory Guidance

AARP Real Possibilities

Multi-Award Winning Training

40TH ANNUAL
BRONZE
WINNER
The Telly Awards

14TH ANNUAL
Small Firms. Big Ideas.
Davey
AWARDS
SILVER WINNER

OMNI
AWARDS
GOLD

HORIZON
INTERACTIVE AWARDS
2018 SILVER WINNER

PLATINUM
LEARNX LIVE!
AWARDS 2019
WINNER
12TH GLOBAL

AARP
Real Possibilities

Industry is Praising Our Award-Winning Training

"[The Bank*Safe* training is] the gold standard in the industry."

"…huge asset to banks and credit unions around the country."

"…a win-win for everybody. How would you not take advantage of this type of training?"

"The Bank*Safe* training really has the fingerprints and the approval of banks and credit unions all across the country."

"The Bank*Safe* training is a game changer…"

"One of the best things about working on Bank*Safe* has been how collaborative AARP has been …"

AARP Real Possibilities

Free to All Credit Unions

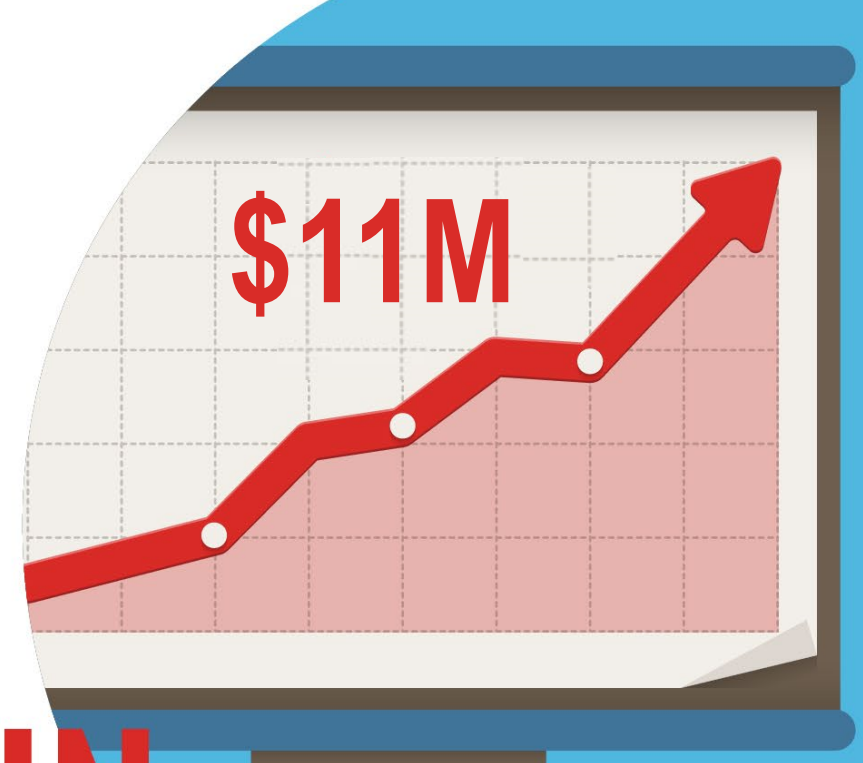
Register at aarp.org/banksafe

AARP Real Possibilities

3 DISRUPT

How can we work together to outsmart the perpetrators?

- ✓ Reputational risk
- ✓ Prevents loss
- ✓ Creates stronger member relationships and trust
- ✓ Improves employee morale and performance



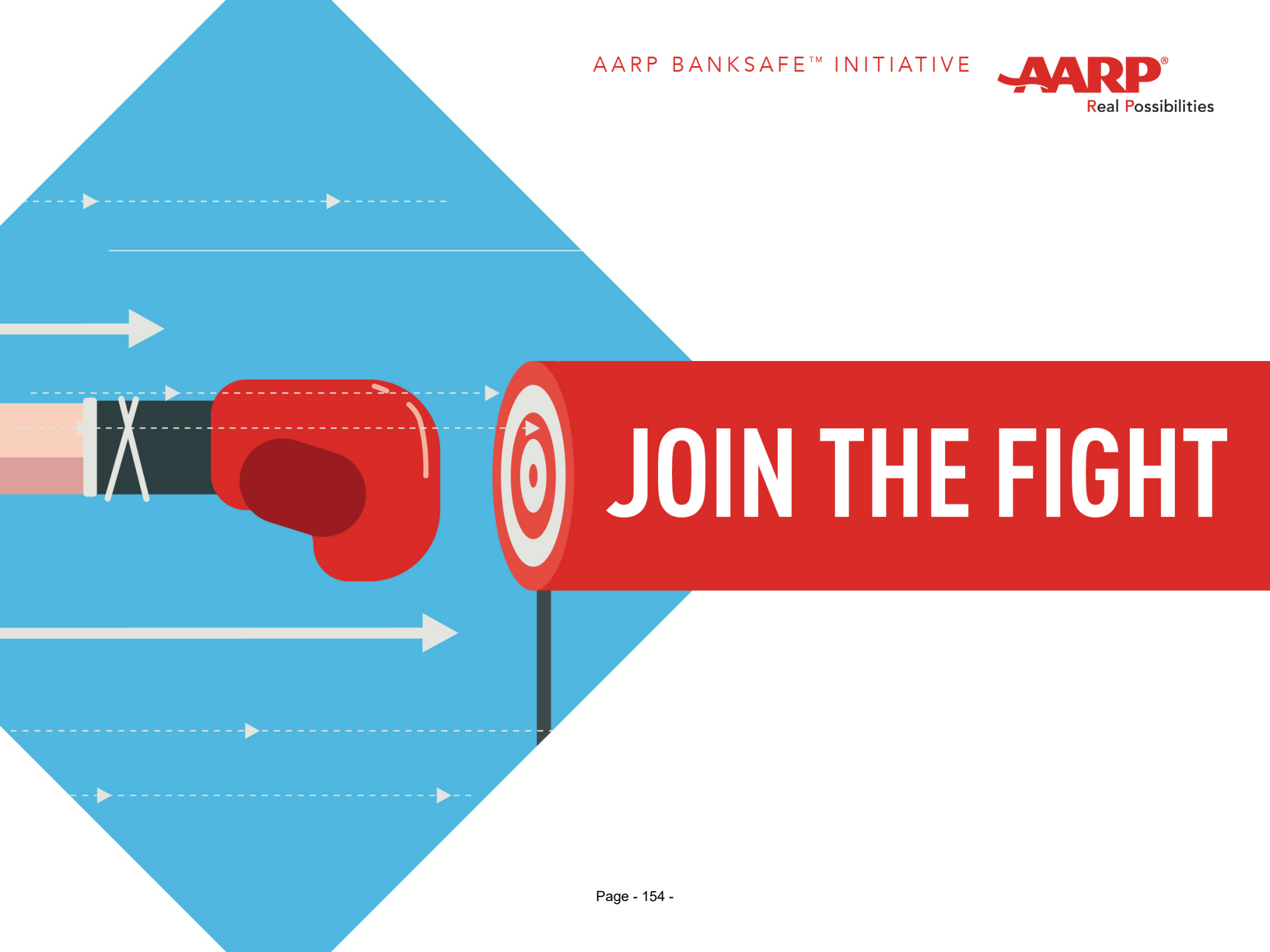
In seven months, Bank*Safe* has saved over $11 million.

WHY JOIN THE FIGHT?

PERCEIVED BARRIERS EXCHANGED FOR BUSINESS BENEFITS

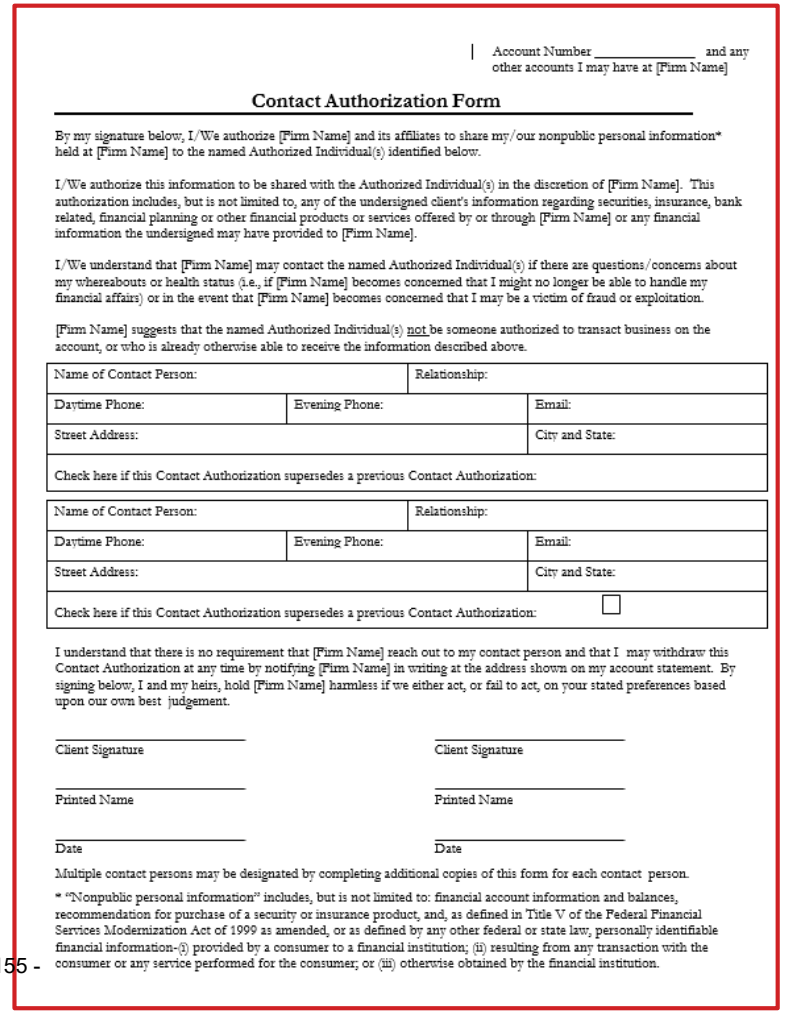
- ✓ Increases brand distinction
- ✓ Saves money
- ✓ Meets regulatory guidance

AARP
Real Possibilities



Trusted Contact Template

- Who to contact?
- Who NOT to contact?



Account Number _____ and any other accounts I may have at [Firm Name]

Contact Authorization Form

By my signature below, I/We authorize [Firm Name] and its affiliates to share my/our nonpublic personal information* held at [Firm Name] to the named Authorized Individual(s) identified below.

I/We authorize this information to be shared with the Authorized Individual(s) in the discretion of [Firm Name]. This authorization includes, but is not limited to, any of the undersigned client's information regarding securities, insurance, bank related, financial planning or other financial products or services offered by or through [Firm Name] or any financial information the undersigned may have provided to [Firm Name].

I/We understand that [Firm Name] may contact the named Authorized Individual(s) if there are questions/concerns about my whereabouts or health status (i.e., if [Firm Name] becomes concerned that I might no longer be able to handle my financial affairs) or in the event that [Firm Name] becomes concerned that I may be a victim of fraud or exploitation.

[Firm Name] suggests that the named Authorized Individual(s) not be someone authorized to transact business on the account, or who is already otherwise able to receive the information described above.

Name of Contact Person:		Relationship:
Daytime Phone:	Evening Phone:	Email:
Street Address:		City and State:
Check here if this Contact Authorization supersedes a previous Contact Authorization:		

Name of Contact Person:		Relationship:
Daytime Phone:	Evening Phone:	Email:
Street Address:		City and State:
Check here if this Contact Authorization supersedes a previous Contact Authorization: ☐		

I understand that there is no requirement that [Firm Name] reach out to my contact person and that I may withdraw this Contact Authorization at any time by notifying [Firm Name] in writing at the address shown on my account statement. By signing below, I and my heirs, hold [Firm Name] harmless if we either act, or fail to act, on your stated preferences based upon our own best judgement.

Client Signature	Client Signature
Printed Name	Printed Name
Date	Date

Multiple contact persons may be designated by completing additional copies of this form for each contact person.

* "Nonpublic personal information" includes, but is not limited to: financial account information and balances, recommendation for purchase of a security or insurance product, and, as defined in Title V of the Federal Financial Services Modernization Act of 1999 as amended, or as defined by any other federal or state law, personally identifiable financial information-(i) provided by a consumer to a financial institution; (ii) resulting from any transaction with the consumer or any service performed for the consumer; or (iii) otherwise obtained by the financial institution.

AARP Real Possibilities

Family Discussion
Dinner without Dessert

Clear Effective Policies and Protocols

AARP BANKSAFE™ INITIATIVE

AUDIT CHECKLIST

Review your policies, training and systems to ensure they contain sound practices to fight financial exploitation.

Specifically, check for inclusion of the following:

Policies:

- External reporting procedures to Adult Protective Services, law enforcement, and the Financial Industry Regulatory Authority, Inc. (FINRA) (i.e. Suspicious Activity Reports).
- Information on Gramm-Leach-Bliley Act regulations and Regulation E.
- References to applicable state laws on financial exploitation—i.e., reporting laws, state's definition of financial exploitation and the specific age at which an older adult is protected.
- Roles and responsibilities for identifying, preventing, and reporting financial exploitation by frontline employees, supervisors, bank security officers, and the board.
- Procedures on responding to record requests from external entities performing investigations.
- Procedures for sharing account information with third parties; use of a "trusted contact form" naming a person to be contacted in the event of suspected exploitation or diminished capacity.
- Procedures enabling and encouraging frontline employees to put notes on accounts for other staff.

Systems:

- A case management system with capabilities for tracking and measuring financial exploitation program effectiveness, covering exploitation case trends and monetary losses and savings.
- Internal reporting and escalation protocols for financial exploitation cases.
- System monitoring for out-of-pattern, large transactions and dormant accounts.
- System alerts triggered by transaction amount, vendor type, and geographical information.
- Ability to add notes on a profile or account level for other employees to review.
- Read-only access to accounts.

Training:

- Information on the following: definition of exploitation, red flags for spotting it, action steps for prevention and reporting of suspicious activity.
- Instruction for frontline staff on recognizing signs of diminished capacity as well as action steps to take when such signs appear.
- Frequent and regular staff-specific training—i.e., tailored to roles including electronic banking operations, retail services, lending services, call centers, and compliance.
- A final assessment required to complete the training.
- A report of certification that can be provided to auditors.
- Training content that include scenarios.
- Requiring staff to repeat training periodically.

AARP Real Possibilities

AARP Real Possibilities

Red Flags Infographic for FAs

THE **RED FLAGS** OF **FINANCIAL EXPLOITATION** AND **COGNITIVE DECLINE**

As clients age, the threat of financial exploitation or cognitive decline grows exponentially, and it is important for individuals with client contact to be vigilant for signs of such events. The following is a list of red flags highlighting conditions or circumstances that may be signs that financial exploitation of a client may be occurring, or that the client is experiencing some level of cognitive decline.

While this list is not exhaustive, and many of the items below can be explained by innocuous phenomena (such as arthritis that causes a client's signature to change or hiring a caregiver for mobility issues), *any individual who recognizes these signs in their client should take the actions identified in their firm's established policies and procedures.*

SOCIAL

Look out for when the client:

- Informs you they have a new, particularly close friend or "sweetheart" and/or they move away from existing relationships towards new associates.
- Is being isolated either deliberately by family or a caregiver, or as a result of life changes.
- Is being accompanied by a caregiver or family member who will not allow the client to speak without them being present.
- Appears or sounds like they are being "coached" by another individual.
- Has an overly trusting personality or a temperament susceptible to manipulation.

PHYSICAL/COGNITIVE

Look out for when the client:

- Has an onset or worsening illness or disability.
- Is dependent on another to provide care.
- Indicates that items are missing from their home.
- Demonstrates a lack of responsiveness or inability to follow-through with a decision.
- Repeatedly calls seeking the same information.
- Requests frequent password/username resets.

BEHAVIORAL

Notice if the client becomes or demonstrates:

- Fearful, distressed or submissive
- Distrusting
- Withdrawn
- Forgetfulness, memory lapses
- Poor judgment
- Disorganized or disoriented
- Changes in their normal routine
- Grief
- Depressed
- Signs of mental illness
- Mood swings
- Alcohol & drug abuse
- Changes in appearance or personal hygiene

POSSIBLE ABUSER INVOLVED

Abuse-related Red Flags include when the client:

- Has family members or others who are financially dependent on the client or who are taking an excessive interest in the client's finances.
- Is reluctant to discuss financial matters which were previously a matter of standard practice.
- Has been denied access to their account statements or funds by someone.
- Relies on a person.
- Is difficult to reach, despite repeated attempts to contact them.
- Has accounts in joint name.

ABRUPT ACCOUNT CHANGES

Finally, notice if the client:

- Has atypical or unexplained withdrawals, wire transfers, debit transactions, or other changes in financial habits.
- Abruptly changes their will, trusts, powers of attorney, or beneficiaries of their accounts.
- Has bills that are not being paid or has mail piling up.
- Suddenly changes their investment style or begins trading excessively in high-risk instruments (such as leveraged ETFs, options or volatile equities) or has excessive outflows or trading losses.
- Has a signature(s) that does not appear to be authentic on documents you receive.
- Has an increase in the number of disbursement requests over a short period of time, or frequent ACH transactions to new accounts or checks issued to unusual recipients.
- Has a debit card tied to their account and the purchases made are inconsistent with their lifestyle or their area of residence or excessive withdrawals.
- Makes changes to transfer on death (TOD) instructions or beneficiary designations in a manner that is unexplained or inconsistent with prior estate plan or prior communication.

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sifma Invested in America

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Dementia Tipsheet for Banks/Credit Unions

AARP BANKSAFE™ INITIATIVE

DECIPHERING DEMENTIA AT YOUR FINANCIAL INSTITUTION

Three out of four people with dementia have difficulty using banks.

x2

The worldwide prevalence of **dementia** is expected to **double by 2050.**

Although banking is an everyday task most of us take for granted, accessing financial services challenges people with dementia. They may begin to have difficulty remembering or understanding their financial decisions.

By recognizing signs of dementia, banks can provide better customer service to their customers.

Know the Signs of Dementia, BUT DO NOT ASSESS CAPACITY

One of the first signs of dementia is the inability to manage one's finances. Frontline employees and families are often the first people to spot the initial signs of dementia.

Other potential signs of dementia include the following:

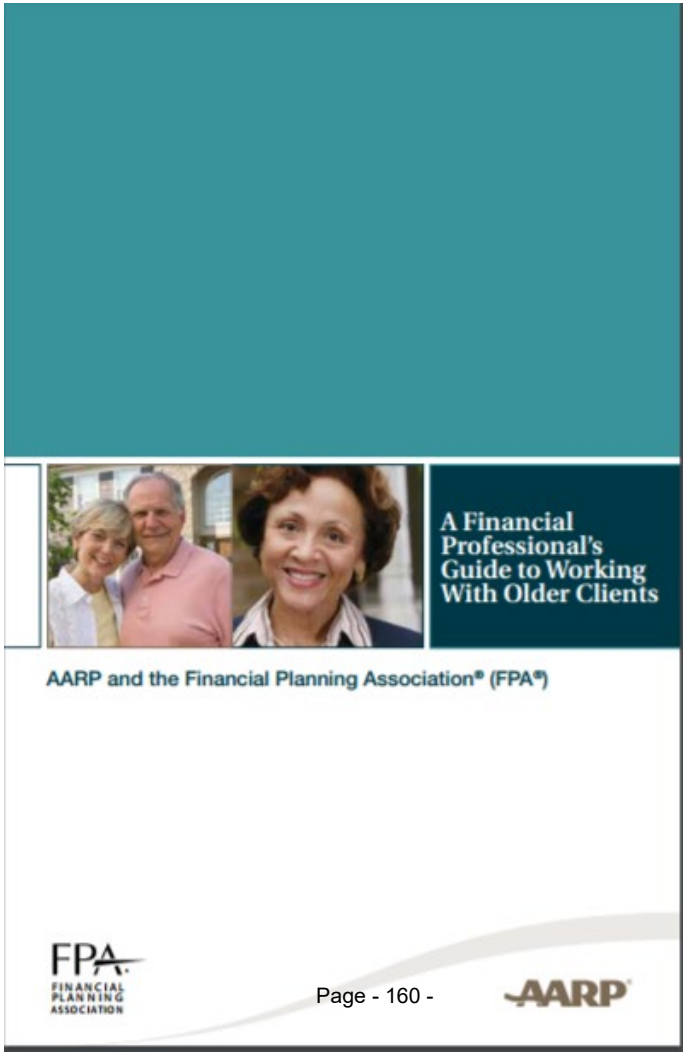
- Taking longer than usual to fill out a form, organize cash, or answer a question
- Forgetting to pay a bill or paying the same bill more than once
- Difficulty completing complicated tasks that require memory, reasoning, and risk assessment
- Repeating questions and increased confusion, stress, or fear

How Frontline Employees can Protect Customers

- Be genuine, be patient, and speak calmly and in short sentences. If a customer seems confused or is repeating questions, the proper response should be reassurance and validation.

AARP Real Possibilities

Financial Professional's Guide to Working With Older Clients



AARP Real Possibilities

THE FINANCIAL INDUSTRY REGULATORY AUTHORITY'S DISPUTE RESOLUTION ACTIVITIES

Revised July 24, 2019

I. BACKGROUND

The Financial Industry Regulatory Authority (FINRA) administers a dispute resolution forum for investors, brokerage firms, and their registered employees in the U.S. through its network of 70 hearing locations, including at least one in each state and Puerto Rico. FINRA administers between 4,000 and 8,500 arbitrations and numerous mediations annually. FINRA maintains a diverse roster of over 7,900 arbitrators and 270 mediators. The National Arbitration and Mediation Committee (NAMC), which is composed of investor, industry, and neutral (arbitrator and mediator) representatives, provides policy guidance to FINRA's Dispute Resolution staff. A majority of the NAMC members and its chair are public. FINRA is regulated by the United States Securities and Exchange Commission (SEC).

FINRA's Dispute Resolution program is administered out of four regional offices: Northeast, Southeast, Midwest, and West, located in New York City, Boca Raton, Chicago, and Los Angeles, respectively, with headquarters in New York City. Contact information for the regional offices, as well as for other FINRA staff, is available on FINRA's website at www.finra.org. Below is a map showing the hearing locations and the regional offices to which they are generally assigned:

Below are highlights on: Statistics and Trends; FINRA Dispute Resolution Task Force; Recent Significant Rule Changes; Proposed Rule Changes; Regulatory Notice on Forum Selection; Significant Initiatives; FINRA Neutrals; Office of Dispute Resolution Technology Initiatives; FINRA Investor Education Foundation; and Mediation.

II. STATISTICS AND TRENDS

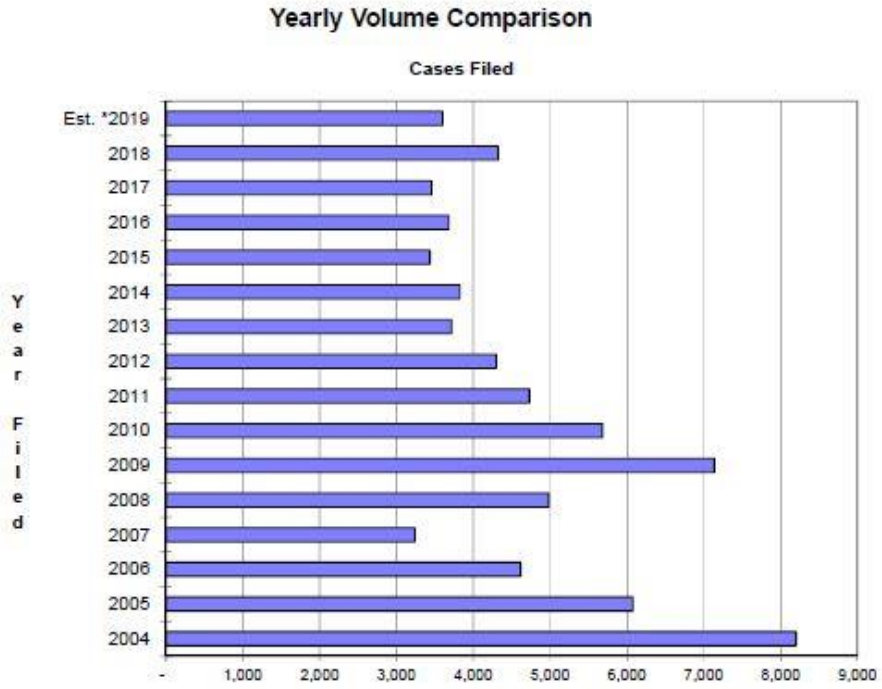
Arbitration case filings decreased in June 2019 compared to June 2018. In June 2019, parties filed 1,799 cases – a 21% decrease from the 2,273 cases filed in June of 2018. Customer claims decreased by 21% compared to June 2018. In June 2019, 38% of filed claims were intra-industry cases.

Mediation cases increased in June 2019 compared to June 2018. Through June 2019, parties filed 287 mediation cases – a 6% increase compared to the 270 mediation cases filed in June 2018.

Case Filing Statistics for 2019 - This section provides key filing data and trends.

Overall arbitration case filings:

- June 2019: 1,799 (21% decrease compared to June 2018).



Mediation case filings

- June 2019: 287 (6% increase compared to June 2018).

Customer Award Statistics

- Cases in which customers are awarded damages
  - 2019 through June:
    - Overall: 44% (40% in 2018, 43% in 2017, and 41% in 2016).

- Hearing cases (not including cases decided by review of documents only): 44% (42% in 2018, 45% in 2017, and 42% in 2016).

Case Processing Statistics

Processing times from service of the claim to close of the case

- June 2019:
  - Overall: 14.1 months (1% decrease compared to June 2018)
  - Hearing cases: 17.3 months (8% increase compared to June 2018)
  - Paper cases (decided on the documents submitted without a hearing): 5.8 months (16% decrease compared to June 2018)
  - Special Proceeding cases: 5.8 months (new category added in 2019)

- Percentage of cases closed by award
  - June 2019: 17% (compared to 17% in 2018, 18% in 2017, and 21% in 2016).
  - In June 2019, Customer cases closed by settlement approximately 74% of the time.

FINRA Office of Dispute Resolution
Top 15 Controversy Types in Customer Arbitrations Through June

Type of Controversy*		2019 Cases Served	2018	2017	2016	2015
Breach of Fiduciary Duty	Through June	981	1,183	920	1,004	763
	Year-End	--	2,290	1,899	2,002	1,807
Negligence	Through June	884	973	816	936	739
	Year-End	--	1,974	1,662	1,862	1,677
Failure to Supervise	Through June	818	959	794	917	665
	Year-End	--	1,935	1,621	1,802	1,554
Misrepresentation	Through June	742	984	771	814	623
	Year-End	--	1,775	1,663	1,670	1,499
Breach of Contract	Through June	722	830	641	771	601
	Year-End	--	1,711	1,318	1,495	1,444
Suitability	Through June	708	1,021	774	788	535
	Year-End	--	1,779	1,606	1,606	1,364
Fraud	Through June	695	864	639	646	417
	Year-End	--	1,707	1,389	1,301	1,089
Omission of Facts	Through June	664	852	684	675	511
	Year-End	--	1,547	1,493	1,394	1,216
Violation of Blue Sky Laws	Through June	291	397	228	166	104
	Year-End	--	810	547	344	236
Manipulation	Through June	166	128	138	137	83
	Year-End	--	302	299	236	208
Unauthorized Trading	Through June	106	128	146	173	123
	Year-End	--	245	263	362	264
Elder Abuse**	Through June	101	117	--	--	--
	Year-End	--	216	61	--	--
Churning	Through June	91	102	127	144	120
	Year-End	--	205	219	254	247
Margin Calls	Through June	50	38	30	39	46
	Year-End	--	85	62	84	97
Errors-charges	Through June	33	45	23	23	30
	Year-End	--	81	66	56	64

* Each case can be coded to contain multiple controversy types. Therefore the columns in this table cannot be totaled to determine the number of cases served in a year.
**These categories were not tracked for the years in which no data appears.

FINRA Office of Dispute Resolution
Top 15 Security Types in Customer Arbitrations Through June

Type of Security *		2019 Cases Served	2018	2017	2016	2015
Municipal Bond Funds	Through June	338	446	205	263	172
	Year-End	--	959	558	480	607
Municipal Bonds	Through June	331	462	209	214	168
	Year-End	--	971	565	433	559
Mutual Funds	Through June	265	341	193	133	105
	Year-End	--	731	447	352	373
Common Stock	Through June	243	324	297	335	251
	Year-End	--	579	604	646	610
Government Securities	Through June	188	222	69	16	19
	Year-End	--	519	229	96	169
Options	Through June	118	103	63	61	65
	Year-End	--	150	127	124	128
Real Estate Investment Trust	Through June	112	91	103	93	93
	Year-End	--	205	177	184	191
Private Equities	Through June	63	54	69	60	46
	Year-End	--	111	111	114	92
Exchange-Traded Funds	Through June	60	104	74	72	66
	Year-End	--	167	131	133	127
Limited Partnerships	Through June	53	77	98	75	41
	Year-End	--	144	183	199	79
Variable Annuities	Through June	53	51	73	51	57
	Year-End	--	105	129	115	104
Annuities	Through June	49	51	58	64	39
	Year-End	--	101	115	127	81
Corporate Bonds	Through June	44	70	57	66	34
	Year-End	--	135	119	154	194
401(k)**	Through June	26	45	38	2	--
	Year-End	--	94	69	27	--
Structured Products	Through June	24	41	21	27	18
	Year-End	--	78	45	57	25

* Each case can be coded to contain multiple security types. Therefore the columns in this table cannot be totaled to determine the number of cases served in a year.
**These categories were not tracked for the years in which no data appears.

FINRA Office of Dispute Resolution
Top 15 Controversy Types in Intra-Industry Arbitrations Through June

Type of Controversy*		2019 Cases Served	2018	2017	2016	2015
Breach of Contract	Through June	175	177	203	195	200
	Year-End	--	413	403	389	373
Promissory Notes	Through June	120	135	138	204	192
	Year-End	--	261	296	401	401
Libel, Slander, or Defamation	Through June	74	90	51	62	57
	Year-End	--	166	117	124	115
Compensation	Through June	71	79	77	73	74
	Year-End	--	168	161	163	140
Libel or Slander on Form U-5	Through June	60	77	64	59	61
	Year-End	--	135	136	124	119
Wrongful Termination	Through June	55	65	59	57	61
	Year-End	--	122	116	127	123
Commissions	Through June	40	42	56	29	39
	Year-End	--	95	103	60	73
Misrepresentation	Through June	26	42	12	5	11
	Year-End	--	68	54	21	17
Discrimination or Harassment**	Through June	26	24	16	32	29
	Year-End	--	38	37	58	54
Breach of Fiduciary Duty	Through June	22	25	17	9	13
	Year-End	--	39	52	18	28
Suitability	Through June	15	53	12	1	1
	Year-End	--	63	59	15	1
Negligence	Through June	14	21	8	5	10
	Year-End	--	32	25	17	21
Omission of Facts	Through June	12	8	8	3	4
	Year-End	--	18	16	7	8
Raiding Disputes	Through June	11	18	14	16	24
	Year-End	--	37	33	42	40
Fraud	Through June	9	13	7	3	7
	Year-End	--	24	26	11	13

* Each case can be coded to contain multiple controversy types. Therefore the columns in this table cannot be totaled to determine the number of cases served in a year.
** This category combines the following discrimination controversy types: disability, age, gender, race, sexual orientation, national origin, religion, employment discrimination, and sexual harassment. This number does not represent the number of cases served, as one case may have multiple discrimination claims.

Comparison of Results of All-Public Panels and Majority-Public Panels in Customer Claimant Cases

Year Decided	Cases Decided by All-Public Panels	Number of Cases Decided by All-Public Panels Where Customer Awarded Damages	Percentage of Cases Decided by All-Public Panels Where Customer Awarded Damages	Cases Decided by Majority-Public Panels	Number of Cases Decided by Majority-Public Panels Where Customer Awarded Damages	Percentage of Cases Decided by Majority-Public Panels Where Customer Awarded Damages
2014	135	59	44%	104	39	38%
2015	163	77	47%	84	38	45%
2016	145	63	43%	72	26	36%
2017	137	66	48%	71	26	37%
2018	158	67	42%	58	27	47%
YTD 2019	74	41	55%	31	9	29%

In June 2019, investors prevailed 55% of the time (41 out of 74 cases) in cases decided by all-public panels and 29% of the time (9 out of 31 cases) in cases

decided by majority-public panels. To find more information on Case Statistics and Award Outcomes please visit the **Dispute Resolution Statistics** page at finra.org.

III. FINRA DISPUTE RESOLUTION TASK FORCE

In 2014, FINRA formed the **FINRA Dispute Resolution Task Force** to suggest strategies to enhance the transparency, impartiality, and efficiency of FINRA's securities dispute resolution forum for all participants. The Task Force brought together a diverse group of leading investor advocates, academics, regulators, and industry representatives to help ensure that FINRA's arbitration and mediation processes continue to serve the needs of the investing public. Seven Task Force members serve on FINRA's arbitrator roster.

The Task Force established an email inbox, which was available throughout the process, to solicit comments from interested parties. It also directly solicited written comments from more than 30 interested organizations and individuals. Over a period of 14 months, the Task Force held four in-person meetings, and its ten subcommittees met 57 times. On December 16, 2015, the Task Force issued its final report and recommendations Final Report and Recommendations of the FINRA Dispute Resolution Task Force. The Task Force recommendations focus, among other matters, on arbitrator training and recruitment, and expanded use of explained decisions and mediation.FINRA Dispute Resolution Task Force members:

- Barbara Black – Retired Professor and Director, Corporate Law Center, University of Cincinnati College of Law (Chair);
- Philip Aidikoff – Investor attorney, Aidikoff, Uhl & Bakhtiari;
- Joseph Borg – Director, Alabama Securities Commission;
- Philip Cottone – FINRA arbitrator and mediator;
- John Cullem – FINRA arbitrator;
- Sandra Grannum – Industry attorney, Davidson & Grannum;
- Mark Maddox – Investor attorney, Maddox Hargett & Caruso;
- Kevin Miller – General Counsel, Securities America;
- Joseph Peiffer – Investor attorney, Peiffer Rosca Wolf Abdullah Carr & Kane;
- Barbara Roper – Director of Investor Protection, Consumer Federation of America;
- Lisa Roth – President, Tessera Capital Partners (formerly Principal, Keystone Capital Corporation);
- Edward Turan – Managing Director, Citigroup Global Markets; and
- Harry Walters – Managing Director, Morgan Stanley Wealth Management.

On February 15, 2019, FINRA posted its intended **Final Status Report** on the implementation of the Dispute Resolution Task Force's 51 recommendations.

IV. RECENT SIGNIFICANT RULE CHANGES

Rule Change to Expand Time for Non-Parties to Respond to Arbitration Subpoenas and Orders of Appearance of Witnesses or Production of Documents

On May 6, 2019, the SEC approved a proposal to amend FINRA Rule 12512(d) through (e) and FINRA Rule 12513(d) through (e) of the Code of Arbitration Procedure for Customer Disputes and FINRA Rule 13512(d) through (e) and FINRA Rule 13513(d) through (e) of the Code of Arbitration Procedure for Industry Disputes to expand time for non-parties to respond to arbitration subpoenas and orders of appearance of witnesses or production of documents, and to make related changes to enhance the discovery process for forum users. The amendments extend the response time for non-parties to object to an order or subpoena from within 10 calendar days of service to within 15 calendar days of receipt, exclude first-class mail as an option to serve these documents on non-parties and for non-parties to file a response, and codify the current practice that the Director send objections and responses to the panel at the same time (after the response date has passed) unless otherwise directed by the panel.

The amendments are effective for cases filed on or after July 1, 2019.

See **Securities Exchange Act Release No. 34-85781,** published in the *Federal Register* on May 10, 2019 (Vol. 84, No. 91, pp. 20669 – 20671).

Rule Change to Pay Arbitrators a $200 Honorarium for Decisions on Contested Subpoena Requests or Contested Orders for Production or Appearance

On October 12, 2018, the Securities and Exchange Commission approved a proposal to amend FINRA Rule 12214(c) through (e) of the Code of Arbitration Procedure for Customer Disputes and FINRA Rule 13214(c) through (e) of the Code of Arbitration Procedure for Industry Disputes to pay each arbitrator a $200 honorarium to decide without a hearing session a contested subpoena request or a contested order for production or appearance.

The amendments are effective for cases filed on or after February 7, 2019.

See **Securities Exchange Act Release No. 34-84418**, published in the *Federal Register* on October 18, 2018 (Vol. 83, No. 202, pp. 52857-52860).

Rule Change to Create a $100 Fee and Honorarium for Late Cancellation of a Prehearing Conference

On July 31, 2018, the SEC approved amendments to FINRA Rules 12500 and 12501 of the Code of Arbitration Procedure for Customer Disputes and FINRA Rules 13500 and 13501 of the Code of Arbitration Procedure for Industry Disputes to charge a $100 per-arbitrator fee to parties who request cancellation of a prehearing conference within three business days before a scheduled prehearing conference. This rule change will also amend FINRA Rules 12214(a) and 13214(a) of the Codes to create a $100 honorarium to pay each arbitrator scheduled to attend a prehearing conference that was cancelled within three business days of the prehearing conference.

These amendments are effective for all cases filed on or after October 29, 2018.

See **Securities Exchange Act Release No. 34-83752**, published in the *Federal Register* on August 6, 2018 (Vol. 83, No. 151, pp 38327-38329).

Rule Change Relating to Simplified Arbitration

On May 17, 2018, the SEC approved SR-FINRA-2018-003, which amends FINRA Rules 12600 and 12800 of the Code of Arbitration Procedure for Customer Disputes and 13600 and 13800 of the Code of Arbitration Procedure for Industry Disputes to provide an additional hearing option for parties in arbitration with claims of $50,000 or less, excluding interest and expenses. This intermediate form of adjudication will provide parties with claims of $50,000 or less an opportunity to argue their cases before an arbitrator in a shorter, limited telephonic hearing format than a regular hearing.

There will be two options for hearings; Option One follows the regular provisions of the Codes relating to prehearings and hearings, including all fee provisions. If the customer (or claimant in industry disputes) chooses Option One, they will continue to have in-person hearings without time limits, and they would continue to be permitted to question opposing parties' witnesses.

Option Two is the new Special Proceeding subject to the regular provisions of the Code relating to prehearings and hearings, including all fee provisions, with several limiting conditions, including timing limitations for hearings, making telephonic hearings the default hearing method (unless the parties jointly agree to another method of appearance), and limiting total hearing sessions to two sessions to be completed in one day, exclusive of prehearing conferences.

If the customer or claimant does not request one of the two hearing options in a simplified case, the matter will be decided by a sole arbitrator based on documents submitted by each party.

This rule amendment is effective for cases filed on or after September 17, 2018.

See **Securities Exchange Act Release No. 34-83276**, published in the *Federal Register* on May 23, 2018 (Vol. 83, No. 100, pp 23959-23963).

V. PROPOSED RULE CHANGES

Proposed Amendments to the Codes of Arbitration Procedure Relating to Requests to Expunge Customer Dispute Information

At its December 2018 meeting, the FINRA Board of Governors approved proposed amendments to the Codes of Arbitration Procedure for Customer and Industry Disputes to codify the Notice to Arbitrators and Parties on Expanded Expungement Guidance and modify the fees for small claim expungement. The proposed rule would establish specific filing fees for claimants filing expungement claims, and would prevent associated persons from filing second requests to expunge the same customer dispute information that was the subject of a prior request that a panel or court denied.

Proposal to Prohibit Compensated Non-Attorney Representatives (NARs) in Arbitration and Mediation

In December 2018, the FINRA Board of Governors approved filing with the SEC proposed amendments to the Codes of Arbitration and Mediation Procedure to prohibit compensated non-attorney representatives from practicing in the FINRA arbitration and mediation forum. The rule proposal would also specify that a student enrolled in a law school, who is participating in a clinical program or its equivalent, and is practicing under the supervision of an attorney pursuant to state law, is allowed to represent parties in arbitration and mediation. It would also include guidelines for resolving issues regarding the qualifications of NARs or law students in the forum.

Regulatory Notice on Discovery of Insurance Information (Regulatory Notice 18-22)

On July 26, 2018, FINRA published Regulatory Notice 18-22 seeking comment on proposed amendments to the Discovery Guide's Firm/Associated Persons Document Production List (List 1). Specifically, the amendments would require firms and associated persons, upon request, to produce documents concerning third-party insurance coverage in customer arbitration. The proposed amendments would strictly limit the circumstances under which insurance coverage information could be presented to the arbitrators. The new list item would state that it may be prejudicial for arbitrators to be given information related to coverage or lack of coverage by liability insurance.

Any party wishing to submit insurance-related evidence at a hearing would have to demonstrate to the arbitration panel that there are extraordinary circumstances warranting admission of this information, or the existence of an insurance policy is directly related to the dispute outlined in the statement of claim.

The comment period ended September 24, 2018.

Regulatory Notice on Inactive Parties (Regulatory Notice 17-33)

On October 18, 2017, FINRA published Regulatory Notice 17-33 which proposes to amend the Code of Arbitration Procedure for Customer Disputes to expand a customer's option to withdraw an arbitration claim and file in court, even if a mandatory arbitration agreement applies to the claim, to situations where a member firm becomes inactive during a pending arbitration, or where an associated person becomes inactive either before a claim is filed or during a pending arbitration. The proposed amendments include changes that allow customers to amend pleadings, postpone hearings, request default proceedings and receive a refund of filing fees under such situations.

The comment period ended on December 18, 2017.

VI. REGULATORY NOTICE ON FORUM SELECTION PROVISIONS INVOLVING CUSTOMERS, ASSOCIATED PERSONS AND MEMBER FIRMS

In July 2016, FINRA published **Regulatory Notice 16-25** to remind member firms that customers have a right to request arbitration at FINRA's arbitration forum at any time and do

not forfeit that right under FINRA rules by signing any agreement with a forum selection provision specifying another dispute resolution process or an arbitration venue other than the FINRA arbitration forum. In addition, FINRA reminded member firms that FINRA rules do not permit member firms to require associated persons to waive their right to arbitration under FINRA's rules in a pre-dispute agreement.

VII. SIGNIFICANT INITIATIVES

List of Member Firms and Associated Persons with Unpaid Customer Arbitration Awards

In October 2018, FINRA posted a list on its website of firms and individuals responsible for unpaid customer arbitration awards. FINRA has provided this information in an effort to increase transparency regarding those firms and individuals with unpaid arbitration awards, and to make this information more readily accessible to investors. The list includes the names of firms and individuals whose FINRA registration has been terminated, suspended, canceled or revoked, or who have been expelled from FINRA. This information will also continue to appear on the firms' or individuals' BrokerCheck reports. FINRA updates this information monthly.

The list is available on the **Member Firms and Associated Persons with Unpaid Customer Arbitration Awards** page on finra.org

Expanded Expungement Guidance for Arbitrators and Parties

Notice to Arbitrators and Parties: In October 2013, the forum sent to all arbitrators a notice and published on its website guidance for parties and arbitrators concerning expungement requests. The guidance emphasizes the extraordinary nature of expungement relief and advises arbitrators to consider the importance of the Central Registration Depository (CRD) information to regulators, firms, and investors (through BrokerCheck) when considering requests for expungement. The guidance encourages arbitrators to request any documentary or other evidence they believe is relevant to the expungement request, particularly in cases that settle before an evidentiary hearing or in cases where only the requesting party participates in the expungement hearing. It also suggests that arbitrators ask the broker requesting expungement to provide a current copy of his or her BrokerCheck report when determining the appropriateness of expungement. The guidance further recommends that arbitrators identify in the award the specific documentary evidence that they relied upon when recommending expungement.

On July 22, 2014, the SEC approved FINRA Rule 2081, which prohibits conditioned settlements, and it became effective on July 30, 2014. In August 2014, the forum sent to all arbitrators a notice and published on its website updated guidance wherein we addressed settlement payments and prohibited conditions relating to expungement of customer dispute information. The updated guidance reminds arbitrators to consider whether the party seeking expungement contributed to the settlement. Further, the updated guidance provides that if arbitrators learn of prohibited conditions, as described in Rule 2081, they should consult FINRA's procedures on disciplinary referrals.

In September 2014, we e-mailed to arbitrators a notice and published on our website updated guidance wherein we addressed the importance of allowing customers and their counsel to participate in the expungement hearing in settled cases. This section of the

updated guidance reminds arbitrators to allow the customer, among other things, to introduce documents and evidence at the expungement hearing, cross-examine the broker and other witnesses called by the party seeking expungement, and to present opening and closing arguments if the panel allows any party to present such arguments.

In December 2014, we published on our website updated guidance about cases in which an associated person will file an arbitration claim against a member firm solely for the purpose of seeking expungement, without naming the customer in the underlying dispute as a respondent. This section of the updated guidance reminds arbitrators to order the associated persons to provide a copy of their Statement of Claim to the customer in the underlying arbitration to ensure that the customer is aware that an expungement claim is pending regarding his or her prior dispute. This will also give the customer an opportunity to advise the arbitrators and parties (in writing or through participation in the expungement hearing) of their position on the expungement request, which may assist arbitrators in making the appropriate finding under Rule 2080.

In September 2017, we updated the guidance published on our website to discuss requests for expungement prior to the conclusion of the underlying arbitration. This section states that a broker may not file a request for expungement of customer dispute information arising from a customer arbitration claim until the underlying arbitration has concluded. If a broker files a request for expungement prior to the conclusion of the related customer arbitration, the Director will deny the forum as to the second expungement-only case. This procedure ensures that the underlying customer arbitration is resolved before any subsequent request to expunge customer dispute information from the underlying customer arbitration is considered.

The **Notice to Arbitrators and Parties on Expanded Expungement Guidance** can be found on the Arbitration Special Procedures page of FINRA.org.

Neutral Workshop: In February 2015, FINRA filmed a neutral workshop addressing expungement, among other matters. In May 2014, FINRA conducted a neutral workshop that provided expanded expungement guidance and an overview of the proposed new rule to address expungement of customer dispute information. In December 2013, FINRA conducted a neutral workshop that provided an overview of CRD and BrokerCheck, stressing the important role arbitrators play in safeguarding the integrity of the information in CRD in the expungement process. The recorded workshop can be found on the Neutral Workshop page on FINRA.org, along with other recorded neutral workshops, providing an additional resource for information to neutrals. FINRA pre-records the workshops to allow neutrals to pause and playback the audio file.

The Neutral Corner: The December 2013 edition (Volume 4, 2013) of the arbitrator newsletter, *The Neutral Corner*, was devoted to the topic of expungement. The issue included an article emphasizing the procedural requirements in recommending expungement and another article discussing the limitations on the types of disclosures that may be expunged from CRD through arbitration. The September 2014 edition (Volume 3, 2014) included articles about the revised Award Information Sheet, the new Rule 2081 to address prohibited conditions relating to expungement of customer dispute information, and expanded expungement guidance for arbitrators to allow customers and their counsel to participate in the expungement hearing. The October 2015 edition (Volume 3, 2015) included information on recent court decisions on expungement. The December 2015

edition (Volume 4, 2015) included information on parties making second expungement requests after a previous denial.

We also developed enhanced online training for arbitrators that expanded on and emphasized the points addressed in our expungement guidance.

The latest edition of ***The Neutral Corner*****,** along with previous issues, can be found on the Publications page on finra.org.

Online Arbitration Claim Filing Guide: FINRA revised the **Online Arbitration Claim Filing Guide** to include new information that asks claimants filing expungement claims to provide the occurrence number for the underlying disclosure and other registration information.

Award Information Sheet: To assist arbitrators with the updated expungement guidance, FINRA revised the Award Information Sheet.

We believe the above initiatives will help arbitrators safeguard the integrity of the information in CRD.

Short List Option to Reduce Extended List Appointments

Forum constituents want to select their own neutrals from the roster and thus have complained about the appointment of "extended list" arbitrators. Extended list arbitrators are not selected by the parties and may only be challenged for cause. (FINRA has virtually eliminated the appointment of extended list arbitrators in the initial appointment process.) FINRA has increased parties' options to reduce the likelihood of extended list appointments when an arbitrator withdraws or is no longer available, no ranked arbitrators remain on the parties' initial ranking lists, and hearing dates are scheduled in a case. Under the "short list option," parties may stipulate to use a list of three arbitrators to select a replacement arbitrator. All parties must agree to use the short list option. Each side may strike one arbitrator's name from the list and may rank all remaining arbitrators' names in order of preference within a prescribed number of days.

If a hearing is scheduled within five calendar days of an arbitrator's withdrawal, removal, or unavailability, parties need to postpone the hearing to use the short list option. The postponement allows FINRA staff time to prescreen arbitrators for conflicts and to ensure they are available for scheduled hearing dates and to provide parties with time to review the list and strike and rank arbitrators. A postponement fee is charged in accordance with current FINRA rules. An additional fee is assessed for postponements granted within ten business days of the hearing date, also in accordance with current FINRA rules. Arbitrators may allocate the fees among the parties that agreed to the postponement. Arbitrators may also waive the fees.

More information, along with an FAQ, about the Short List Procedure can be found at the **Short List Option to Reduce Extended List Appointments** page of finra.org.

Voluntary Program for Large Cases

On July 2, 2012, FINRA implemented a voluntary program in all regional offices for large cases (i.e., cases with damages claims of at least $10 million exclusive of interest, costs,

and attorneys' fees). FINRA Office of Dispute Resolution processes many cases that involve very substantial amounts in dispute. While the rules give the parties flexibility to agree on an ad hoc basis to vary from the procedures in the Arbitration Codes, the large case program was introduced to provide a more formal approach to these cases.

Upon receiving written party agreement to use the program, the Regional Director and an experienced, specially trained case administrator will conduct an early administrative conference with counsel to develop a plan for the administration of the case. Areas to be discussed will include: arbitrator qualifications and the procedures for appointing arbitrators; the use of depositions and interrogatories; the form of the hearing record; and different hearing facilities (costs would be paid by the parties). Parties can use arbitrators from outside of FINRA's roster or provide FINRA with criteria/qualifications to screen arbitrators on FINRA's roster. Parties may pay additional compensation to arbitrators above the standard FINRA honorarium. There is also a non-refundable administrative fee of $1,000 for each separately represented party to use the program. The large case program is available to eligible cases in each of our regional offices.

The program is targeted at cases involving damages claims of at least $10 million. However, any case can participate in the program where all parties agree and are represented by counsel.

A list of frequently asked questions and the news release for the voluntary program for large cases are available on our website at the **Large Case Pilot – FAQ** page of finra.org

VIII. FINRA NEUTRALS

Arbitrator Disclosure

FINRA continually stresses to arbitrators the need to make complete and accurate disclosures. Below are recent measures we have taken to emphasize the importance of disclosing all information that may be relevant:

Arbitrator Disclosure Report Reviews

FINRA staff regularly conducts comprehensive reviews of arbitrators' disclosure reports to ensure accuracy and freshness of information.

- This review includes a search of legal databases such as PACER, detailed internet searches for new public information or publications, employment records, professional license records, etc.

- If new information is found, staff will contact the arbitrator for confirmation and add the information to the arbitrator's disclosure report.

Internet Searches

- We verify the accuracy of arbitrator disclosure by conducting internet searches of arbitrators prior to appointment to a case.

- If staff finds information during an internet search that is not disclosed in the arbitrator's disclosure report, staff contacts the arbitrator, confirms the validity of the information, and adds the information to the neutral's disclosure report.

Last Affirmation Dates

- FINRA displays the date that arbitrators last affirmed the accuracy of their disclosure reports at the top of the disclosure report documents.

- Arbitrators are advised to regularly review and affirm the accuracy of their disclosures on the DR Portal, as parties may consider the last affirmation date as a factor when selecting arbitrators for their cases.

- Arbitrators can confirm the accuracy of their disclosures in two ways:
  - Submitting an update through the DR Portal;
  - Submitting an Oath of Arbitrator when assigned to a case.

Attorney Information

- Disclosure reports feature the names of party representatives and the city and state in which the representative practices on each of the arbitrator's active cases.

- This feature helps to alert parties to potential conflicts based on legal representation.

More information on **Arbitrator Disclosure** can be found on the Information for Arbitrators page at finra.org,

Arbitrator Recruitment

A primary goal of FINRA's arbitrator recruitment program is to identify and train a qualified pool of potential arbitrators from which parties can choose to hear their disputes. The strategic goal has been to continue to shift the balance of the arbitrator pool to include more public arbitrators and a more diverse roster nationwide. FINRA has implemented an aggressive recruitment campaign to seek individuals from diverse backgrounds from across different industries to serve as arbitrators. Ongoing recruitment initiatives thus far have included more than 100 women and minority organizations nationwide to source and recruit all types of people through on-site events, targeted recruiting advertisement and direct marketing campaigns.

To help maximize our resources and opportunities further, we leveraged our staff talent in the regions to assist with recruitment efforts, particularly in reaching women-focused groups, LGBT communities and other untapped diverse organizations. We also hired an additional full-time national recruiter in 2015.

FINRA began working to recruit arbitrators with the following professional organizations in 2018:

- NASPA, Black Psychiatrists of America, The Association of Junior Leagues International, National Academy of Elder Law Attorneys, American Immigration

Lawyers Association, American Library Association, Links National Assembly, National Educators Network, National Association of Blacks in Criminal Justice, The Association of LGBTQ Journalists, The Society for the Advancement of Chicanos/Hispanics and Native Americans in Science, NODA, and Society for Human Resource Management

In 2019, we are hosting recruitment events in nine mid-sized cities: Nashville, Charlotte, Oklahoma City, Kansas City, Cincinnati, Columbus, Cleveland, Portland and Seattle.

We are continuously enhancing the diversity of our arbitrator and mediator roster. In 2018, we saw increases in the number of women on the roster. We also saw increases in the number of Hispanic or Latino and LGBT arbitrators. Of the new arbitrators added to the roster in 2018, 37% were women, 8% were Hispanic or Latino, and 5% were LGBT.

Our number of mediators from diverse backgrounds also increased in 2018. We saw gains in number of women, African-American, Hispanic or Latino, Asian, and LGBT meditators. Of mediators (who may also be arbitrators) polled in 2018, 27% were women, 7% African-American, 4% Hispanic or Latino, 2% Asian, and 3% were LGBT.

To learn more about FINRA's efforts to diversify our arbitrator and mediator rosters visit **Our Commitment to Achieving Arbitrator and Mediator Diversity at FINRA** at finra.org

Finally, to become more effective in how we communicate our message, we have begun using social media to recruit arbitrators. All Office of Dispute Resolution Twitter updates can be found under FINRA's Twitter handle, @FINRA. We also released our first formal recruitment video on several social media platforms including Vimeo, LinkedIn, and YouTube in December 2016: https://vimeo.com/188349814.

Arbitrator Application and Approval

Individuals interested in becoming an arbitrator can apply to our roster using the online arbitrator application available in the **Become an Arbitrator** section of our website. Applicants can complete the arbitrator application and submit it electronically along with a completed Consent to Background Search and Investigation Form and Social Security Number Verification Form. FINRA conducts a review of applications and works with applicants to ensure their submissions are complete before forwarding them to a subcommittee of the NAMC for final approval. FINRA processes applications and notifies applicants within 120 days from the date of receipt.

In 2018 we received 1,051 applications, exceeding our 2018 goal of 750 applications. The average time for application process completion was 89 days. As of June 19, 2019, there are 3,658 public arbitrators on our roster.

Arbitrator Training

Through 2018, Arbitrator applicants were required to complete the Basic Arbitrator Training program, consisting of: 1) online basic training; 2) online expungement training; and 3) classroom training. After successfully completing the online basic and expungement courses, candidates were required to attend the classroom training at one of our regional offices or by live video. FINRA offered live video training in an interactive WebEx format to

allow candidates to participate remotely. In 2018, on average, arbitrators completed this training in 91 days.

As of February 2019, in an effort to streamline training, FINRA discontinued the live classroom training requirement. Instead, we now offer voluntary live Arbitrator Orientation Sessions where new arbitrators can ask questions and learn more about the forum in an informal setting. We are continuing to expand and improve our online training offerings.

To be considered for the chairperson roster, arbitrators must complete FINRA's online chairperson training and satisfy the case service requirement. FINRA staff has discretion to select arbitrators to serve on the chairperson roster from among those arbitrators who have completed the online chairperson training and: 1) have a law degree, are a member of a bar of at least one jurisdiction, and served as an arbitrator through award in at least one arbitration administered by an SRO; or 2) if not an attorney, served as an arbitrator through award in at least three arbitrations administered by an SRO (Customer Code Rule 12400(c) and Industry Code Rule 13400(c)).

In addition to the required trainings, FINRA offers advanced, subject-specific courses.

For more information on Basic and Advanced Arbitrator Training visit the **Arbitrator Training** page at finra.org

IX. OFFICE OF DISPUTE RESOLUTION TECHNOLOGY INITIATIVES

Online Portals

Portal for Parties. Use of the Portal is mandatory for all parties, excluding pro se investors. This rule applies to all cases filed on or after April 3, 2017. Parties using the Portal can sign into a secure website and perform many functions online, including:

- filing a claim;
- receiving service of a claim;
- submitting an answer to a received claim;
- submitting additional case documents;
- viewing the status of a case;
- viewing case documents;
- striking and ranking arbitrators online;
- viewing and downloading disclosure reports of prospective arbitrators;
- scheduling hearing dates online; and
- paying invoiced fees.

Portal for Neutrals. Neutrals are not required to use the portal on a mandatory basis, but arbitrators and mediators must register in the Portal to take advantage of the numerous functions it provides, such as:

- viewing and printing their disclosure reports;
- viewing and updating their personal profiles and disclosures;
- accessing information about their assigned cases, including upcoming hearings and payment information;

- viewing case documents;
- submitting documents;
- scheduling hearing dates; and
- viewing how often their names have appeared on arbitrator ranking lists sent to parties, and how often they are ranked or struck on those lists.

Paperless Office Initiative

All Regional Offices have digitized their respective paper-based arbitration files (including portal and non-portal cases). Any paper documents received will be converted to an electronic format, and all case documents will be stored in electronic arbitration and mediation case files. Staff assignments and correspondence are organized and distributed using electronic mailboxes. FINRA is continuing the process of digitizing neutral files.

FINRA Office of Dispute Resolution Website

FINRA Office of Dispute Resolution's website, http://www.finra.org/arbitration-and-mediation, provides various resources for parties and neutrals regarding FINRA's arbitration and mediation processes. On the website users can find, among other things: an overview of arbitration and mediation; information on how to file a claim; forms that parties and arbitrators need in the arbitration process; arbitrator and mediator applications; The Codes of Arbitration Procedure; and rule filing information. The website also contains a "What's New" section, where users can access case statistics and information on recent FINRA initiatives and announcements.

Arbitration Awards Online

FINRA's Arbitration Awards Online database is available without charge on FINRA's website at http://www.finra.org/arbitration-and-mediation/arbitration-awards. Through the database, users can access FINRA arbitration awards from February 1989 through the present.

In addition, users can access all NYSE arbitration awards, as well as the awards of all arbitration programs absorbed over the years by FINRA (which include the American Stock Exchange, Chicago Board Options Exchange, International Stock Exchange, Philadelphia Stock Exchange, and Municipal Securities Rulemaking Board) and NYSE (which includes Pacific Exchange/NYSE ARCA).

The database provides users with access to awards and the ability to search for awards by using multiple criteria, such as by case number, keywords within awards, arbitrator names, date ranges set by the user, and any combination of these features. FINRA now includes in customer awards information about the panel selection method and panel composition.

Videoconferencing

All four of FINRA's regional office locations have videoconferencing capabilities. With the consent of all parties or with the permission of the arbitration panel, parties or witnesses may appear at hearings by videoconference for hearings held in one of the regional office locations. There is no additional cost to use the videoconferencing equipment at FINRA. Parties are encouraged to notify their case administrator at least 30 days prior to the hearing

to request videoconferencing services. All videoconferencing requests are honored in the order they are received.

In addition, the following companies offer videoconferencing services compatible with FINRA's:

- Regus
  www.regus.com
  1-800-633-4237

- Veritext
  www.veritext.com
  (contact phone numbers vary by region and are listed on the Veritext website).

Additional information on specific Regus and Veritext locations, costs, and reservations to use videoconferencing services are available by contacting these companies directly. All costs to use videoconferencing services outside of a FINRA regional office location are the responsibility of the party reserving the facilities.

X. MEDIATION

Mediation remains an important service that FINRA offers. Since the program's inception in 1995, FINRA's mediation staff has administered thousands of cases involving a wide variety of securities disputes with over 80 percent resulting in settlement between the parties.

Parties interested in mediation can fill out an online Request for Mediation Form which is located on the Initiate a Mediation page of www.finra.org. Parties involved in current arbitration cases can also indicate their interest in mediation by checking the box on the Party Case Submission Form in the DR Portal. Both methods relay a message to mediation staff, who will follow-up with other parties regarding available mediation options.

FINRA Mediation Settlement Month

In order to solicit parties' use of mediation and raise awareness of its mediation program, FINRA provides an annual "Settlement Month" program every October, which offers reduced mediation fees for smaller cases.

In 2018, we extended FINRA Mediation Settlement Month to two months. Parties were able to take advantage of cost savings with participating mediators from September 15 through November 15, 2018.

The Office of Dispute Resolution invites parties to take advantage of significantly reduced mediation prices during FINRA Mediation Settlement Month each year. Our aim is to encourage parties to experience the benefits of mediation for the first time, and to reinforce its value and effectiveness for those who have mediated already.

Mediation Program for Small Arbitration Claims

Since February 2013, FINRA has offered reduced fee and pro bono telephonic mediation to parties in simplified cases. Under the program, mediators serve on a pro bono basis on cases alleging $25,000 or less in damages. We have also offered significantly reduced fee mediation at $50 per hour on cases alleging damages between $25,000.01 and $50,000. The program benefits forum users by: 1) increasing the number of cases that settle and giving parties more control over the results of their cases; 2) reducing travel and preparation costs; and 3) providing an alternative for senior, seriously ill, and physically challenged parties who may find traveling to and attending an in-person mediation especially difficult; and 4) offering parties in small cases an efficient and cost-effective option to meet their needs within our forum.

Separately, the program provides newer mediators with an opportunity to demonstrate their mediation skills. Staff has processed hundreds of requests to mediate through the Mediation Program for Small Arbitration Claims with parties settling over 80% of cases mediated. FINRA continues to communicate the opportunity for parties to mediate through this program to all eligible cases, and highlights the benefits of this affordable mediation option for small claims.

For more information on FINRA's Mediation Program visit the **Learn About Mediation** page at finra.org.

SECTION ONE

NASAA Prohibited Conduct of Investment Advisers, Investment Adviser Representatives and Federal Covered Investment Advisers
Model Rule USA 2002 502(b)
Adopted 9/17/2008, amended 11/06/17, 5/19/2019

Rule USA 2002 502(b) Prohibited Conduct in Providing Investment Advice

A person who is an investment adviser, an investment adviser representative or a federal covered investment adviser is a fiduciary and has a duty to act primarily for the benefit of its clients. The provisions of this subsection apply to federal covered investment advisers to the extent that the conduct alleged is fraudulent, deceptive, or as otherwise permitted by the National Securities Markets Improvement Act of 1996. While the extent and nature of this duty varies according to the nature of the relationship between an investment adviser, an investment adviser representative or a federal covered investment adviser and its clients and the circumstances of each case, an investment adviser, an investment adviser representative or a federal covered investment adviser shall not engage in prohibited fraudulent, deceptive, or manipulative conduct, including but not limited to the following:

(a) Recommending to a client to whom investment advisory services are provided the purchase, sale or exchange of any security without reasonable grounds to believe that the recommendation is suitable for the client on the basis of information furnished by the client after reasonable inquiry concerning the client's investment objectives, financial situation and needs, and any other information known by the investment adviser, investment adviser representative or federal covered investment adviser.

(b) Exercising any discretionary authority in placing an order for the purchase or sale of securities for a client without obtaining written discretionary authority from the client within ten (10) business days after the date of the first transaction placed pursuant to oral discretionary authority, unless the discretionary authority relates solely to the price at which, or the time when, an order involving a definite amount of a specified security shall be executed, or both.

(c) Inducing trading in a client's account that is excessive in size or frequency in view of the financial resources, investment objectives and character of the account.[1]

(d) Placing an order to purchase or sell a security for the account of a client without authority to do so.

(e) Placing an order to purchase or sell a security for the account of a client upon instruction of a third party without first having obtained a written third-party trading authorization from the client.

(f) Borrowing money or securities from a client unless the client is a broker-dealer, an affiliate of the investment adviser or a financial institution engaged in the business of loaning funds.

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[1] The rule appropriately forbids an excessive number of transaction orders to be induced by an adviser for a "customer's account" in light of the fact that an investment adviser or an investment adviser representative in such situations can directly benefit from the number of securities transactions effected in a client's account.

(g) Loaning money or securities to a client unless the investment adviser is a financial institution engaged in the business of loaning funds or the client is an affiliate of the investment adviser.

(h) Misrepresenting to any client, or prospective client, the qualifications of the investment adviser, investment adviser representative, federal covered investment adviser, or any employee, or person affiliated with the investment adviser, investment adviser representative or federal covered investment adviser, or misrepresenting the nature of the advisory services being offered or fees to be charged for such service, or to omit to state a material fact necessary to make the statements made regarding qualifications, services or fees, in light of the circumstances under which they are made, not misleading.

(i) Providing a report or recommendation to any client prepared by someone other than the investment adviser, investment adviser representative or federal covered investment adviser without disclosing that fact. This prohibition does not apply to a situation where the investment adviser, investment adviser representative or federal covered investment adviser uses published research reports or statistical analyses to render advice or where an investment adviser, investment adviser representative or federal covered investment adviser orders such a report in the normal course of providing service.

(j) Charging a client an unreasonable fee.

(k) Failing to disclose to clients in writing before any advice is rendered any material conflict of interest relating to the investment adviser, investment adviser representative or federal covered investment adviser, or any of its employees, or affiliated persons which could reasonably be expected to impair the rendering of unbiased and objective advice including but not limited to:

(1) Compensation arrangements connected with investment advisory services to clients which are in addition to compensation from such clients for such services; and

(2) Charging a client an investment advisory fee for rendering investment advice when compensation for effecting securities transactions pursuant to such advice will be received by the investment adviser, investment adviser representative or federal covered investment adviser or its employees, or affiliated persons.

(l) While acting as principal for its own advisory account, to knowingly sell any security to or purchase any security from a client, or while acting as broker-dealer for a person other than the client, to knowingly effect any sale or purchase of any security for the account of the client, without disclosing to the client in writing before the completion of the transaction the capacity in which it is acting and obtaining the consent of the client to the transaction.

(1) The prohibitions of this subsection shall not apply to any transaction with a customer of a broker-dealer if the broker-dealer is not acting as an investment adviser in relation to the transaction.[2]

(2) The prohibitions of this subsection shall not apply to any transaction with a

[2] Note: 1956 Act § 102(a)(3) not included in 2002 Act.

customer of a broker-dealer if the broker-dealer acts as an investment adviser solely:

(A) by means of publicly distributed written materials or publicly made oral statements;

(B) by means of written materials or oral statements not purporting to meet the objectives or needs of specific individuals or accounts;

(C) through the issuance of statistical information containing no expressions of opinion as to the investment merits of a particular security; or

(D) any combination of the foregoing services.[3]

(3) Publicly distributed written materials or publicly made oral statements shall disclose that, if the purchaser of the advisory communication uses the investment adviser's services in connection with the sale or purchase of a security which is a subject of the communication, the investment adviser may act as principal for its own account or as agent for another person. Compliance by the investment adviser with the foregoing disclosure requirement shall not relieve it of any other disclosure obligations under the Act.[4]

(4) Definitions for purposes of this Rule,

(A) "Publicly distributed written materials" means written materials which are distributed to 35 or more persons who pay for those materials.

(B) "Publicly made oral statements" means oral statements made simultaneously to 35 or more persons who pay for access to those statements.

(m) The prohibitions of this Rule shall not apply to an investment adviser effecting an agency cross transaction for an advisory client provided the following conditions are met:[5]

(1) The advisory client executes a written consent prospectively authorizing the investment adviser to effect agency cross transactions for such client;

(2) Before obtaining such written consent from the client, the investment adviser makes full written disclosure to the client that, with respect to agency cross transactions, the investment adviser will act as broker-dealer for, receive commissions from and have a potentially conflicting division of loyalties and responsibilities regarding both parties to the transactions;

(3) At or before the completion of each agency cross transaction, the investment adviser or any other person relying on this rule sends the client a written confirmation. The written confirmation shall include:

(A) A statement of the nature of the transaction;

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[3] Note: 1956 Rule 102(f)-2(b) not included in 2002 Act.

[4] Note: 1956 Rule 102(f)-2(c).

[5] Note: 1956 Rule 102(f)-1.

(B) The date the transaction took place;

(C) An offer to furnish, upon request, the time when the transaction took place; and

(D) The source and amount of any other remuneration the investment adviser received or will receive in connection with the transaction. In the case of a purchase, if the investment adviser was not participating in a distribution, or, in the case of a sale, if the investment adviser was not participating in a tender offer, the written confirmation may state whether the investment adviser has been receiving or will receive any other remuneration and that the investment adviser will furnish the source and amount of such remuneration to the client upon the client's written request;

(4) At least annually, and with or as part of any written statement or summary of the account from the investment adviser, the investment adviser or any other person relying on this rule sends each client a written disclosure statement identifying:

(A) The total number of agency cross transactions during the period for the client since the date of the last such statement or summary; and

(B) The total amount of all commissions or other remuneration the investment adviser received or will receive in connection with agency cross transactions for the client during the period.

(5) Each written disclosure and confirmation required by this rule must include a conspicuous statement that the client may revoke the written consent required under subsection (m)(1) of this rule at any time by providing written notice to the investment adviser.

(6) No agency cross transaction may be effected in which the same investment adviser recommended the transaction to both any seller and any purchaser.

(7) For purposes of this rule, "agency cross transaction for an advisory client" means a transaction in which a person acts as an investment adviser in relation to a transaction in which the investment adviser, or any person controlling, controlled by, or under common control with such investment adviser, including an investment adviser representative, acts as a broker-dealer for both the advisory client and another person on the other side of the transaction. When acting in such capacity such person is required to be registered [licensed] as a broker-dealer in this state unless excluded from the definition.

(8) Nothing in this rule shall be construed to relieve an investment adviser or investment adviser representative from acting in the best interests of the client, including fulfilling his duty with respect to the best price and execution for the particular transaction for the client nor shall it relieve any investment adviser or investment adviser representative of any other disclosure obligations imposed by the Act.

(n) Guaranteeing a client that a specific result will be achieved with advice rendered.

(o) **[Alternative 1]** Publishing, circulating or distributing any advertisement which does not comply with Rule 206(4)-1 under the Investment Advisers Act of 1940.

(o) **[Alternative 2]** Publishing, circulating or distributing any advertisement which directly or indirectly does any one of the following:

(1) Refers to any testimonial of any kind concerning the investment adviser, investment adviser representative or federal covered investment adviser, or concerning any advice, analysis, report, or other service rendered by such investment adviser or investment adviser representative.

(2) Refers to past specific recommendations of the investment adviser, investment adviser representative or federal covered investment adviser that were or would have been profitable to any person; except that an investment adviser or investment adviser representative may furnish or offer to furnish a list of all recommendations made by the investment adviser, investment adviser representative or federal covered investment adviser within the immediately preceding period of not less than one year if the advertisement or list also includes both of the following:

(A) The name of each security recommended, the date and nature of each recommendation, the market price at that time, the price at which the recommendation was to be acted upon, and the most recently available market price of each such security.

(B) A legend on the first page in prominent print or type that states that the reader should not assume that recommendations made in the future will be profitable or will equal the performance of the securities in the list.

(3) Represents that any graph, chart, formula, or other device being offered can in and of itself be used to determine which securities to buy or sell, or when to buy or sell them; or which represents, directly or indirectly, that any graph, chart, formula, or other device being offered will assist any person in making that person's own decisions as to which securities to buy or sell, or when to buy or sell them, without prominently disclosing in such advertisement the limitations thereof and the difficulties with respect to its use.

(4) Represents that any report, analysis, or other service will be furnished for free or without charge, unless such report, analysis, or other service actually is or will be furnished entirely free and without any direct or indirect condition or obligation.

(5) Represents that the [Administrator] has approved any advertisement.

(6) Contains any untrue statement of a material fact, or that is otherwise false or misleading.

(7) For the purposes of this section, the term "advertisement" shall include any notice, circular, letter, or other written communication addressed to more than one person, or any notice or other announcement in any electronic or paper publication, by

radio or television, or by any medium, that offers any one of the following:

(A) Any analysis, report, or publication concerning securities.

(B) Any analysis, report, or publication that is to be used in making any determination as to when to buy or sell any security or which security to buy or sell.

(C) Any graph, chart, formula, or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell.

(D) Any other investment advisory service with regard to securities.

(p) Making, in the solicitation of clients, any untrue statement of a material fact, or omitting to state a material fact necessary in order to make the statement made, in light of the circumstances under which they are made, not misleading.[6]

(q) Failing to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material nonpublic information contrary to the provisions of Section 204A of the Investment Advisers Act of 1940.

(r) Disclosing the identity, investments, or other financial information of any client or former client unless required by law to do so, or unless consented to by the client.

(s) Taking any action, directly or indirectly, with respect to those securities or funds in which any client has any beneficial interest, where the investment adviser has custody or possession of such securities or funds when the action of the investment adviser or investment adviser representative is subject to and does not comply with the requirements of Rule 411(f)-1.

(t) Engaging in any act, practice, or course of business which is fraudulent, deceptive, manipulative or unethical.

(u) Engaging in conduct or any act, indirectly or through or by any other person, which would be unlawful for such person to do directly under the provisions of the Act or any rule or regulation thereunder.

(v) Accessing a client's account by using the client's own unique identifying information (such as username and password).*

(w) Failing to establish, maintain, and enforce a required policy or procedure.

* This rule amendment is not intended to apply to data aggregation software where: (a) the investment

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[6] Note: 1956 Act § 102(b).

adviser does not know, or have access to, the client's password(s); (b) there is an agreement between the data aggregation software company and the custodian(s)/online account platform which permits this
"back-door" access; and (c) the data is read-only (*i.e.*, the investment adviser can only view the information and cannot effectuate any changes to the client's underlying account(s)).

56 Act cross reference 102(a)(4)-1

SECTION TWO

INVESTMENT ADVISER INFORMATION SECURITY AND PRIVACY RULE

Adopted 5/19/2019

(a) **Physical Security and Cybersecurity Policies and Procedures.** Every investment adviser registered or required to be registered shall establish, implement, update, and enforce written physical security and cybersecurity policies and procedures reasonably designed to ensure the confidentiality, integrity, and availability of physical and electronic records and information. The policies and procedures must be tailored to the investment adviser's business model, taking into account the size of the firm, type(s) of services provided, and the number of locations of the investment adviser.

(1) The physical security and cybersecurity policies and procedures must:

(A) Protect against reasonably anticipated threats or hazards to the security or integrity of client records and information;

(B) Ensure that the investment adviser safeguards confidential client records and information; and

(C) Protect any records and information the release of which could result in harm or inconvenience to any client.

(2) The physical security and cybersecurity policies and procedures must cover at least five functions:

(A) Identify. Develop the organizational understanding to manage information security risk to systems, assets, data, and capabilities;

(B) Protect. Develop and implement the appropriate safeguards to ensure delivery of critical infrastructure services;

(C) Detect. Develop and implement the appropriate activities to identify the occurrence of an information security event;

(D) Respond. Develop and implement the appropriate activities to take action regarding a detected information security event; and

(E) Recover. Develop and implement the appropriate activities to maintain plans for resilience and to restore any capabilities or services that were impaired due to an information security event.

(3) **Maintenance.** The investment adviser must review, no less frequently than annually, and modify, as needed, these policies and procedures to ensure the adequacy of the security measures and the effectiveness of their implementation.

(b) **Privacy Policy.** The investment adviser must deliver upon the investment adviser's engagement by a client, and on an annual basis thereafter, a privacy policy to each client that is reasonably designed to aid in the client's understanding of how the investment adviser collects and shares, to the extent permitted by state and federal law, non-public personal information. The investment adviser must promptly update and deliver to each client an amended privacy policy if any of the information in the policy becomes inaccurate.

NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION

Cybersecurity Checklist for Investment Advisers

Identify | Protect | Detect | Respond | Recover

Identify: Risk Assessments & Management	YES	NO	N/A
1. Risk assessments are conducted frequently (e.g. annually, quarterly).			
2. Cybersecurity is included in the risk assessment.			
3. The risk assessment includes a review of the data collected or created, where the data is stored, and if the data is encrypted.			
4. Internal "insider" risk (e.g. disgruntled employees) and external risks are included in the risk assessment.			
5. The risk assessment includes relationships with third parties.			
6. Adequate policies and procedures demonstrate expectations of employees regarding cybersecurity practices (e.g. frequent password changes, locking of devices, reporting of lost or stolen devices, etc.).			
7. Primary and secondary person(s) are assigned as the central point of contact in the event of a cybersecurity incident.			
8. Specific roles and responsibilities are tasked to the primary and secondary person(s) regarding a cybersecurity incident.			
9. The firm has an inventory of all hardware and software.			
Protect: Use of Electronic Mail	YES	NO	N/A
1. Identifiable information of a client is transmitted via email.			
2. Authentication practices for access to email on all devices (computer and mobile devices) is required.			
3. Passwords for access to email are changed frequently (e.g. monthly, quarterly).			
4. Policies and procedures detail how to authenticate client instructions received via email.			

5. Email communications are secured. (If the response is no, proceed to the next question.)			
6. Employees and clients are aware that email communication is not secured.			
Protect: Devices	YES	NO	N/A
1. Device access (physical and digital) is permitted for authorized users, including personnel and clients.			
2. Device access is routinely audited and updated appropriately.			
3. Devices are routinely backed up and underlying data is stored in a separate location (i.e. on an external drive, in the cloud, etc.)			
4. Backups are routinely tested.			
5. The investment adviser has written policies and procedures regarding destruction of electronic data and physical documents.			
6. Destruction of electronic data and physical documents are destroyed in accordance with written policies and procedures.			
Protect: Use of Cloud Services	YES	NO	N/A
1. Due diligence has been conducted on the cloud service provider prior to signing an agreement or contract.			
2. As part of the due diligence, the investment adviser has evaluated whether the cloud service provider has safeguards against breaches and a documented process in the event of breaches.			
3. The investment adviser has a business relationship with the cloud service provider and has the contact information for that entity.			
4. The investment adviser is aware of the assignability terms of the contract.			
5. The investment adviser understands how the firm's data is segregated from other entities' data within the cloud service.			
6. The investment adviser is familiar with the restoration procedures in the event of a breach or loss of data stored through the cloud service.			
7. The investment adviser has written policies and procedures in the event that the cloud service provider is purchased, closed, or otherwise unable to be accessed.			

8. The investment adviser solely relies on free cloud storage.			
9. The investment adviser has a back-up of all records off-site.			
10. Data containing sensitive or personally identifiable information is stored through a cloud service.			
11. Data containing sensitive or personally identifiable information, which is stored through a cloud service, is encrypted.			
12. The investment adviser has written policies and procedures related to the use of mobile devices by staff who access data in the cloud.			
13. The cloud service provider (or its staff) may access and/or view the investment adviser's data stored in the cloud.			
14. The investment adviser allows remote access to its network (e.g. through use of VPN).			
15. The VPN access of employees is monitored.			
16. The investment adviser has written policies and procedures related to the termination of VPN access when an employee resigns or is terminated.			
Protect: Use of Firm Websites	YES	NO	N/A
1. The investment adviser relies on a parent or affiliated company for the construction and maintenance of the website.			
2. The investment adviser relies on internal personnel for the construction and maintenance of the website.			
3. The investment adviser relies on a third-party vendor for the construction and maintenance of the website.			
4. If the investment adviser relies on a third party for website maintenance, there is an agreement with the third party regarding the services and the confidentiality of information.			
5. The investment adviser can directly make changes to the website.			
6. The investment adviser can directly access the domain renewal information and the security certificate information.			
7. The firm's website is used to access client information.			

8. SSL or other encryption is used when accessing client information on the firm's website.			
9. The firm's website includes a client portal.			
10. SSL or other encryption is used when accessing a client portal.			
11. When accessing the client portal, user authentication credentials (i.e., user name and password) are encrypted.			
12. Additional authentication credentials (i.e., challenge questions, etc.) are required when accessing the client portal from an unfamiliar network or computer.			
13. The investment adviser has written policies and procedures related to a denial of service issue.			
Protect: Custodians & Other Third-Party Vendors	YES	NO	N/A
1. The investment adviser's due diligence on third parties includes cybersecurity as a component.			
2. The investment adviser has requested vendors to complete a cybersecurity questionnaire, with a focus on issues of liability sharing and whether vendors have policies and procedures based on industry standards.			
3. The investment adviser understands that the vendor has IT staff or outsources some of its functions.			
4. The investment adviser has obtained a written attestation from the vendor that it uses software to ensure customer data is protected.			
5. The investment adviser has inquired whether a vendor performs a cybersecurity risk assessment or audit on a regular basis.			
6. The cyber-security terms of the agreement with an outside vendor is not voided because of the actions of an employee of the investment adviser.			
7. Confidentiality agreements are signed by the investment adviser and third-party vendors.			
8. The investment adviser has been provided enough information to assess the cybersecurity practices of any third-party vendors.			
9. [Relevant to custodians only] The investment adviser has discussed with the custodian matters regarding impersonation of clients and authentication of client orders.			

Protect: Encryption	YES	NO	N/A
1. The investment adviser routinely consults with an IT professional knowledgeable in cybersecurity.			
2. The investment adviser has written policies and procedures in place to categorize data as either confidential or non-confidential.			
3. The investment adviser has written policies and procedures in place to address data security and/or encryption requirements.			
4. The investment adviser has written policies and procedures in place to address the physical security of confidential data and systems containing confidential data (i.e., servers, laptops, tablets, removable media, etc.).			
5. The investment adviser utilizes encryption on all data systems that contain (or access) confidential information.			
6. The identities and credentials for authorized users are monitored.			
Detect: Anti-Virus Protection and Firewalls	YES	NO	N/A
1. The investment adviser firm regularly use anti-virus software on all devices accessing the firm's network, including mobile phones.			
2. The investment adviser firm regularly use anti-virus software on all devices accessing the firm's network, including mobile phones.			
3. The investment adviser understands how the anti-virus software deploys and how to handle alerts.			
4. The investment adviser understands how the anti-virus software deploys and how to handle alerts.			
5. Anti-virus updates are run on a regular and continuous basis.			
6. All software is scheduled to update.			
7. Employees are trained and educated on the basic function of anti-virus programs and how to report potential malicious events.			
8. If the alerts are set up by an outside vendor, there is an ongoing relationship between the vendor and the investment adviser to ensure continuity and updates.			

9. A firewall is employed and configured appropriate to the firm's needs.			
10. The firm has policies and procedures to address flagged network events.			
Respond: Responding to a Cyber Event	YES	NO	N/A
1. The investment adviser has a plan and procedure for immediately notifying authorities in the case of a disaster or security incident.			
2. The plans and procedures identify which authorities should be contacted based on the type of incident and who should be responsible for initiating those contacts.			
3. The investment adviser has a communications plan, which identifies who will speak to the public/press in the case of an incident and how internal communications will be managed.			
4. The communications plan identifies the process for notifying clients.			
Recover: Cyber-insurance	YES	NO	N/A
1. The investment adviser has considered whether cyber-insurance is necessary or appropriate for the firm.			
2. The firm has evaluated the coverage in a cybersecurity insurance policy to determine whether it covers breaches, including; breaches by foreign cyber intruders; insider breaches (e.g. an employee who steals sensitive data); and breaches as a result of third-party relationships.			
3. The cybersecurity insurance policy covers notification (clients and regulators) costs.			
4. The investment adviser has evaluated whether the policy includes first-party coverage (e.g. damages associated with theft, data loss, hacking and denial of service attacks) or third-party coverage (e.g. legal expenses, notification expenses, third-party remediation expenses).			
5. The exclusions of the cybersecurity insurance policy are appropriate for the investment adviser's business model.			
6. The investment adviser has put into place all safeguards necessary to ensure that the cyber-security policy is not voided through investment adviser employee actions, such as negligent computer security where software patches and updates are not installed in a timely manner.			

Recover: Disaster Recovery	YES	NO	N/A
1. The investment adviser has a business continuity plan to implement in the event of a cybersecurity event.			
2. The investment adviser has a process for retrieving backed up data and archival copies of information.			
3. The investment adviser has written policies and procedures for employees regarding the storage and archival of information.			
4. The investment adviser provides training on the recovery process.			

SECTION THREE

NASAA Recordkeeping Requirements For Investment Advisers Model Rule 203(a)-2

Adopted 9/3/87, amended 5/3/99, 4/18/04, 9/11/05; Amended 9/11/2011; Amended 5/19/2019

NOTE: Italicized information is explanatory and not intended for inclusion in the rule text. Language based on the Uniform Securities Act of 1956, as amended.

Rule 203(a)-2 Recordkeeping Requirements [ALTERNATIVE 1]:

(a) Every investment adviser registered or required to be registered under the Act shall make and keep true, accurate and current the following books, ledgers and records:

1. A journal or journals, including cash receipts and disbursements records, and any other records of original entry forming the basis of entries in any ledger.

2. General and auxiliary ledgers (or other comparable records) reflecting asset, liability, reserve, capital, income and expense accounts.

3. A memorandum of each order given by the investment adviser for the purchase or sale of any security, of any instruction received by the investment adviser from the client concerning the purchase, sale, receipt or delivery of a particular security, and of any modification or cancellation of any such order or instruction. The memoranda shall show the terms and conditions of the order, instruction, modification or cancellation; shall identify the person connected with the investment adviser who recommended the transaction to the client and the person who placed the order; and shall show the account for which entered, the date of entry, and the bank, broker-dealer by or through whom executed where appropriate. Orders entered pursuant to the exercise of discretionary power shall be so designated.

4. All check books, bank statements, canceled checks and cash reconciliations of the investment adviser.

5. All bills or statements (or copies of), paid or unpaid, relating to the investment adviser's business as an investment adviser.

6. All trial balances, financial statements prepared in accordance with generally accepted accounting principles, and internal audit working papers relating to the investment adviser's business as an investment adviser. For purposes of this subsection, "financial statements" shall mean a balance sheet prepared in accordance with generally accepted accounting principles, an income statement, a cash flow statement and a net worth computation, if applicable, as required by Rule 202(d)-1 of this Act.

7. Originals of all written communications received and copies of all written communications sent by the investment adviser relating to (A) any recommendation made or proposed to be made and any advice given or proposed to be given, (B) any receipt, disbursement or delivery of funds or securities, or (C) the placing or execution of any order to purchase or sell any security, provided, however, (i) that the investment adviser shall not be required to keep any unsolicited market letters and other similar communications of general public distribution not prepared by or for the investment adviser, and (ii) that if the investment adviser sends any notice, circular or other advertisement offering any report, analysis, publication or other investment advisory

service to more than 10 persons, the investment adviser shall not be required to keep a record of the names and addresses of the persons to whom it was sent; except that if the notice, circular or advertisement is distributed to persons named on any list, the investment adviser shall retain with the copy of the notice, circular or advertisement a memorandum describing the list and its source.

8. A list or other record of all accounts which list identifies the accounts in which the investment adviser is vested with any discretionary power with respect to the funds, securities or transactions of any client.

9. A copy of all powers of attorney and other evidences of the granting of any discretionary authority by any client to the investment adviser.

10. A copy in writing of each agreement entered into by the investment adviser with any client, and all other written agreements otherwise relating to the investment adviser's business as an investment adviser.

11. A file containing a copy of each notice, circular, advertisement, newspaper article, investment letter, bulletin, or other communication including by electronic media that the investment adviser circulates or distributes, directly or indirectly, to two or more persons (other than persons connected with the investment adviser), and if the notice, circular, advertisement, newspaper article, investment letter, bulletin, or other communication including by electronic media recommends the purchase or sale of a specific security and does not state the reasons for the recommendation, a memorandum of the investment adviser indicating the reasons for the recommendation.

12. (A) A record of every transaction in a security in which the investment adviser or any advisory representative (as hereinafter defined) of the investment adviser has, or by reason of any transaction acquires, any direct or indirect beneficial ownership, except

i. transactions effected in any account over which neither the investment adviser nor any advisory representative of the investment adviser has any direct or indirect influence or control; and

ii. transactions in securities which are direct obligations of the United States. The record shall state the title and amount of the security involved; the date and nature of the transaction (i.e. purchase, sale or other acquisition or disposition); the price at which it was effected; and the name of the broker-dealer or bank with or through whom the transaction was effected. The record may also contain a statement declaring that the reporting or recording of any transaction shall not be construed as an admission that the investment adviser or advisory representative has any direct or indirect beneficial ownership in the security. A transaction shall be recorded not later than 10 days after the end of the calendar quarter in which the transaction was effected.

(B) For purposes of this subdivision (12) the following definitions will apply. The term "advisory representative" shall mean any partner, officer or director of the investment adviser; any employee who participates in any way in the determination of which recommendations shall be made; any employee who, in connection with his duties, obtains any information concerning which securities are being recommended prior to the effective dissemination of the recommendations; and any of the following persons who obtain information concerning securities recommendations being made by the investment adviser

prior to the effective dissemination of the recommendations:

i. any person in a control relationship to the investment adviser,

ii. any affiliated person of a controlling person and

iii. any affiliated person of an affiliated person.

Control" shall mean the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with such company. Any person who owns beneficially, either directly or through one or more controlled companies, more than 25 % of the voting securities of a company shall be presumed to control such company.

(C) An investment adviser shall not be deemed to have violated the provisions of this subdivision (12) because of the failure to record securities transactions of any advisory representative if the investment adviser establishes that it instituted adequate procedures and used reasonable diligence to obtain promptly reports of all transactions required to be recorded.

13. (A) Notwithstanding the provisions of subdivision (12) above, where the investment adviser is primarily engaged in a business or businesses other than advising investment advisory clients, a record must be maintained of every transaction in a security in which the investment adviser or any advisory representative (as hereinafter defined) of the investment adviser has, or by reason of any transaction acquires, any direct or indirect beneficial ownership, except

i. transactions effected in any account over which neither the investment adviser nor any advisory representative of the investment adviser has any direct or indirect influence or control; and

ii. transactions in securities which are direct obligations of the United States.

(B) The record shall state the title and amount of the security involved; the date and nature of the transaction (i.e. purchase, sale, or other acquisition or disposition); the price at which it was effected; and the name of the broker-dealer or bank with or through whom the transaction was effected. The record may also contain a statement declaring that the reporting or recording of any transaction shall not be construed as an admission that the investment adviser or advisory representative has any direct or indirect beneficial ownership in the security. A transaction shall be recorded not later than 10 days after the end of the calendar quarter in which the transaction was effected.

(C) An investment adviser is "primarily engaged in a business or businesses other than advising investment advisory clients" when, for each of its most recent three fiscal years or for the period of time since organization, whichever is lesser, the investment adviser derived, on an unconsolidated basis, more than 50% of

i. its total sales and revenues, and

ii.its income (or loss) before income taxes and extraordinary items, from such

other business or businesses.

(D) For purposes of this subdivision (13) the following definitions will apply. The term "advisory representative", when used in connection with a company primarily engaged in a business or businesses other than advising investment advisory clients, shall mean any partner, officer, director or employee of the investment adviser who participates in any way in the determination of which recommendation shall be made, or whose functions or duties relate to the determination of which securities are being recommended prior to the effective dissemination of the recommendations; and any of the following persons, who obtain information concerning securities recommendations being made by the investment adviser prior to the effective dissemination of such the recommendations or of the information concerning the recommendations:

i. any person in a control relationship to the investment adviser,

ii. any affiliated person of a controlling person and

iii. any affiliated person of an affiliated person.

"Control" shall mean the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with such company. Any person who owns beneficially, either directly or through one or more controlled companies, more than 25 percent of the voting securities of a company shall be presumed to control such company.

(E) An investment adviser shall not be deemed to have violated the provisions of this subdivision (13) because of the failure to record securities transactions of any advisory representative if the investment adviser establishes that it instituted adequate procedures and used reasonable diligence to obtain promptly reports of all transactions required to be recorded.

14. A copy of each written statement and each amendment or revision, given or sent to any client or prospective client of the investment adviser in accordance with the provisions of Rule 203(b)1 of this Act, and a record of the dates that each written statement, and each amendment or revision, was given, or offered to be given, to any client or prospective client who subsequently becomes a client.

15. For each client that was obtained by the adviser by means of a solicitor to whom a cash fee was paid by the adviser

(A) evidence of a written agreement to which the adviser is a party related to the payment of such fee;

(B) a signed and dated acknowledgment of receipt from the client evidencing the client's receipt of the investment adviser's disclosure statement and a written disclosure statement of the solicitor; and,

(C) a copy of the solicitor's written disclosure statement. The written agreement, acknowledgment and solicitor disclosure statement will be considered to be in

compliance if such documents are in compliance with Rule 275.206(4)-3 of the Investment Advisers Act of 1940. For purposes of this rule, the term "solicitor" shall mean any person or entity who, for compensation, acts as an agent of an investment adviser in referring potential clients.

16. All accounts, books, internal working papers, and any other records or documents that are necessary to form the basis for or demonstrate the calculation of the performance or rate of return of all managed accounts or securities recommendations in any notice, circular, advertisement, newspaper article, investment letter, bulletin, or other communication including but not limited to electronic media that the investment adviser circulates or distributes, directly or indirectly, to two or more persons (other than persons connected with the investment adviser); provided, however, that, with respect to the performance of managed accounts, the retention of all account statements, if they reflect all debits, credits, and other transactions in a client's account for the period of the statement, and all worksheets necessary to demonstrate the calculation of the performance or rate of return of all managed accounts shall be deemed to satisfy the requirements of this paragraph.

17. A file containing a copy of all written communications received or sent regarding any litigation involving the investment adviser or any investment adviser representative or employee, and regarding any written customer or client complaint.

18. Written information about each investment advisory client that is the basis for making any recommendation or providing any investment advice to such client.

19. Written procedures to supervise the activities of employees and investment adviser representatives that are reasonably designed to achieve compliance with applicable securities laws and regulations.

20. A file containing a copy of each document (other than any notices of general dissemination) that was filed with or received from any state or federal agency or self regulatory organization and that pertains to the registrant or its investment adviser representatives as that term is defined in subdivision (a)(12)(A) of this Rule, which file should contain, but is not limited to, all applications, amendments, renewal filings, and correspondence.

21. Copies, with original signatures of the investment adviser's appropriate signatory and the investment adviser representative, of each initial Form U-4 and each amendment to Disclosure Reporting Pages (DRPs U-4) must be retained by the investment adviser (filing on behalf of the investment adviser representative) and must be made available for inspection upon regulatory request.

22. Where the adviser inadvertently held or obtained a client's securities or funds and returned them to the client within three business days or has forwarded third party checks within 24 hours the adviser will be considered as not having custody but shall keep the following records relating to the inadvertent custody:

A ledger or other listing of all securities or funds held or obtained, including the following information:

(A) Issuer;

(B) Type of security and series; Date of issue;

(C) For debt instruments, the denomination, interest rate and maturity date;

(D) Certificate number, including alphabetical prefix or suffix;

(E) Name in which registered;

(F) Date given to the adviser;

(G) Date sent to client or sender;

(H) Form of delivery to client or sender, or copy of the form of delivery to client or sender; and

(I) Mail confirmation number, if applicable, or confirmation by client or sender of the fund's or security's return.

23. If an investment adviser obtains possession of securities that are acquired from the issuer in a transaction or chain of transactions not involving any public offering that comply with the exception from custody under NASAA Model Rule 102(e)((1)-1(b)(2), the adviser shall keep the following records;

(A) A record showing the issuer or current transfer agent's name address, phone number and other applicable contract information pertaining to the party responsible for recording client interests in the securities; and

(B) A copy of any legend, shareholder agreement or other agreement showing that those securities that are transferable only with prior consent of the issuer or holders of the outstanding securities of the issuer.

24. (A) A copy of the investment adviser's Physical Security and Cybersecurity Policies and Procedures and Privacy Policy pursuant to [INSERT RULE CITATION]. In addition to the investment adviser's recordkeeping requirements pursuant to sections (e) and (g) of this rule, the investment adviser must maintain a current copy of these policies and procedures either in hard copy in a separate location or stored on electronic storage media that is separate from and not dependent upon access to the investment adviser's computers or a network;

(B) All records documenting the investment adviser's compliance with [INSERT RULE CITATION], including, but not limited to, evidence of the annual review of the policies and procedures;

(C) A record of any violation of the [INSERT RULE CITATION], and of any action taken as a result of the violation.

(b) 1. If an investment adviser has custody, as that term is defined in NASAA Model Rule 102(e)(1)-1(d)(2), of the NASAA Custody Rules, the records required to be made and kept under paragraph (a) above shall include:

(A) A copy of any and all documents executed by the client (including a limited power of attorney) under which the adviser is authorized or permitted to withdraw a client's funds or securities maintained with a custodian upon the adviser's instruction to the custodian.

(B) A journal or other record showing all purchases, sales, receipts and deliveries of securities (including certificate numbers) for all accounts and all other debits and credits to the accounts.

(C) A separate ledger account for each client showing all purchases, sales, receipts and deliveries of securities, the date and price of each purchase and sale, and all debits and credits.

(D) Copies of confirmations of all transactions effected by or for the account of any client.

(E) A record for each security in which any client has a position, which record shall show the name of each client having any interest in each security, the amount or interest of each client, and the location of each security.

(F) A copy of each of the client's quarterly account statements, as generated and delivered by the qualified custodian. If the adviser also generates a statement that is delivered to the client, the adviser shall also maintain copies of such statements along with the date such statements were sent to the clients. If applicable to the adviser's situation, a copy of the special examination report verifying the completion of the examination by an independent certified public accountant and describing the nature and extent of the examination.

(G) A record of any finding by the independent certified public accountant of any material discrepancies found during the examination.

(H) If applicable, evidence of the client's designation of an independent representative.

2. If an investment adviser has custody because it advises a pooled investment vehicle, as defined in Rule 102(e)(1)-1(d)(2)(A)(iii), the adviser shall also keep the following records:

(A) True, accurate and current account statements;

(B) Where the adviser complies with Rule 102(e)(1)-1(b)(4) the records required to be made and kept shall include:

i. the date(s) of the audit;

ii. a copy of the audited financial statements; and

iii. evidence of the mailing of the audited financial to all limited partners, members or other beneficial owners within 120 days of the end of its fiscal year.

(C) Where the adviser complies with rule 102(e)(1)-1(a)(5) the records required

to be made and kept shall include:

i. A copy of the written agreement with the independent party reviewing all fees and expenses, indicating the responsibilities of the independent third party.

ii. Copies of all invoices and receipts showing approval by the independent party for payment through the qualified custodian.

(c) Every investment adviser subject to subsection (a) of this Rule who renders any investment supervisory or management service to any client shall, with respect to the portfolio being supervised or managed and to the extent that the information is reasonably available to or obtainable by the investment adviser, make and keep true, accurate and current:

1. Records showing separately for each client the securities purchased and sold, and the date, amount and price of each purchase and sale.

2. For each security in which any client has a current position, information from which the investment adviser can promptly furnish the name of each the client, and the current amount or interest of the client.

(d) Any books or records required by this Rule may be maintained by the investment adviser in such manner that the identity of any client to whom the investment adviser renders investment supervisory services is indicated by numerical or alphabetical code or some similar designation.

(e) Every investment adviser subject to subsection (a) of this rule shall preserve the following records in the manner prescribed:

1. All books and records required to be made under the provisions of paragraph (a) to (c)(1), inclusive, of this Rule (except for books and records required to be made under the provisions of paragraphs (a)(11) and (a)(16) of this Rule), shall be maintained and preserved in an easily accessible place for a period of not less than five years from the end of the fiscal year during which the last entry was made on record, the first two years in the principal office of the investment adviser.

2. Partnership articles and any amendments, articles of incorporation, charters, minute books, and stock certificate books of the investment adviser and of any predecessor, shall be maintained in the principal office of the investment adviser and preserved until at least three years after termination of the enterprise.

3. Books and records required to be made under the provisions of paragraphs (a)(11) and (a)(16) of this Rule shall be maintained and preserved in an easily accessible place for a period of not less than five years, the first two years in an the principal office of the investment adviser, from the end of the fiscal year during which the investment adviser last published or otherwise disseminated, directly or indirectly, the notice, circular,

advertisement, newspaper article, investment letter, bulletin, or other communication including by electronic media.

4. Books and records required to be made under the provisions of paragraphs (a)(17)-(22), inclusive, of this Rule shall be maintained and preserved in an easily accessible place for a period of not less than five years from the end of the fiscal year during which the last entry was made on such record, the first two years in the principal office of the investment adviser, or for the time period during which the investment adviser was registered or required to be registered in the state, if less.

(f) Notwithstanding other record preservation requirements of this Rule, the following records or copies shall be required to be maintained at the business location of the investment adviser from which the customer or client is being provided or has been provided with investment advisory services: (A) records required to be preserved under paragraphs (a)(3),(a)(7)-(10), (a)(14)-(15), (a)(17)- (19), (b) and (c) inclusive, of this Rule, and (B) the records or copies required under the provision of paragraphs (a)(11) and (a)(16) of this Rule which records or related records identify the name of the investment adviser representative providing investment advice from that business location, or which identify the business locations' physical address, mailing address, electronic mailing address, or telephone number. The records will be maintained for the period described in subdivision (e) of this Rule.

(g) An investment adviser subject to subsection (a) of this Rule, before ceasing to conduct or discontinuing business as an investment adviser shall arrange for and be responsible for the preservation of the books and records required to be maintained and preserved under this Rule for the remainder of the period specified in this Rule, and shall notify the [Administrator] in writing of the exact address where the books and records will be maintained during the period.

(h) 1. Pursuant to Rule 203(a)2 (e) the records required to be maintained and preserved may be immediately produced or reproduced, and maintained and preserved for the required time, by an investment adviser on:

(A) Paper or hard copy form, as those records are kept in their original form; or

(B) Micrographic media, including microfilm, microfiche, or any similar medium; or

(C) Electronic storage media, including any digital storage medium or system that meets the terms of this section.

2. The investment adviser must:

(A) Arrange and index the records in a way that permits easy location, access, and retrieval of any particular record;

(B) Provide promptly any of the following that the [Administrator] (by its examiners or other representatives) may request:

(i) A legible, true, and complete copy of the record in the medium and format in which it is stored;
(ii) A legible, true, and complete printout of the record; and
(iii) Means to access, view, and print the records; and

(C) Separately store, for the time required for preservation of the original record, a duplicate copy of the record on any medium allowed by this section.

3. In the case of records created or maintained on electronic storage media, the investment adviser must establish and maintain procedures:

(A) To maintain and preserve the records, so as to reasonably safeguard them from loss, alteration, or destruction;

(B) To limit access to the records to properly authorized personnel and the [Administrator] (including its examiners and other representatives); and To reasonably ensure that any reproduction of a non-electronic original record on electronic storage media is complete, true, and legible when retrieved.

(i) For purposes of this Rule, "investment supervisory services" means the giving of continuous advice as to the investment of funds on the basis of the individual needs of each client; and "discretionary power" shall not include discretion as to the price at which or the time when a transaction is or is to be effected, if, before the order is given by the investment adviser, the client has directed or approved the purchase or sale of a definite amount of the particular security.

(j) Any book or other record made, kept, maintained and preserved in compliance with Rules 17a-3 [17 C.F.R. 240.17a-3] and 17a-4 [17 C.F.R. 240.17a-4] under the Securities Exchange Act of 1934, which is substantially the same as the book or other record required to be made, kept, maintained and preserved under this Rule, shall be deemed to be made, kept, maintained and preserved in compliance with this Rule.

(k) Every investment adviser registered or required to be registered in this state and that has its principal place of business in a state other than this state shall be exempt from the requirements of this section, provided the investment adviser is licensed in such state and is in compliance with such state's recordkeeping requirements.

Rule USA 2002 411(c)-1 Recordkeeping Requirements [ALTERNATIVE 2]

(Language for states which incorporate by reference Rule 204-2 of the Investment Advisers Act of 1940)

(a) Every investment adviser registered [licensed] or required to be registered [licensed] under this Act shall make and keep true, accurate and current the following books, ledgers and records:

(1) Those books and records required to be maintained and preserved in compliance with Rule 204- 2 of the Investment Advisers Act of 1940 (17 C.F.R. 275.204-2 (1996)),

notwithstanding the fact that the investment adviser is not registered or required to be registered under the Investment Advisers Act of 1940.

(2) All trial balances, financial statements prepared in accordance with generally accepted accounting principles, and internal audit working papers relating to the investment adviser's business as an investment adviser. For purposes of this subsection, "financial statements" means balance sheets, income statements, cash flow statements and net worth computations as required by Rule 202(d)-1.

(3) A list or other record of all accounts with respect to the funds, securities, or transactions of any client.

(4) A copy in writing of each agreement entered into by the investment adviser with any client.

(5) A file containing a copy of each record required by Rule 204-2(11) of the Investment Advisers Act of 1940 including any communication by electronic media that the investment adviser circulates or distributes, directly or indirectly, to two or more persons (other than persons connected with the investment adviser)

(6) A copy of each written statement and each amendment or revision given or sent to any client or prospective client of the investment adviser in accordance with the provisions of Rule 411(g) of the Act and a record of the dates that each written statement, and each amendment or revision was given or offered to be given to any client or prospective client who subsequently becomes a client.

(7) For each client that was obtained by the adviser by means of a solicitor to whom a cash fee was paid by the adviser, records required by Rule 206(4)-3 of the Investment Advisers Act of 1940, notwithstanding the fact that the investment adviser is not registered or required to be registered under the Investment Advisers Act of 1940.

(8) All records required by Rule 204-2(16) of the Investment Advisers Act of 1940 including but not limited to electronic media that the investment adviser circulates or distributes, directly or indirectly, to two or more persons (other than persons connected with the investment adviser).

(9) A file containing a copy of all written communications received or sent regarding any litigation involving the investment adviser or any investment adviser representative or employee, and regarding any written customer or client complaint.

(10) Written information about each investment advisory client that is the basis for making any recommendation or providing any investment advice to such client.

(11) Written procedures to supervise the activities of employees and investment adviser representatives that are reasonably designed to achieve compliance with applicable securities laws and regulations.

(12) A file containing a copy of each document (other than any notices of general dissemination) that was filed with or received from any state or federal agency or self regulatory organization and that pertains to the registrant or its investment adviser representatives which file should contain, but is not limited to, all applications, amendments, renewal filings, and correspondence. For investment advisers who have custody, as that term is defined in Rule 411(f)-1(d)(2), of client funds or securities, all records and evidence of compliance required by Rule 206(4)-2 under the Investment Advisers Act of 1940.

(13) (i) A copy of the investment adviser's Physical Security and Cybersecurity Policies and Procedures and Privacy Policy pursuant to [INSERT RULE CITATION]. In addition to the investment adviser's recordkeeping requirements pursuant to sections (b) of this rule, the investment adviser must maintain a current copy of these policies and procedures either in hard copy in a separate location or stored on electronic storage media that is separate from and not dependent upon access to the investment adviser's computers or a network;

(ii) All records documenting the investment adviser's compliance with [INSERT RULE CITATION], including, but not limited to, evidence of the annual review of the policies and procedures;

(iii) A record of any violation of the [INSERT RULE CITATION], and of any action taken as a result of the violation.

(b) Every investment adviser subject to subsection (a) of this rule shall preserve for the period described in subsection (e) of this Rule the following records in the manner prescribed:

(1) Books and records required to be made under the provisions of paragraph (a)(1) of this Rule shall be maintained and preserved in an easily accessible place for a period of not less than five years from the end of the fiscal year during which the last entry was made on such record, the first two years in the principal office of the investment adviser.

(2) Books and records required to be made under the provisions of paragraphs (a)(2)-(a)(13), inclusive, of this Rule shall be maintained and preserved in an easily accessible place for a period of not less than five years from the end of the fiscal year during which the last entry was made on such record, the first two years in the principal office of the investment adviser, or for the time period during which the investment adviser was registered or required to be registered in the state, if less.

(3) Notwithstanding other record preservation requirements of this Rule, the following records or copies shall be required to be maintained at the business location of the investment adviser from which the customer or client is being provided or has been provided with investment advisory services:

(A) records required to be preserved under

i. paragraphs (a)(3), (a)(7)-(10), (a)(14)-(15), (b) and (c) inclusive, of SEC Rule 204-2 of the Investment Advisers Act of 1940.

ii. paragraphs (a)(9)-(11) of this Rule; and

(B) the records or copies required under the provision of paragraphs (a)(11) and (a)(16) of this Rule which records or related records identify the name of the investment adviser representative providing investment advice from that business location, or which identify the business locations' physical address, mailing address, electronic mailing address, or telephone number.

(c) To the extent that the U.S. Securities and Exchange Commission promulgates changes to the above- referenced rules of the Investment Advisers Act of 1940, investment advisers in compliance with such rules as amended shall not be subject to enforcement action by the [Administrator] for violation of this Rule to the extent that the violation results solely from the investment adviser's compliance with the amended rule.

(d) Every investment adviser that has its principal place of business in a state other than this state shall be exempt from the requirements of this section, provided the investment adviser is registered or licensed in such state and is in compliance with the state's recordkeeping requirements.

(e) Every investment adviser subject to subsection (a) of this rule shall preserve the following records in the manner prescribed:

(1) All books and records required to be made under the provisions of paragraph (a) to (c)(1), inclusive, of this Rule (except for books and records required to be made under the provisions of paragraphs (a)(11) and (a)(16) of this Rule), shall be maintained and preserved in an easily accessible place for a period of not less than five years from the end of the fiscal year during which the last entry was made on record, the first two years in the principal office of the investment adviser.

(2) Partnership articles and any amendments, articles of incorporation, charters, minute books, and stock certificate books of the investment adviser and of any predecessor, shall be maintained in the principal office of the investment adviser and preserved until at least three years after termination of the enterprise.

(3) Books and records required to be made under the provisions of paragraphs (a)(11) and (a)(16) of this Rule shall be maintained and preserved in an easily accessible place for a period of not less than five years, the first two years in the principal office of the investment adviser, from the end of the fiscal year during which the investment adviser last published or otherwise disseminated, directly or indirectly, the notice, circular, advertisement, newspaper article, investment letter, bulletin, or other communication including by electronic media.

(4) Books and records required to be made under the provisions of paragraphs (a)(17)-(22), inclusive, of this Rule shall be maintained and preserved in an easily accessible place for a period of not less than five years from the end of the fiscal year during which the last entry was made on such record, the first two years in the principal office of the investment adviser, or for the time period during which the investment adviser was registered or required to be registered in the state, if less.

(5) Notwithstanding other record preservation requirements of this Rule, the following records or copies shall be required to be maintained at the business location of the investment adviser from which the customer or client is being provided or has been provided with investment advisory services:

(A) records required to be preserved under paragraphs (a)(3),(a)(7)-(10), (a)(14)-(15), (a)(17)- (19), (b) and (c) inclusive, of this Rule, and

(B) the records or copies required under the provision of paragraphs (a)(11) and (a)(16) of this Rule which records or related records identify the name of the investment adviser representative providing investment advice from that business location, or which identify the business locations' physical address, mailing address, electronic mailing address, or telephone number. The records will be maintained for the period described in subsection (e) of this Rule.

SECTION FOUR

NASAA Unethical Business Practices Of Investment Advisers, Investment Adviser Representatives, And Federal Covered Advisers
Model Rule 102(a)(4)-1

Adopted 4/27/97, amended 4/18/04, 9/11/05, 11/06/17, 5/19/2019

Rule 102(a)(4)-1 Unethical Business Practices Of Investment Advisers, Investment Adviser Representatives, And Federal Covered Advisers

[Introduction] A person who is an investment adviser, an investment adviser representative or a federal covered adviser is a fiduciary and has a duty to act primarily for the benefit of its clients. The provisions of this subsection apply to federal covered advisers to the extent that the conduct alleged is fraudulent, deceptive, or as otherwise permitted by the National Securities Markets Improvement Act of 1996 (Pub. L. No. 104-290). While the extent and nature of this duty varies according to the nature of the relationship between an investment adviser or an investment adviser representative and its clients and the circumstances of each case, an investment adviser, an investment adviser representative or a federal covered adviser shall not engage in unethical business practices, including the following:

(a) Recommending to a client to whom investment supervisory, management or consulting services are provided the purchase, sale or exchange of any security without reasonable grounds to believe that the recommendation is suitable for the client on the basis of information furnished by the client after reasonable inquiry concerning the client's investment objectives, financial situation and needs, and any other information known by the investment adviser.

(b) Exercising any discretionary power in placing an order for the purchase or sale of securities for a client without obtaining written discretionary authority from the client within ten (10) business days after the date of the first transaction placed pursuant to oral discretionary authority, unless the discretionary power relates solely to the price at which, or the time when, an order involving a definite amount of a specified security shall be executed, or both.

(c) Inducing trading in a client's account that is excessive in size or frequency in view of the financial resources, investment objectives and character of the account in light of the fact that an investment adviser or an investment adviser representative in such situations can directly benefit from the number of securities transactions effected in a client's account. The rule appropriately forbids an excessive number of transaction orders to be induced by an adviser for a "customer's account."

(d) Placing an order to purchase or sell a security for the account of a client without authority to do so.

(e) Placing an order to purchase or sell a security for the account of a client upon instruction of a third party without first having obtained a written third-party trading authorization from the client. Borrowing money or securities from a client unless the client is a broker-dealer, an affiliate of the investment adviser, or a financial institution engaged in the business of loaning funds.

(f) Loaning money to a client unless the investment adviser is a financial institution engaged in the business of loaning funds or the client is an affiliate of the investment adviser.

(g) Misrepresenting to any advisory client, or prospective advisory client, the qualifications of the

investment adviser or any employee of the investment adviser, or misrepresenting the nature of the advisory services being offered or fees to be charged for such service, or to omit to state a material fact necessary to make the statements made regarding qualifications, services or fees, in light of the circumstances under which they are made, not misleading.

(h) Providing a report or recommendation to any advisory client prepared by someone other than the adviser without disclosing that fact. (This prohibition does not apply to a situation where the adviser uses published research reports or statistical analyses to render advice or where an adviser orders such a report in the normal course of providing service.)

(i) Charging a client an unreasonable advisory fee.

(j) Failing to disclose to clients in writing before any advice is rendered any material conflict of interest relating to the adviser, or any of its employees which could reasonably be expected to impair the rendering of unbiased and objective advice including:

(1.) Compensation arrangements connected with advisory services to clients which are in addition to compensation from such clients for such services; and

(2.) Charging a client an advisory fee for rendering advice when a commission for executing securities transactions pursuant to such advice will be received by the adviser or its employees.

(k) Guaranteeing a client that a specific result will be achieved (gain or no loss) with advice which will be rendered.

(l) **[Alternative 1]** Publishing, circulating or distributing any advertisement which does not comply with Rule 206(4)-1 under the Investment Advisers Act of 1940.

(m) [Alternative 2]

(1.) Except as otherwise provided in subsection (2.), it shall constitute a dishonest or unethical practice within the meaning of [Uniform Act Sec. 102(a)(4)] for any investment adviser or investment adviser representative, directly or indirectly, to use any advertisement that does any one of the following:

(i.) Refers to any testimonial of any kind concerning the investment adviser or investment adviser representative or concerning any advice, analysis, report, or other service rendered by such investment adviser or investment adviser representative.

(ii.) Refers to past specific recommendations of the investment adviser or investment adviser representative that were or would have been profitable to any person; except that an investment adviser or investment adviser representative may furnish or offer to furnish a list of all recommendations made by the investment adviser or investment adviser representative within the immediately preceding period of not less than one year if the advertisement or list also includes both of the following:

(A) The name of each security recommended, the date and nature of each recommendation, the market price at that time, the price at which the recommendation was to be acted upon, and the most

recently available market price of each such security.

(B) A legend on the first page in prominent print or type that states that the reader should not assume that recommendations made in the future will be profitable or will equal the performance of the securities in the list.

(iii.) Represents that any graph, chart, formula, or other device being offered can in and of itself be used to determine which securities to buy or sell, or when to buy or sell them; or which represents, directly or indirectly, that any graph, chart, formula, or other device being offered will assist any person in making that person's own decisions as to which securities to buy or sell, or when to buy or sell them, without prominently disclosing in such advertisement the limitations thereof and the difficulties with respect to its use.

(iv.) Represents that any report, analysis, or other service will be furnished for free or without charge, unless such report, analysis, or other service actually is or will be furnished entirely free and without any direct or indirect condition or obligation.

(v.) Represents that the [Administrator] has approved any advertisement.

(vi.) Contains any untrue statement of a material fact, or that is otherwise false or misleading.

(2.) With respect to federal covered advisers, the provisions of this section only apply to the extent permitted by Section 203A of the Investment Advisers Act of 1940.

(3.) For the purposes of this section, the term "advertisement" shall include any notice, circular, letter, or other written communication addressed to more than one person, or any notice or other announcement in any electronic or paper publication, by radio or television, or by any medium, that offers any one of the following:

(i.) Any analysis, report, or publication concerning securities.

(ii.) Any analysis, report, or publication that is to be used in making any determination as to when to buy or sell any security or which security to buy or sell.

(iii.) Any graph, chart, formula, or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell.

(iv.) Any other investment advisory service with regard to securities.

(n) Disclosing the identity, affairs, or investments of any client unless required by law to do so, or unless consented to by the client.

(o) Taking any action, directly or indirectly, with respect to those securities or funds in which any client has any beneficial interest, where the investment adviser has custody or possession of such securities or funds when the advisor's action is subject to and does not comply with the requirements of Rule 102e(1)-1. and any subsequent amendments.

(p) Entering into, extending or renewing any investment advisory contract, unless such contract is in writing and discloses, in substance, the services to be provided, the term of the contract, the advisory fee, the formula for computing the fee, the amount of prepaid fee to be returned in the event of contract termination or non-performance, whether the contract grants discretionary power to the adviser and that no assignment of such contract shall be made by the investment adviser without the consent of the other party to the contract.

(q) Failing to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material nonpublic information contrary to the provisions of Section 204A of the Investment Advisers Act of 1940.

(r) Entering into, extending, or renewing any advisory contract contrary to the provisions of Section 205 of the Investment Advisers Act of 1940. This provision shall apply to all advisers and investment adviser representatives registered or required to be registered under this Act, notwithstanding whether such adviser or representative would be exempt from federal registration pursuant to Section 203(b) of the Investment Advisers Act of 1940.

(s) To indicate, in an advisory contract, any condition, stipulation, or provisions binding any person to waive compliance with any provision of this act or of the Investment Advisers Act of 1940, or any other practice contrary to the provisions of Section 215 of the Investment Advisers Act of 1940.

(t) Engaging in any act, practice, or course of business which is fraudulent, deceptive, or manipulative in contrary to the provisions of Section 206(4) of the Investment Advisers Act of 1940, notwithstanding the fact that such investment adviser or investment adviser representative is not registered or required to be registered under Section 203 of the Investment Advisers Act of 1940.

(u) Engaging in conduct or any act, indirectly or through or by any other person, which would be unlawful for such person to do directly under the provisions of this act or any rule or regulation thereunder.

(v) Accessing a client's account by using the client's own unique identifying information (such as username and password).*

(w) Failing to establish, maintain, and enforce a required policy or procedure.

The conduct set forth above is not inclusive. Engaging in other conduct such as non-disclosure, incomplete disclosure, or deceptive practices shall be deemed an unethical business practice. The federal statutory and regulatory provisions referenced herein shall apply to investment advisers, investment adviser representatives and federal covered advisers to the extent permitted by the National Securities Markets Improvement Act of 1996 (Pub. L. No. 104-290).

* This rule amendment is not intended to apply to data aggregation software where: (a) the investment adviser does not know, or have access to, the client's password(s); (b) there is an agreement between the data aggregation software company and the custodian(s)/online account platform which permits this "back-door" access; and (c) the data is read-only (*i.e.*, the investment

adviser can only view the information and cannot effectuate any changes to the client's underlying account(s)).

SECTION FIVE

NASAA 2019

Enforcement Report

Based on 2018 Data

NASAA

NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION

Introduction

NASAA at 100: What's Old is New Again

"Another Gusher will soon be flowing."

"The company owns clear unencumbered title to eighty acres of the best proved oil lands in the world, and is as sure to get oil as the stars shine."

"Should only one of these properties produce a gusher . . . the returns will be many times the capital stock of the Company. So that we claim this Company presents one of the best propositions to investors in this field."[1]

These are all statements that you would expect to hear describing an oil and gas offering. It may surprise you to know that these statements are not from current offerings in the oil and gas area but are from offerings a hundred years ago.

In 1917, the U.S. Supreme Court recognized that states had the right to pass reasonable state securities regulations, even if they affected interstate markets. Justice McKenna wrote for the Court, "the purpose being to protect the public against the imposition of unsubstantial schemes and the securities based upon them. Whatever prohibition there is is a means to the same purpose, made necessary, it may be supposed, by the persistence of evil and its insidious forms and the experience of the inadequacy of penalties or other repressive measures. The name that is given to the law indicates the evil at which it is aimed – that is, to use the language of a cited case, 'speculative schemes which have no more basis than so many feet of blue sky; ' or, as stated by counsel in another case, ' to stop the sale of stock in fly-by-night concerns, visionary oil wells, distan gold mines, and other like fraudulent exploitations."[2]

The More Things Change The More They Stay The Same

What's so different about scams that occurred over 100 years ago and those that we deal with on a daily basis?

Fictious Businesses

Whitaker Wright (1900) – Putting prestigious names on the boards of directors of his companies resulted in investments in his companies by the public. On paper, his companies were solvent. In reality the companies were lending money to one another tc balance the books. When discovered, the shares collapsed leaving investors penniless.

Barry Minkow (1986) – Minkow took his company, ZZZZ Best, an industrial rug cleaning firm, public with a stock valuation of $200 million. ZZZZ Best did not exist and was funded through credit card thefts.

[1] *Dallas Morning News, April 18, 1901.*

[2] *Hall v. Geiger Jones Co., 242 U.S. 539 (1917); Caldwell v. Sioux Falls Stockyards Co., 242 U.S. 559 (1917); Merrick v. N.W. Halsey & Co.,242 U.S. 568 (1917).*

Ponzi Schemes

Charles Ponzi (1920) – Ponzi purchased postal coupons at a discount and sold them abroad for full price. He promised investors 50% returns in 45 days. Ponzi paid early investors with later investors' funds. Overall, investors lost nearly $10 million.

Bernie Madoff (2008) – Madoff ran an $18 billion Ponzi scheme.

Robert H. Shapiro (Woodbridge Group of Companies LLC)(2015)– Shapiro ran various Woodbridge Funds that made hard-money loans secured by commercial property. Shapiro and his Woodbridge entities raised $1.8 billion. Woodbridge was a Ponzi scheme that resulted in actions brought by multiple state securities regulators and the SEC, along with ongoing criminal prosecutions.

Juan Miguel Lopez (2018) – Lopez raised about $4.9 million involving the sale of business contracts to fund small business loans. Lopez promised investors, most of whom are Hispanic, various companies that would pay between 3% and 8% return when in fact he was operating a Ponzi scheme.

Others

Ivan Boesky (1986) – Boesky amassed a fortune of more than $200 million by betting on corporate takeovers. He was convicted of insider trading.

Bitconnect (2018) – This cryptocurrency lending program had market capitalization of more than $2.6 billion when the Texas State Securities Board and the North Carolina Secretary of State, Securities Division issued cease and desist orders. Bitconnect shuttered, citing the two orders.

Timothy Lloyd Booth (2018) – A pastor, Booth raised $23 million from mostly elderly individuals who invested in Stamedia, Inc. Booth promised a guaranteed 9% annualized return. Instead, the money was used to fund a lavish lifestyle.

Metals.com (2019) – Metals.com cold-called potential investors, mostly between 65 and 90, and advised them that their money was not safe in the hands of registered brokers or investment advisers. Seniors were urged to liquidate their funds to purchase precious metals investments. To date, more than $12.9 million of rescissions have been ordered by the Texas State Securities Board and Colorado Securities Division.

As these examples show, unscrupulous promoters continue to salt the mines to impress investors. Promoters are still paying early investors with new investor money. People are still buying real estate investments based upon artificially inflated prices.

As you look at the history of securities fraud, and peel the transactions down to the basics, the frauds all operate the same. Promoters claim to have the next new project – get in at the start, a secret process, inside information, no risk, promise high returns, or tout special skills all of which will make huge profits for those investors willing to take a chance.

In the last 100 years, scams may not have changed much— tell investors what they want to hear to convince them to part with their money—but the communications with investors has. In the past, communication about potential investments was in person, through newspaper advertisements, or through the mail. Investors had time to think through their investment decisions. Today, everything is electronic allowing for instantaneous responses, and funds are transferred with a push of the button. There is no "cooling off" period now. If it sounds too good to be true, it probably is.

Regulators must keep up with the times, and as this report demonstrates, NASAA members stand ready to aggressively protect investors from fraud and police the integrity of our capital markets well into the 21st century.

Enforcement Overview

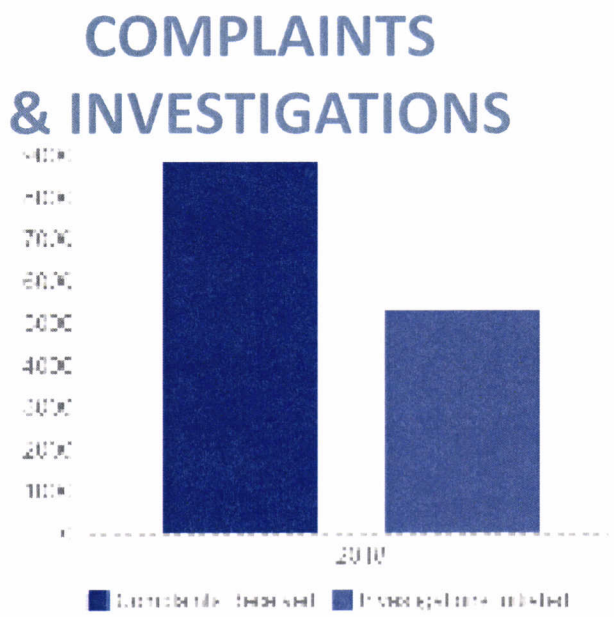
The results from this year's enforcement survey once again demonstrate the critical role that NASAA members continue to play in protecting investors and holding securities law violators accountable for the damage that they cause to individual investors and to the integrity of our capital markets.

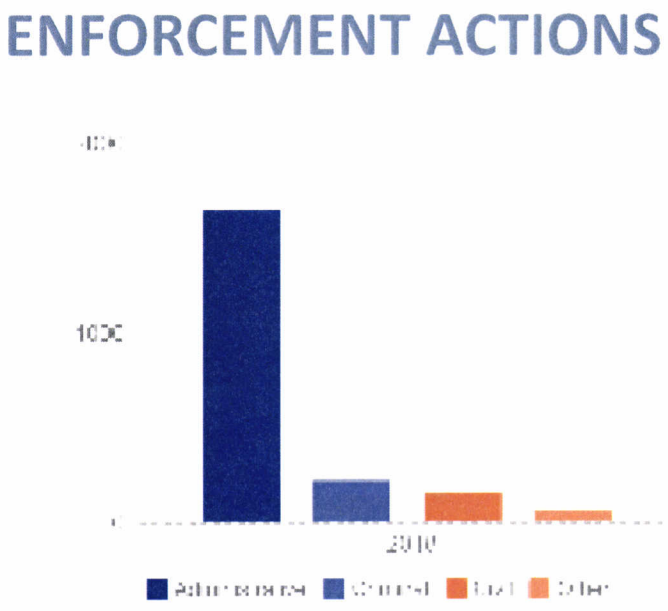
Complaints, Investigations and Enforcement Actions

COMPLAINTS & INVESTIGATIONS

8,814 Complaints Recieved
5,320 Investigations Initiated

The statistics above reflect the number of complaints received and investigations initiated. These formal investigations are supplemented by extensive efforts to informally resolve complaints and referrals. As such, investigations differ widely in their complexity and in the number of respondents and victims involved. The amount of time required to conduct an investigation can range from a few weeks to multiple years.



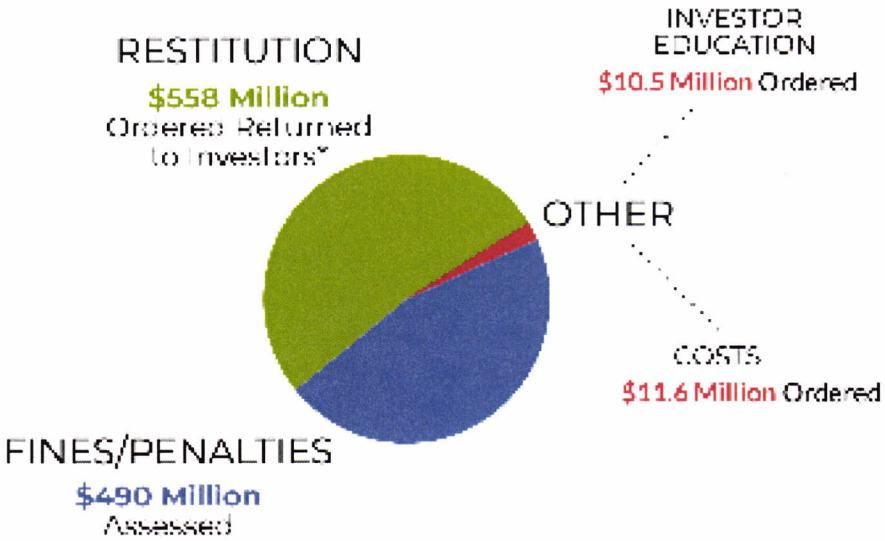


ENFORCEMENT ACTIONS

1,640 Administrative
218 Criminal
146 Civil
63 Other

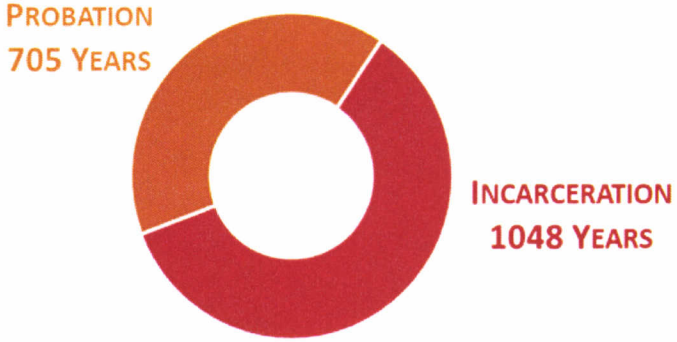
TOTAL: 2,067 Enforcement Actions

MORE THAN $1 BILLION IN MONETARY RELIEF ORDERED



** This figure represents restitution reported by NASAA U.S. member jurisdictions. Not all jurisdictions provided a restitution amount. This figure does not account for unilateral and unreported returns to investors, or rescission offers by firms or investigation targets.*

CRIMINAL RELIEF



RELIEF ORDERED

The sanctions imposed by state securities regulators can vary considerably from year to year, depending on the nature of the cases pursued. In addition to monetary restitution to investors, common types of sanctions include fines and penalties, criminal sentences, and restrictions or prohibitions on participation in the securities industry.

MONETARY RELIEF

$558 million ordered returned to investors.*

$490 million assessed in fines/penalties

$11.6 million ordered for costs

$10.5 million ordered for investor education

CRIMINAL RELIEF

1,753 total years of criminal relief

1,048 years of incarceration

705 years of probation

Licensing Activity

For the 2018 survey year, NASAA's U.S. members reported that their enforcement actions involved registered and unregistered actors in equal numbers. States reported taking action against 639 registered individuals and firms in the securities industry (broker-dealers and investment advisers), and 639 unregistered individuals and firms.

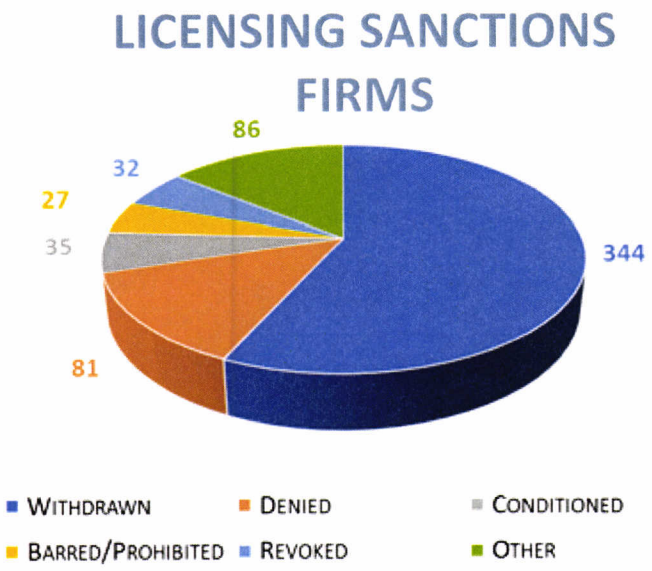
This even breakdown is consistent with a long-term trend: During the five-year period from 2014 to 2018, NASAA's U.S. members reported actions against 3,318 registered individuals and 3,287 unregistered individuals. The numbers of other types of respondents were also broadly consistent with long-term averages. For 2018, states reported taking action against 33 insurance agents and firms, 11 finders and solicitors and 6 financial planners.

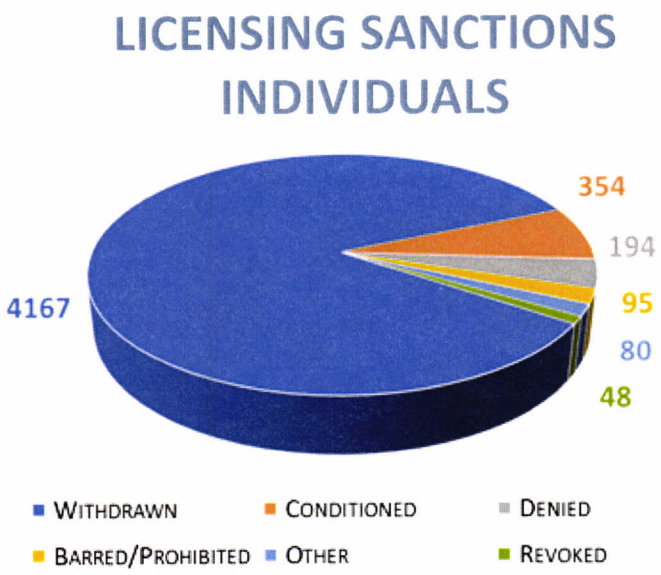
Within the licensed securities industry, NASAA's U.S. members reported a five-year high in the proportion of enforcement actions involving investment adviser (IA) firms. For the 2018 survey year, states reported that 17% of their actions involved IA firms, more than any other category of registered actors. That share has nearly doubled since 2014, when IA firms represented only 9% of respondents.

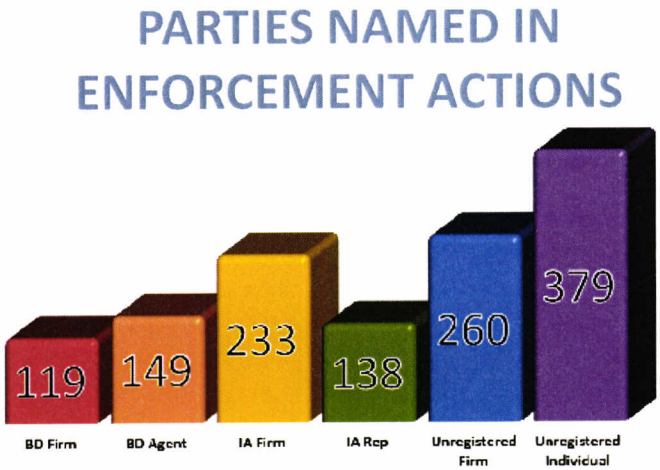
Overall, state securities regulators continued to take strong steps to prevent bad actors from operating within the licensed securities industry, and to limit the activity of licensees and registrants. In 2018, NASAA's U.S. members imposed licensing sanctions on nearly 1,000 respondents: they revoked, barred or suspended the licenses/registrations of more than 230 individuals and firms, and denied or conditioned the licenses/registrations of more than 760 others.

In addition, more than 4,500 license/registration requests were withdrawn as a result of state action or attention. While not always the case, many license/registration requests are withdrawn as a state is preparing to take action to deny, suspend or revoke a license/registration.

Looking ahead, NASAA's U.S. members again reported an increase in investigations of unregistered individuals, to no fewer than 700 in the 2018 survey year. This number has risen for three consecutive years, more than doubling from 335 in 2015. Given the ongoing state enforcement efforts against fraudulent activity involving cryptocurrencies, it would not be surprising to see a sustained high level of investigations and actions against unregistered individuals and firms in the coming years.







Enforcement Coordination

State and provincial securities regulators coordinate their enforcement efforts to maximize their collective ability to protect the investing public. This cooperative approach to enforcement ensures that NASAA members can leverage their resources for enhanced efficiency and investor protection by working together.

From the Files . . .

OPERATION CRYPTOSWEEP

Bad actors continue their attempts to capitalize on widespread interest in cryptocurrencies and blockchain technology. In April 2018, NASAA recognized the need to protect investors by organizing an international task force consisting of more than 40 state and provincial securities regulators. The task force initiated Operation Cryptosweep, a coordinated series of investigations and enforcement actions brought against promoters of illegal and fraudulent cryptocurrency investment schemes. The results are compelling, as task force members have opened more than 330 inquiries and investigations and brought more than 85 enforcement actions relating to ICOs and cryptocurrencies.

MULTISTATE INVESTIGATION & SETTLEMENT

The Woodbridge Group of Companies, controlled by Robert Shapiro, sold securities throughout the United States and raised approximately $1.2 billion. Woodbridge purported to be a hard-money lender that made loans to third parties secured by real estate. Woodbridge's main securities product were notes with a term of approximately one year that were purportedly secured by an assignment of a security interest in real estate. Woodbridge was, instead, a Ponzi scheme that lent little money to third parties and instead lent money to companies controlled by Shapiro that purchased property but never paid interest to Woodbridge. With little loan interest income, Woodbridge made principal and interest payments to its investors using other investors' funds.

In May 2015, Massachusetts was the first jurisdiction to take action regarding Woodbridge when the company agreed to a pre-complaint consent order that found Woodbridge's main investment product was an unregistered security. In July 2015, Texas issued an emergency cease and desist order against Woodbridge and Shapiro, alleging registration violations and also alleging that they fraudulently omitted to tell investors about the Massachusetts action. Woodbridge and Shapiro agreed to a consent order in Texas in March 2016.

Arizona issued a temporary order to cease and desist in October 2016 alleging registration violations and alleging that Woodbridge and Shapiro were liable for fraudulently omitting to tell investors about the Massachusetts and Texas actions. Woodbridge and Shapiro eventually agreed to consent orders in Arizona in November 2018 that found them liable for fraud, including the fraudulent omission of the Massachusetts and Texas actions.

Since Arizona's action in October 2016, several other states have taken action against Woodbridge, including California, Colorado, Florida, Idaho, Michigan, and Pennsylvania. Wisconsin and FINRA also took action against several Woodbridge securities sales agents.

Woodbridge petitioned for Chapter 11 bankruptcy protection in December 2017 in the District of Delaware. The company reported in a declaration filed with its bankruptcy petition that it had received information requests from approximately 25 state securities regulators. The bankruptcy court confirmed a plan of liquidation for Woodbridge in October 2018.

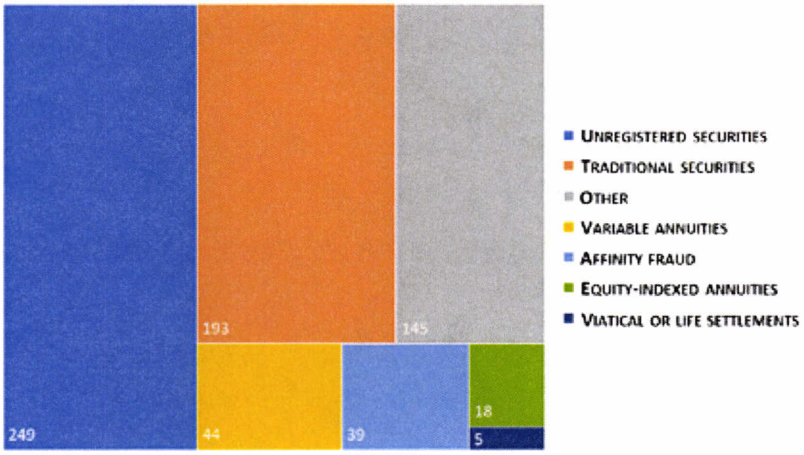
The SEC also brought a securities enforcement action against Woodbridge and Shapiro in December 2017. Woodbridge and Shapiro consented to judgments in the SEC action in December 2018. Shapiro was indicted for federal mail and wire fraud in April 2019. Shapiro plead guilty in August 2019. Sentencing is scheduled for October 2019.

Senior Investor Protection

Senior investors remain a major target of fraudsters, and NASAA member jurisdictions remain focused on this threat.

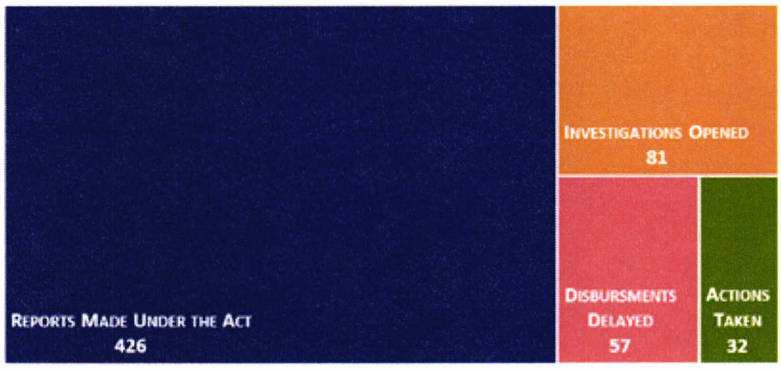
In 2018, NASAA member jurisdictions brought enforcement actions involving 758 senior victims. Regarding the chart below, "Other" schemes include, but are not limited to, internet romance scams, lottery or sweepstakes scams, Nigerian schemes, and identity theft.

Schemes and Products Used to Target Seniors



This focus has also manifested itself in model legislation. In 2016, NASAA members voted to to approve the NASAA Model Act to Protect Vulnerable Adults from Financial Exploitation, which offers broker-dealer and investment adviser firms qualified immunity for delaying disbursements when the firm reasonably believed financial exploitation would result. The model act also requires financial advisors and others at broker-dealer and investment adviser firms to report any reasonable suspicion of an attempt of financial exploitation.

NASAA Model Act Statistics



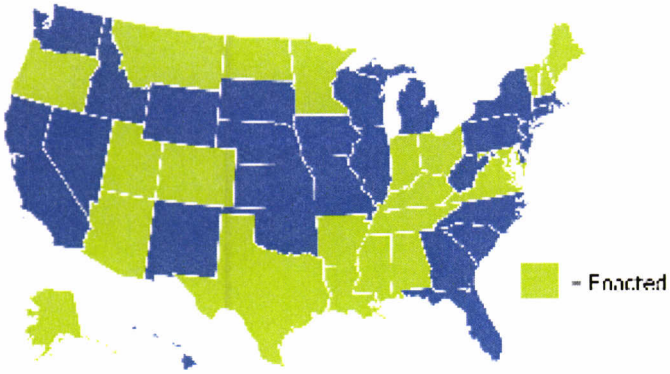
To date, 23 jurisdictions have enacted rules or legislation based on the NASAA model act, including four in 2019 (Arizona, Maine, New Hampshire and Virginia). FINRA also has implemented a rule allowing broker-dealers to delay disbursements to avoid financial exploitation.

In 2018, states received more than 400 reports from broker-dealers and investment advisers. These 400-plus reports shed light on victims of securities fraud, elder exploitation, and other seniors who need some form of assistance.

States have taken action to prevent or stop senior financial exploitation, to punish those responsible, and have also referred reports to more appropriate agencies and sometimes even sought to refer seniors to non-investigative services.

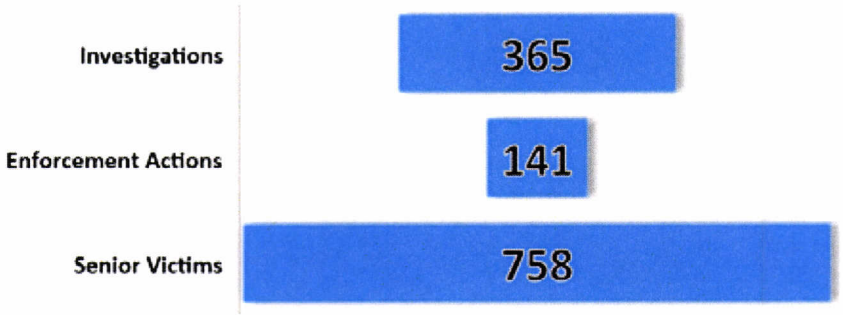
Many of the first states to enact the Model Act have seen a drastic increase in use of these statutes and the number of reports of potential financial exploitation from firms. For example, in 2018, the number of reports received in Alabama increased 225% over fiscal year 2017. Alabama's reports are on track to exceed fiscal 2018's numbers.

States That Have Enacted Legislation Based on NASAA's Model Act to Protect Vulnerable Adults From Financial Exploitation



Senior Investor Protection

2018 Overall Senior-Related Enforcement Activity



From the Files . . .

Shortly after Texas enacted legislation to protect seniors from financial exploitation, a registered firm contacted the Texas State Securities Board to report that metals.com, a nationwide distributor of precious metals, may have financially exploited an 80-year-old-client.

The firm explained that metals.com advised the client to liquidate her retirement accounts and transfer almost $850,000 to invest in precious metals through metals.com. The agency immediately began investigating metals.com and concluded the firm was engaging in a broad, illegal investment advisory scheme.

Texas securities regulators brought an ex parte enforcement action against metals.com to stop it from continuing to illegally render investment advice in Texas and resolved the case through an administrative order that requires metals.com to offer full rescission to more than 80 Texas investors. The Texas State Securities Board coordinated with other state regulators and other agencies, such as the Colorado Division of Securities and the Alabama Securities Commission (or other agencies that file prior to printing). Those states have since conducted their own investigations and brought enforcement actions against metals.com.

A report to the Alabama Securities Commission from an investment adviser regarding a 77-year-old Birmingham, Alabama, resident prevented $200,000 from leaving the investor's accounts.

The investor received a cold call solicitation from a representative of an oil and gas company who convinced him to invest $100,000. The elderly investor contacted his investment advisor to arrange the wire transfer. A few days later, the investor requested a second wire transfer, but this time the adviser asked a series of questions and determined there were enough red flags to warrant a report to the Alabama Securities Commission and Adult Protective Services. A hold was placed on the account, preventing another $200,000 from being lost. The Alabama Securities Commission has also filed enforcement actions against the company and its principals.

2018/19 Canadian NASAA Member Enforcement Activity

Enforcement demands a highly collaborative approach to protect Canadian investors. In addition to local enforcement actions, the CSA Enforcement Committee ("the Committee") members coordinate multijurisdictional investigations and share tools and techniques that help their staff investigate and prosecute securities law violations that cross domestic and international borders.

The Committee provides a forum for jurisdictions to share enforcement intelligence, helping to identify trends and threats as well as transfer ideas and processes among Committee members. The Committee undertakes initiatives that improve enforcement across the country through the work of the following specialized taskforces and working groups:

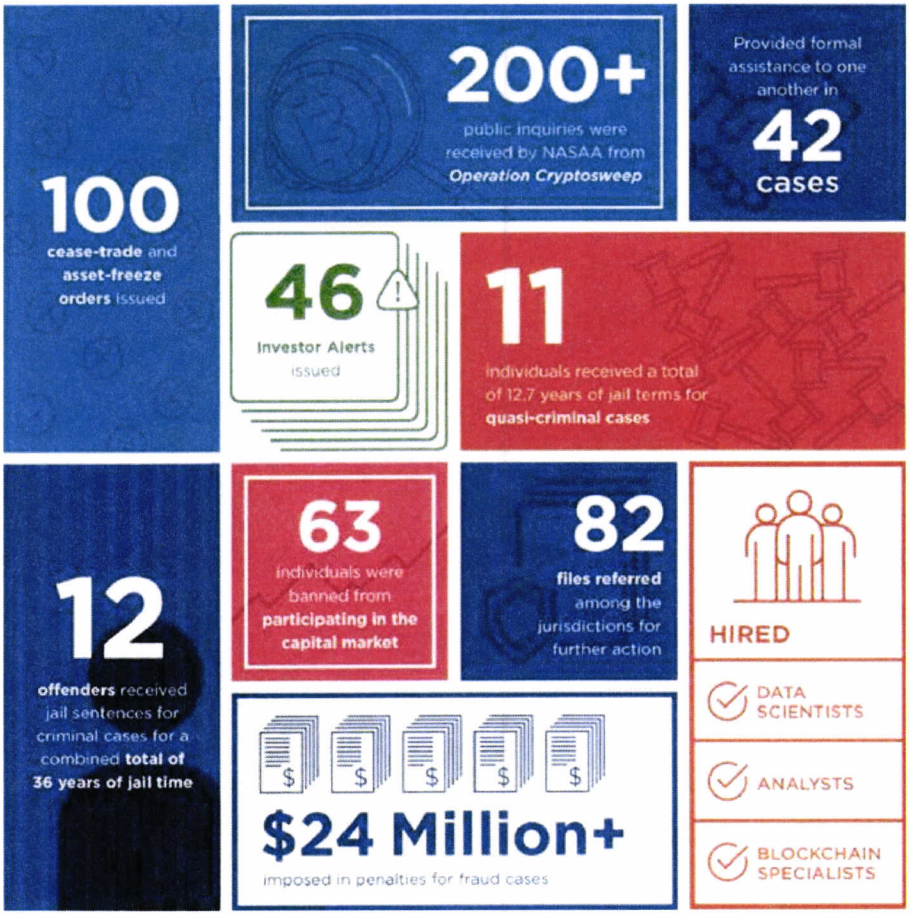
Enforcement Technology and Analytics Working Group
Facilitates regular, cooperative information sharing focused on the use of technology by enforcement staff, including electronic management, e-discovery, advanced analytics, surveillance and product management issues.

Investment Fraud Taskforce (Emerging Issues)
Responds to emerging investment frauds and threats with holistic and highly targeted initiatives, deploying them in a timely fashion to safeguard Canadian investors. Specific areas include binary options fraud, crypto-asset fraud, and Initial Coin Offering fraud.

Collection Practices and Strategies Working Group
Builds strategies for improving collection of monetary orders through information-sharing and facilitating increased awareness of collections actions and/or results.

Cross-Border Market Fraud Initiative ("Pump-and-Dump")
Encourages proactive approaches and solutions aimed at eradicating pump-and-dump schemes and enabling the initiative members to take action against those engaged in them – across national and international borders.

Enforcement Highlights: At a Glance



U.S. NASAA Member Enforcement Activity 2014-2018

Category	2014	2015	2016	2017	2018	5-Year Total
Investigations	4,853	4,112	4,341	4,790	5,320	23,416
Overall Enforcement Actions	2,042	2,060	2,017	2,150	2,067	12,403
Administrative	1,634	1,593	1,606	1,682	1,640	8,155
Civil	137	151	138	116	146	688
Criminal	271	261	241	255	218	1,246
Other	*not collected*	55	32	52	63	202
Overall Criminal Relief [2]	2,122 years	1,246 years	1,346 years	1,985 years	1,753 years	8,452 years
Incarceration	1,624 years	838 years	824 years	1,551 years	1,048 years	5,885 years
Probation	498 years	408 years	522 years	434 years	705 years	2,567 years
Restitution [3]	$405 million	$536 million	$231 million	$486 million	$558 million	$2.2 billion
Fines/Penalties [4]	$174 million	$230 million	$682 million	$79 million	$490 million	$1.6 billion
Overall License Sanctions [5]	3,585	4,265	3,500	4,456	5,543	21,349
Withdrawn	2,857	3,380	2,843	3,578	4,511	17,169
Denied/Revoked/ Suspended/ Conditioned/Barred	728	885	657	878	1,032	4,180

Notes: 1) Includes administrative, civil, criminal and other actions. 2) Includes prison time sentenced and probation. 3) Money ordered returned to investors by state securities regulators. 4) The method for reporting fines/penalties data was modified beginning with the data collected in 2016. 5.) Includes individual and firm licenses withdrawn, conditioned, barred, denied, revoked or suspended as a result of state action or attention.

2018-2019 NASAA Enforcement Section and Project Groups

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Andrew Hartnett (IA), Chair (6/19 - 9/19)
Joseph Rotunda (TX), Vice-Chair
William Carrigan (VT)
Wendy Coy (AZ)
Jesse Devine (NY)
Ricky Locklar (AL)
Jason Roy (MB)
A. Valerie Mirko, NASAA Liaison

PROJECT GROUPS

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Jocelyn Bramble ((DC)
Max Brauer (MD)
Vincent Ledlow (IA)
Ann Rankin (VA)

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James Moore (AB)
Glenn Skreppen (PA)
Lori Toledano (ON)
James Apistolas, NASAA Liaison

ENFORCEMENT ZONES

Zone 1 (Northeast) Eric Forcier (NH)
Zone 2 (Southeast) Ricky Locklar (AL)
Zone 3 (Mid-Atlantic) Marion Quirk (DE)
Zone 4 (Central) Roger Patrick (OH)
Zone 5 (South/Central) Tina Lawrence (TX)
Zone 6 (Mountain) Jonathan Block (CO)
Zone 7 (Western) Alex Calero (CA)
Zone 8 (Canadian) Jason Roy (MB)

NASAA

Organized in 1919, the North American Securities Administrators Association (NASAA) is the oldest international organization devoted to investor protection. NASAA is a voluntary association whose membership consists of 67 state, provincial, and territorial securities administrators in the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada, and Mexico.

In the United States, NASAA is the voice of state securities agencies responsible for efficient capital formation and grass-roots investor protection. Their fundamental mission is protecting investors who purchase securities or investment advice, and their jurisdiction extends to a wide variety of issuers and intermediaries who offer and sell securities to the public. NASAA members license firms and their agents, investigate violations of state and provincial law, file enforcement actions when appropriate, and educate the public about investment fraud. Through the association, NASAA members also participate in multi-state enforcement actions and information sharing.

For more information, visit: www.nasaa.org

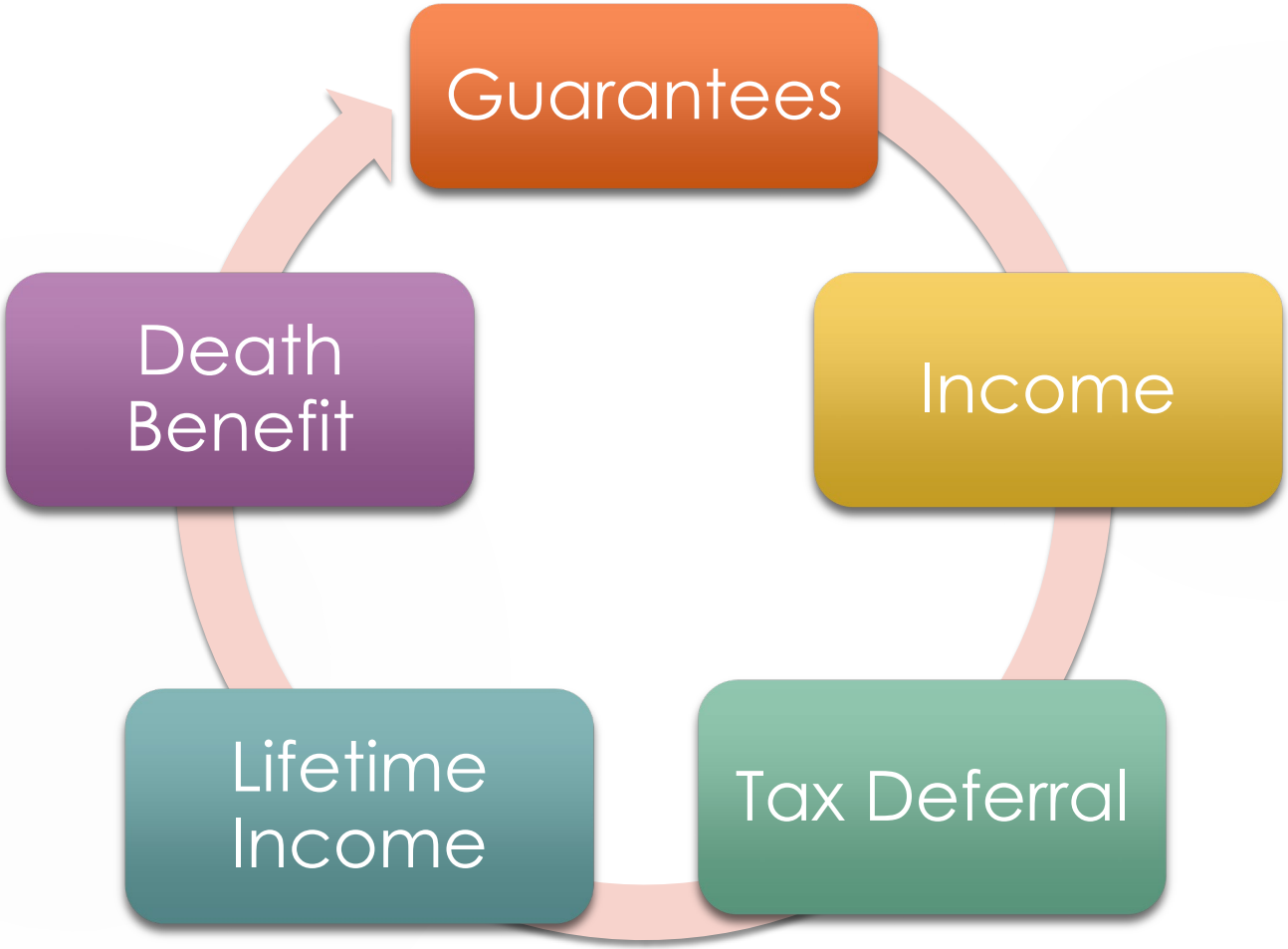
VARIABLE ANNUITY FEATURES

Frederick Rosenberg

- Relevant Features and Benefits
  - Tax Deferral-Tax Cost
  - Death Benefits
  - Penalty-Free Withdrawals GMWB
  - Lifetime Income Benefits GLIB, GMIB
  - Annuitization
  - Taking an Income

Promoted Features

Frederick Rosenberg



Immediate Annuity

- Immediate conversion of cash into a guaranteed stream of revenues calculated using an actuarial Constant.
- Constant: The annual payout percentage of the Annuity Base at election for any given age. Constant increases as life expectancy decreases & Payout Increases.
- Minimum growth rate, 2%-3%
- 80%-90% of distribution is a Return of Premium and not taxable.
- Various Options Impact Payout
  - Term: Life or Fixed Period
  - Lives covered
  - Return of Premium Guarantee
- Illiquid: Substantial Discounted Cash Flow (DCF) Value
- Depending on the age of the annuitant the limitations of immediate annuities are offset by higher lifetime payout and no market or enterprise risk.
- Payouts are guaranteed for life, require no sinking fund, eliminate reinvestment risk.

Deferred Variable Annuity

- VA Investment
  - Mutual Fund Sub-Accounts
  - Market Risk to Principal
  - Tax Deferred Appreciation
  - Diversified Allocation
- VA Phases
  - Accumulation-Appreciation
    - Guarantees
    - Enhancement Riders and bonuses
    - Step-Up-Roll-up
    - Permitted Withdrawals
    - Mortality
  - Distribution-Withdrawing Funds
    - Annuitization
    - Surrender- Full or Partial
    - Lifetime Income Benefits
- Notional Death Benefit (Taxable as Withdrawal)
- Converts capital gains to Ordinary income taxed on a first out basis
- High Annual Cost-High Hurdle 2.5%-3.5%

Fixed Index Annuity

- **An Insurance Contract (not a security) NTM 05-50 Supervision**
  - Guarantees of Principal and an Income
  - Competes With CDs and T-Bills : Cap on yearly Gains and Loss
  - Notional Balances Replace VA Sub Accounts
  - Living Benefit Riders
  - Death Benefit
  - Index based performance-(Dividends excluded?)
  - Principal Depletion
    - Fees and Mortality Expenses
    - Excess Withdrawals and Surrenders
  - Recapture
    - Bonus
    - Enhancements
  - Death Benefit Taxable
  - High Annual Costs 3%-4%
  - CDSC

How It Works

Accumulation Phase

Incentive Bonus

- Sub-Account Appreciation (loss)
- Notional Accounts Accrual
- Roll –up
- Step Up
- Withdrawals
  - May constitute a Surrender
  - CDSC
  - Penalty free withdrawal $ can rise or fall based upon market activity and fees and withdrawals that cause partial surrender
- 3% +/- annual cost
- Mortality

Distribution Phase

- Annuitize
- Surrender
  - CDSC
  - Recapture and Recalculation
- Lifetime Withdrawal Benefit
  - Contract Value Fixed
  - Distribution Fixed
  - Excess withdrawals =surrenders
  - Rider charges continue
- Lifetime Income Benefit
  - Minimum growth rate on Protected Balance
  - Withdrawals prohibited
  - Guaranteed payout rate (constant) of Income Base
  - Rider Charge until election
- Death

Death Benefit

- Death Benefit: Notional payout if, upon death, the portfolio declined to zero. The Death Benefit is initially the Contract Value.
- Step-up: A paid rider allows the Death Benefit to be ratcheted up if the portfolio appreciates.
- Excess withdrawals and partial surrenders could reduce Contract Value and the Notional Death Benefit proportionately.

Death Benefit

- The Death Benefit is a Put, a form of Portfolio Insurance .
- If at Death the portfolio is less than the Guaranteed Death Benefit, the Put will be In-the-Money and its value equal to the difference between the Notional (theoretical) Guaranteed Death Benefit and the portfolio's market value. The Investment Accounts will be "Put" to the Annuity Company in exchange for the Death Proceeds.
- If at death the Investment Accounts' value exceeds the Guaranteed Benefit, the Put will be Out-Of-The-Money and will be valueless and there will no benefit whatsoever or refund of rider premiums.
- Below is a Comparison of a Guaranteed Death Benefit vs. average market returns coupled with a $500K term policy for Life+20-year guaranteed for a 58-year-old male. Regardless of the Death Year, the Index/Term policy resulted in substantially better outcomes.

Death Benefit Analysis

- "MONEYNESS"
- The Put was In-the-Money in only six of the 12 years.
- The impact of fees resulted in a $1million deficit after 12 years of identical market performance.
- VA costs are $432,850 over 12 years vs with $104,080 in index costs (.25%/yr.) and Term Policy costs, $5,200/yr.
- Over 12 years the excess VA cost amount to a $327,700 drag on performance.

Death Benefit Analysis and Comparison

Variable Annuity with Step Up

	A	B	C	D	E	F	G	H	I	J
	Death Year	Open Value Contract Val	Avg Return	New Value Sub Acct	Costs** -3%	End Value	Notional Death Benefit	Upon Death	Put Value Death Bene.	*Death Delta VA vs idx*
age			8.1%	B x C		D + E	With Step-Up	G or F	G - F	*Term Life*
58	1	1,000,000	14%	1,140,000	(34,200)	1,105,800	1,000,000	1,105,800	0	(526,150)
59	2	1,105,800	-5%	1,050,510	(31,515)	1,018,995	1,105,800	1,105,800	86,805	(461,664)
60	3	1,018,995	-25%	764,246	(22,927)	741,319	1,105,800	1,105,800	364,481	(187,597)
61	4	741,319	34%	993,367	(29,801)	963,566	1,105,800	1,105,800	142,234	(449,494)
62	5	963,566	12%	1,079,194	(32,376)	1,046,818	1,105,800	1,105,800	58,982	(567,974)
63	6	1,046,818	14%	1,193,373	(35,801)	1,157,571	1,157,571	1,157,571	0	(671,986)
64	7	1,157,571	2%	1,180,723	(35,422)	1,145,301	1,157,571	1,157,571	12,270	(689,986)
65	8	1,145,301	17%	1,340,002	(40,200)	1,299,802	1,299,802	1,299,802	0	(767,699)
66	9	1,299,802	-7%	1,208,816	(36,264)	1,172,552	1,299,802	1,299,802	127,251	(649,129)
67	10	1,172,552	18%	1,383,611	(41,508)	1,342,103	1,342,103	1,342,103	0	(858,162)
68	11	1,342,103	10%	1,476,313	(44,289)	1,432,023	1,432,023	1,432,023	0	(928,392)
69	12	1,432,023	13%	1,618,187	(48,546)	1,569,641	1,569,641	1,569,641	0	(1,022,173)
					(432,850)					

* Contract Value will be adjusted proportionally for surrenders and partial surrenders and for recapture of bonuses and

** Assumes Annual Step-up Death Benefit. (Many policies, mostly older, allow only limited step-up on a 1 or 2 time basis

Note While all surrenders reduce benefits proportionally, each VA prospectus should be consulted to calculate partial surrenders

Index*** and $500K Life-20-yr Term Policy

	A	B	C	D	E	F	G	H	I	J
	Death Year	Open Value Contract Val	Avg Return	New Value Index Bal	0.25% Idx+ $5200/yr	End Value	Policy Death Benefit	Upon Death	Death Benefit	*Death Delta VA vs idx*
age			8.1%	B x C	Ins Prem	D + E	$ 500,000	G + F		*Term Life*
58	1	1,000,000	14%	1,140,000	(8,050)	1,131,950	500,000	1,631,950	500,000	526,150
59	2	1,131,950	-5%	1,075,353	(7,888)	1,067,464	500,000	1,567,464	500,000	461,664
60	3	1,067,464	-25%	800,598	(7,201)	793,397	500,000	1,293,397	500,000	187,597
61	4	793,397	34%	1,063,151	(7,858)	1,055,294	500,000	1,555,294	500,000	449,494
62	5	1,055,294	12%	1,181,929	(8,155)	1,173,774	500,000	1,673,774	500,000	567,974
63	6	1,173,774	14%	1,338,102	(8,545)	1,329,557	500,000	1,829,557	500,000	671,986
64	7	1,329,557	2%	1,356,148	(8,590)	1,347,558	500,000	1,847,558	500,000	689,986
65	8	1,347,558	17%	1,576,643	(9,142)	1,567,501	500,000	2,067,501	500,000	767,699
66	9	1,567,501	-7%	1,457,776	(8,844)	1,448,932	500,000	1,948,932	500,000	649,129
67	10	1,448,932	18%	1,709,739	(9,474)	1,700,265	500,000	2,200,265	500,000	858,162
68	11	1,700,265	10%	1,870,291	(9,876)	1,860,416	500,000	2,360,416	500,000	928,392
69	12	1,860,416	13%	2,102,270	(10,456)	2,091,814	500,000	2,591,814	500,000	1,022,173
					(104,080)					

*** Capital Gains treatment on Index Distributions vs Ordinary tax treatment on VA distributions, CDSC and 72T recaptures

Moneyness and Step-Up

- As discussed above, the Death Benefit will be either in-or-out-of–the-money, a factor termed “Moneyness”.
- Living Benefits will also be in-or-out-of–the-money if the portfolio outpaces the guaranteed benefit.
- Step-Up benefits are fee-based features that ratchet up the guarantees to keep them from going out of the money. In substance, if the benefits are not ratcheted up the investor will be paying annual fees for features they cannot and will not use.
- Moneyness is important to Annuity companies because there is a substantially higher Surrender rate when benefits are out of the money.

Enhancements and Bonuses

Conditioned upon Annuitization or a Lifetime Income.

- Vesting Schedule
- Roll Up @Guaranteed Rate
- Step-up Benefit

→

Recapture: Proportional Upon Partial Surrender

- Bonuses and Step-up
- Guaranteed Notional Withdrawal Balance
- Roll-up Guarantee
- Death Benefit

Features Alphabet Varies by Company

- GMWB- Guaranteed Minimum Withdrawal Benefit
  - A guaranteed minimum withdrawal benefit (GMWB) rider guarantees that a certain percentage (usually 5-10%) of the contract value can be withdrawn annually until the entire amount is completely recovered, regardless of market performance assuming balance not fully depleted.
- GMIB- Guaranteed Minimum Income Benefit
  - A guaranteed minimum income benefit (GMIB) rider is designed to provide the investor with a base amount of lifetime income when they retire regardless of how the investments have performed. It guarantees that when the owner elects an Income, payments are based on the amount invested, credited with an interest rate--typically 5-8%/yr. An investor must take a stipulated fixed Income based on age at election. There is typically a seven-ten year holding period before it can be exercised. Age limits may also apply.
- GLWB-GLIB- Guaranteed Lifetime Withdrawal/Income Benefit
  - The guaranteed lifetime withdrawal benefit (GLWB) guarantees that a certain percentage (typically 2-8%, based on age) of the Contract Value can be withdrawn each year for as long as the contract holder lives. This percentage will be set based on the person's age when withdrawals begin. Rider Fees Continue and allocations are severely restricted. Withdrawals reduce contract value
- GMDB- Guaranteed Minimum Death Benefit
  - Provides for Step-Up of the Notional Death Benefit to keep pace with appreciation

GMWB Rider

- Permits annual withdrawals of 6%-10% of Contract Value without CDSC
- Not Annuitization or an Income Benefit
- Not a guarantee of Amount
- Only guarantees a penalty-free % withdrawal.
- Usually exceeds Lifetime Income Benefit when withdrawals begin
- Reduces gains first and premium second,
- May be treated as a partial or total surrender
- May reduce benefits including death benefit proportionally
- Automatic fixed withdrawals regardless of performance
- **Most common factor in Investor claims**

GMIB Rider

- Roll Up Benefit-(Notional)
  - Guarantees an Income Base at a fixed growth rate of 6%-10%.
  - Fees based on Notional Growth Account
  - Sets an age-based payout percentage based upon age, 3%-8%
  - Minimum withdrawal-free Step-up holding period 7-10 years
  - Guarantees a Lifetime Payout at % of Income Based on age and sex.
  - Restricts Portfolio Allocation
  - The Income Base is Notional-Cannot be Withdrawn except by taking an Income

It's the Constant Stupid!

- The "Constant" is the actuarily determined fixed percentage applied to Investment to calculate distributions. It increases as life expectancy decreases.
- Outweighs importance of Growth Rate for seniors over 65
- IA Distributions includes repayment of investment and return on investment
- Annuity Companies offset high Guaranteed growth rates with lower constants increasing fees and decreasing contract value vs. lower growth rate and higher constant, a lower fee alternative.
- Essential to formulate Damages

GMIB Roll Up *Actual Index Annuity*

- The annual charge is 1.25% of the Income Base, a notional account growing 8%/yr. for 12 years assuming no withdrawals. (Great American Valor II)
- Higher Notional Growth rates increase fees
- Rider cost is in addition to all other elected riders
- Fees and costs reduce account value, not Income Base.
- As the Income Base grows over the years, so does the Lifetime Income.
- E.G. At age 85, the investor can
  - **Take an Income** of$29,998 annually on an Income Base of $428, 400 extinguishing all benefits
  - or 2) **Pay an additional rider charge**, grow the Income Base by 8%, and maintain the Death Benefit for another year for a higher payout.
- Lifetime Income is based on substantially lower payout rate, the Constant, vs IA. (see next table).

GMIB Illustration

Yellow Column Added for illustration

Rollup Rate/Period: 8.00 % for 12 years

Rider Charge: 1.25 %

year	Age	Beginning Account Value	Beginning Income Base	Available Lifetime Income	Dist	1.25% Rider Charge	Fee % vs. acct val	Ending Income Base	Ending Account Value	Ending 5 Year Death Benefit	Lump Sum Death Benefit
1	80	306,000	306,000	-	-	3,825	**1.25%**	330,480	302,175	302,175	302,175
2	81	302,175	330,480	21,812	-	4,131	**1.37%**	354,960	298,044	298,044	298,044
3	82	298,044	354,960	23,782	-	4,437	**1.49%**	379,440	293,607	293,607	293,607
4	83	293,607	379,440	25,802	-	4,743	**1.62%**	403,920	288,864	291,961	291,961
5	84	288,864	403,920	27,870	-	5,049	**1.75%**	428,400	283,815	298,274	298,274
6	85	283,815	428,400	29,988	-	5,355	**1.89%**	452,880	278,460	452,880	365,670
7	86	278,460	452,880	32,154	-	5,661	**2.03%**	477,360	272,799	477,360	375,080
8	87	272,799	477,360	34,370	-	5,967	**2.19%**	501,840	266,832	501,840	384,336
9	88	266,832	501,840	36,634	-	6,273	**2.35%**	526,320	260,559	526,320	393,440
10	89	260,559	526,320	38,948	-	6,579	**2.52%**	550,800	253,980	550,800	402,390
11	90	253,980	550,800	41,310	-	6,885	**2.71%**	575,280	247,095	575,280	411,188
12	91	247,095	575,280	43,146	-	7,191	**2.91%**	599,760	239,904	599,760	419,832
13	92	239,904	599,760	44,982	-	7,497	**3.13%**	599,760	232,407	599,760	416,084
14	93	232,407	599,760	44,982	-	7,497	**3.23%**	599,760	224,910	599,760	412,335
15	94	224,910	599,760	44,982	-	7,497	**3.33%**	599,760	217,413	599,760	408,587
16	95	217,413	599,760	44,982	-	7,497	**3.45%**	599,760	209,916	599,760	404,838

Constants Control

IA vs GMIB -10-yr G'tee)

- Top Table
  - Assumes no growth in Account (Shoebox)
  - Payout based solely on IA Constant
  - IA Constant on a shoebox of $306K produces better income than the GMIB
- Middle Table
  - Assumes 2%/year Minimum Growth Rate
  - Payout based on IA Constant
  - produces a consistently 25% better outcome than the GMIB
- Bottom Table
  - Account Value equals notional Income Base
  - Payout based on IA Constant
  - 75% differential in Payout?
- Most take an income by or before 7 years.

Annuitization					GMIB w Roll-up				
Annuity year	Age	Account Value, grow/yr	Constant*	Annual $	Beginning Income Base	GMIB Lifetime Income/yr	Constant	GLWB Rider Fee	Excess Annuity $/yr.
1	80	306,000	8.95%	27,387	306,000	-	0.00%	(3,825)	27,387
2	81	306,000	9.73%	29,774	330,480	21,812	6.60%	(4,131)	7,962
3	82	306,000	9.97%	30,508	354,960	23,782	6.70%	(4,437)	6,726
4	83	306,000	10.20%	31,212	379,440	25,802	6.80%	(4,743)	5,410
5	84	306,000	10.45%	31,977	403,920	27,870	6.90%	(5,049)	4,107
6	85	306,000	11.19%	34,241	428,400	29,988	7.00%	(5,355)	4,253
7	86	306,000	11.64%	35,618	452,880	32,154	7.10%	(5,661)	3,464
8	87	306,000	12.11%	37,057	477,360	34,370	7.20%	(5,967)	2,687
9	88	306,000	12.61%	38,587	501,840	36,634	7.30%	(6,273)	1,953
10	89	306,000	13.12%	40,147	526,320	38,948	7.40%	(6,579)	1,199
11	90	306,000	13.66%	41,800	550,800	41,310	7.50%	(6,885)	490
* based upon constants from immediateannuities.com							Total Fees	(58,905)	

Annuitization					GMIB w Roll-up				
Annuity year	Age	Account Value, grow/yr 102%	Constant*	Annual $	Beginning Income Base	GMIB Lifetime Income/yr	0	GLWB Rider Fee	Excess Annuity $/yr.
1	80	306,000	8.95%	27,387	306,000	-	0.00%	(3,825)	27,387
2	81	312,120	9.73%	30,369	330,480	21,812	6.60%	(4,131)	8,557
3	82	318,362	9.97%	31,741	354,960	23,782	6.70%	(4,437)	7,959
4	83	324,730	10.20%	33,122	379,440	25,802	6.80%	(4,743)	7,320
5	84	331,224	10.45%	34,613	403,920	27,870	6.90%	(5,049)	6,743
6	85	337,849	11.19%	37,805	428,400	29,988	7.00%	(5,355)	7,817
7	86	344,606	11.64%	40,112	452,880	32,154	7.10%	(5,661)	7,958
8	87	351,498	12.11%	42,566	477,360	34,370	7.20%	(5,967)	8,196
9	88	358,528	12.61%	45,210	501,840	36,634	7.30%	(6,273)	8,576
10	89	365,698	13.12%	47,980	526,320	38,948	7.40%	(6,579)	9,032
11	90	373,012	13.66%	50,953	550,800	41,310	7.50%	(6,885)	9,643
* based upon constants from immediateannuities.com							Total Fees	(58,905)	

Annuitization					GMIB w Roll-up				
Annuity year	Age	Account Value, grow/yr 100%	Constant*	Annual $	Beginning Income Base	GMIB Lifetime Income/yr	Constant	GLWB Rider Fee	Excess Annuity $/yr.
1	80	306,000	8.95%	27,387	306,000	-		(3,825)	27,387
2	81	330,480	9.73%	32,156	330,480	21,812	6.60%	(4,131)	10,344
3	82	354,960	9.97%	35,390	354,960	23,782	6.70%	(4,437)	11,608
4	83	379,440	10.20%	38,703	379,440	25,802	6.80%	(4,743)	12,901
5	84	403,920	10.45%	42,210	403,920	27,870	6.90%	(5,049)	14,340
6	85	428,400	11.19%	47,938	428,400	29,988	7.00%	(5,355)	17,950
7	86	452,880	11.64%	52,715	452,880	32,154	7.10%	(5,661)	20,561
8	87	477,360	12.11%	57,808	477,360	34,370	7.20%	(5,967)	23,438
9	88	501,840	12.61%	63,282	501,840	36,634	7.30%	(6,273)	26,648
10	89	526,320	13.12%	69,053	526,320	38,948	7.40%	(6,579)	30,105
11	90	550,800	13.66%	75,239	550,800	41,310	7.50%	(6,885)	33,929
* based upon constants from immediateannuities.com							Total Fees	(58,905)	

HOW LAWS ARE MADE

Compilation of Materials
by Robin S. Ringo

Introduction[1]

This online resource provides a basic outline of the numerous steps of our federal law-making process from the source of an idea for a legislative proposal through its publication as a statute. The legislative process is a matter about which every person should be well informed in order to understand and appreciate the work of Congress. It is hoped that this guide will enable readers to gain a greater understanding of the federal legislative process and its role as one of the foundations of our representative system. One of the most practical safeguards of the American democratic way of life is this legislative process with its emphasis on the protection of the minority, allowing ample opportunity to all sides to be heard and make their views known. The fact that a proposal cannot become a law without consideration and approval by both Houses of Congress is an outstanding virtue of our bicameral legislative system. The open and full discussion provided under the Constitution often results in the notable improvement of a bill by amendment before it becomes law or in the eventual defeat of an inadvisable proposal. As the majority of laws originate in the House of Representatives, this discussion will focus principally on the procedure in that body.

The Congress[2]

Article I, Section 1, of the United States Constitution, provides that:

All legislative Powers herein granted shall be vested in a Congress of the United States, which shall consist of a Senate and House of Representatives.

The Senate is composed of 100 Members—two from each state, regardless of population or area—elected by the people in accordance with the 17th Amendment to the Constitution. The 17th Amendment changed the former constitutional method under which Senators were chosen by the respective state legislatures. A Senator must be at least 30 years of age, have been a citizen of the United States for nine years, and, when elected, be an inhabitant of the state for which the Senator is chosen. The term of office is six years and one-third of the total membership of the Senate is elected every second year. The terms of both Senators from a particular state are arranged so that they do not terminate at the same time. Of the two Senators from a state serving at the same time the one who was elected first—or if both were elected at the same time, the one elected for a full term—is referred to as the ‘‘senior’’ Senator from that state. The other is referred to as the ‘‘junior’’ Senator. If a Senator dies or resigns during the term, the governor of the state must call a special election unless the state legislature has authorized the governor to appoint a successor until the next election, at which time a successor is elected for the balance of the term. Most of the state legislatures have granted their governors the power of appointment.

Each Senator has one vote.

[1]*How Our Laws Are Made – Learn About the Legislative Process.* https://www.congress.gov/resources/display/content/How+Our+Laws+Are+Made+-+Learn+About+the+Legislative+Process

[2]*Id*.

As constituted in the 110th Congress, the House of Representatives is composed of 435 Members elected every two years from among the 50 states, apportioned to their total populations. The permanent number of 435 was established by federal law following the Thirteenth Decennial Census in 1910, in accordance with Article I, Section 2, of the Constitution. This number was increased temporarily to 437 for the 87th Congress to provide for one Representative each for Alaska and Hawaii. The Constitution limits the number of representatives to not more than one for every 30,000 of population. Under a former apportionment in one state, a particular Representative represented more than 900,000 constituents, while another in the same state was elected from a district having a population of only 175,000. The Supreme Court has since held unconstitutional a Missouri statute permitting a maximum population variance of 3.1 percent from mathematical equality. The Court ruled in *Kirkpatrick v. Preisler*, 394 U.S. 526 (1969), that the variances among the districts were not unavoidable and, therefore, were invalid. That decision was an interpretation of the Court's earlier ruling in *Wesberry v. Sanders*, 376 U.S. 1 (1964), that the Constitution requires that ''as nearly as is practicable one man's vote in a congressional election is to be worth as much as another's.'

A law enacted in 1967 abolished all ''at-large'' elections except in those less populous states entitled to only one Representative. An ''at-large'' election is one in which a Representative is elected by the voters of the entire state rather than by the voters in a congressional district within the state.

A Representative must be at least 25 years of age, have been a citizen of the United States for seven years, and, when elected, be an inhabitant of the state in which the Representative is chosen. Unlike the Senate where a successor may be appointed by a governor when a vacancy occurs during a term, if a Representative dies or resigns during the term, the executive authority of the state must call a special election pursuant to state law for the choosing of a successor to serve for the unexpired portion of the term.

Each Representative has one vote.

In addition to the Representatives from each of the States, a Resident Commissioner from the Commonwealth of Puerto Rico and Delegates from the District of Columbia, American Samoa, Guam, and the Virgin Islands are elected pursuant to federal law. The Resident Commissioner, elected for a four-year term, and the Delegates, elected for two-year terms, have most of the prerogatives of Representatives including the right to vote in committee to which they are elected, the right to vote in the Committee of the Whole (subject to an automatic revote in the House whenever a recorded vote has been decided by a margin within which the votes cast by the Delegates and the Resident Commissioner have been decisive), and the right to preside over the Committee of the Whole. However, the Resident Commissioner and the Delegates do not have the right to vote on matters before the House. Under the provisions of Section 2 of the 20th Amendment to the Constitution, Congress must assemble at least once every year, at noon on the third day of January, unless by law they appoint a different day.

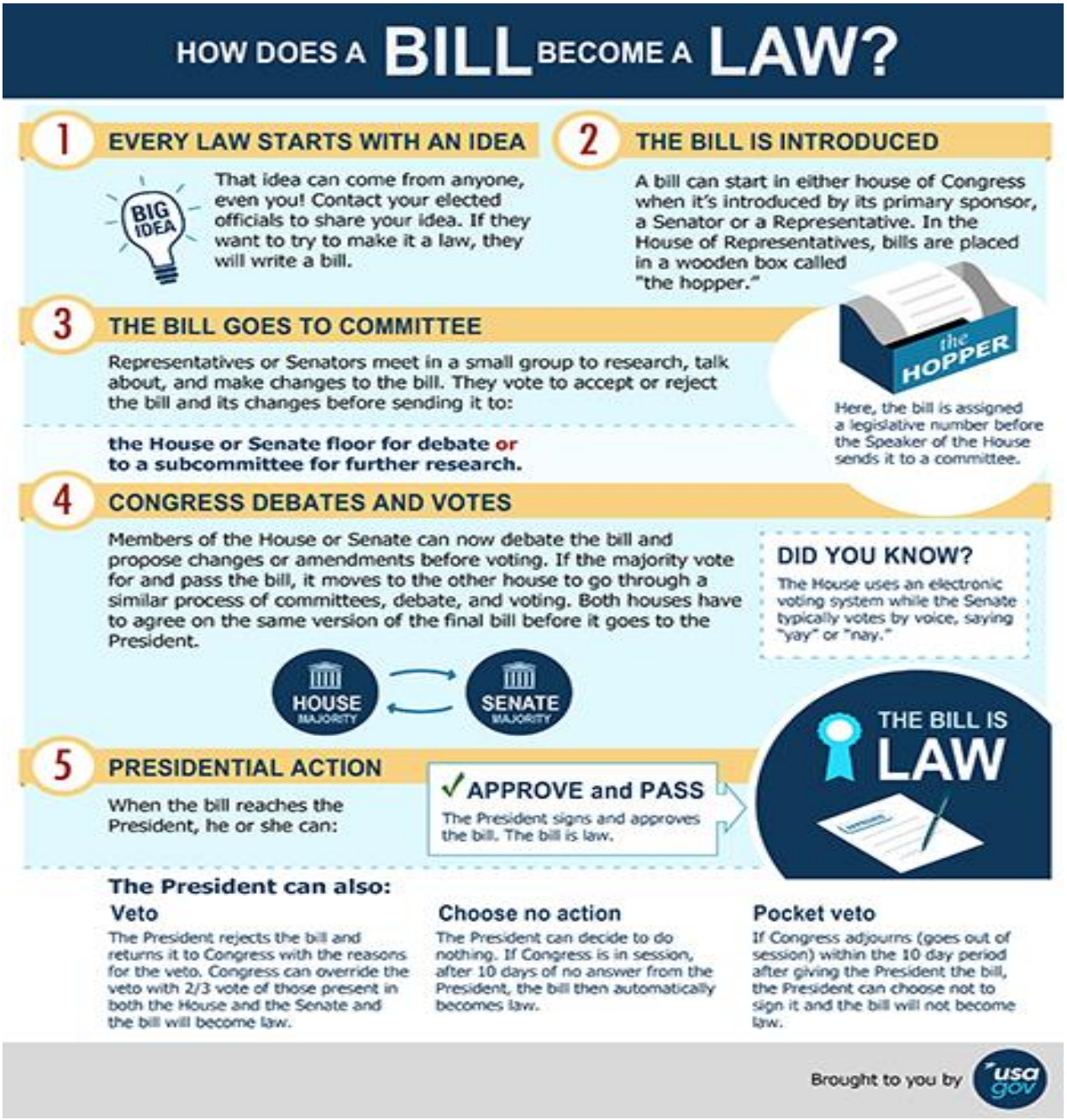
A Congress lasts for two years, commencing in January of the year following the biennial election of Members. A Congress is divided into two regular sessions.

The Constitution authorizes each House to determine the rules of its proceedings. Pursuant to that authority, the House of Representatives adopts its rules anew each Congress, ordinarily on the opening day of the first session. The Senate considers itself a continuing body and operates under continuous standing rules that it amends from time to time. Unlike some other parliamentary bodies, both the Senate and the House of Representatives have equal legislative functions and powers with certain exceptions. For example, the Constitution provides that only the House of Representatives may originate revenue bills. By tradition, the House also originates appropriation bills. As both bodies

have equal legislative powers, the designation of one as the ‘‘upper’’ House and the other as the ‘‘lower’’ House is not applicable.

The chief function of Congress is the making of laws. In addition, the Senate has the function of advising and consenting to treaties and to certain nominations by the President. Under the 25th Amendment to the Constitution, a vote in each House is required to confirm the President’s nomination for Vice-President when there is a vacancy in that office. In the matter of impeachments, the House of Representatives presents the charges—a function similar to that of a grand jury—and the Senate sits as a court to try the impeachment. No impeached person may be removed without a two-thirds vote of those Senators voting, a quorum being present. The Congress under the Constitution and by statute also plays a role in presidential elections. Both Houses meet in joint session on the sixth day of January following a presidential election, unless by law they appoint a different day, to count the electoral votes. If no candidate receives a majority of the total electoral votes, the House of Representatives, each state delegation having one vote, chooses the President from among the three candidates having the largest number of electoral votes. The Senate, each Senator having one vote, chooses the Vice President from the two candidates having the largest number of votes for that office.

How Does A Bill Become A Law? [3]



[3]*How A Bill Becomes A Law. Infographic,* https://app_usa_prod_eqffnyamdzrb.s3.amazonaws.com/How_Bill_Becomes_Law_0.pdf.

How Federal Laws Are Made [4]

The U.S. Congress is the legislative branch of the federal government and makes laws for the nation. Congress has two legislative bodies or chambers: the U.S. Senate and the U.S. House of Representatives. Anyone elected to either body can propose a new law. A proposal for a new law is called a bill.

Steps in Making a Law

A bill can be introduced in either chamber of Congress by a Senator or Representative who sponsors it.

Once a bill is introduced, it is assigned to a committee whose members will research, discuss, and make changes to the bill.

The bill is then put before that chamber to be voted on.

If the bill passes one body of Congress, it is then presented to the other body to go through a similar process of research, discussion, changes, and voting.

Once both bodies vote to accept a bill, they must work out any differences between the two versions. Then both chambers vote on the same exact bill and, if it passes, they present it to the president.

The president then considers the bill. The president can approve the bill and sign it into law or not approve (veto) a bill.

> Article I, section 7 of the Constitution grants the President the authority to veto legislation passed by Congress. This authority is one of the most significant tools the President can employ to prevent the passage of legislation. Even the threat of a veto can bring about changes in the content of legislation long before the bill is ever presented to the President. The Constitution provides the President 10 days (excluding Sundays) to act on legislation or the legislation automatically becomes law. There are two types of vetoes: the “regular veto” and the “pocket veto.”
>
> The regular veto is a qualified negative veto. The President returns the unsigned legislation to the originating house of Congress within a 10-day period usually with a memorandum of disapproval or a “veto message.” Congress can override the President’s decision if it musters the necessary two–thirds vote of each house. President George Washington issued the first regular veto on April 5, 1792. The first successful congressional override occurred on March 3, 1845, when Congress overrode President John Tyler’s veto of S. 66.
>
> The pocket veto is an absolute veto that cannot be overridden. The veto becomes effective when the President fails to sign a bill after Congress has adjourned and is unable to override the veto. The authority of the pocket veto is derived from the Constitution’s Article I, section 7, “the Congress by their adjournment prevent its return, in which case, it shall not be law.” Over time, Congress and the President have clashed over the use of the pocket veto, debating the term “adjournment.” The President has attempted to use the pocket veto during

[4] *How a Bill Becomes A Law*, https://www.usa.gov/how-laws-are-made#item-35837. Except where otherwise cited, the entirety of this article is reprinted from usa.gov, and is provided for educational purposes only.

intra- and inter- session adjournments and Congress has denied this use of the veto. The Legislative Branch, backed by modern court rulings, asserts that the Executive Branch may only pocket veto legislation when Congress has adjourned sine die from a session. President James Madison was the first President to use the pocket veto in 1812.[5]

Differences Between the House and Senate Procedures

The Senate and the House have some procedural differences between them.

How a bill becomes law when it originates in the House of Representatives[6]

Making and enacting laws is Congress's greatest responsibility. The U.S. House of Representatives and the U.S. Senate consider legislation in four forms:

Bills: There are two types of bills, public and private. Public bills affect the general public while private bills affect a specific individual or group. In order to become law, bills must be approved by both Chambers and the President.

Joint resolution: Similar to a bill, joint resolutions originate in either the U.S. House of Representatives or the U.S. Senate, but—opposite of what the name suggests—never jointly in both Chambers. Also like bills, joint resolutions require the President's approval to become law.

Concurrent resolution: Legislation addressing a matter affecting the operations of both the U.S. House of Representatives and the U.S. Senate, concurrent resolutions are voted on by both Chambers of Congress and do not need the President's signature to pass.

Simple resolution: Legislation addressing a matter affecting the operations of either the U.S. House of Representatives or the U.S. Senate, simple resolutions only need to pass in the Chamber it effects.

Bills are the most common form of legislation. While most bills can originate in either Chamber, bills regarding revenue always begin in the U.S. House of Representatives.

Beginning of the Bill

Although ideas for bills can come from anywhere, the two most common sources are Members and their constituents. For example, a bill may be inspired by campaign promises made by Members. Or constituents with ideas for laws may contact their Representatives. The Constitution guarantees a constituent's right to submit ideas for legislation to his or her Representative in Congress.

Introduction to the Bill

In the U.S. House of Representatives, any Member, Delegate, or Resident Commissioner may introduce a bill any time the House is in session. In order to officially introduce the bill,

[5]https://history.house.gov/Institution/Presidential-Vetoes/Presidential-Vetoes/.

[6]*How a Bill Becomes A Law*, https://kids-clerk.house.gov/middle-school/lesson.html?intID=17.

the Member places it in the “hopper,” a wooden box on the side of the Clerk’s desk. The Member introducing the bill is known as its primary sponsor, and an unlimited number of Members can cosponsor a bill.

When a bill is introduced, the title of the bill is entered in the House Journal and printed in the Congressional Record. The Clerk assigns the bill a legislative number and the Speaker of the House assigns the bill to the appropriate committee.

The Bill Goes to Committee

When the Chairman of the committee receives a copy of a bill, the clerk of the committee places the bill on the committee’s legislative calendar. While the bill is in committee, the committee members will seek expert input, hold “mark-up” sessions to make any changes or updates deemed important, and, if necessary, send the bill to a subcommittee for further analysis through research and hearings.

When the committee is satisfied with the content of the bill, it is sent back to the House for debate. It is also possible for a bill to die in committee if the legislation is deemed unnecessary.

Consideration and Debate

By tradition, all bills must be given consideration by the entire membership of the House, with adequate opportunity for the Members to debate and propose amendments. The rules of debate are decided during the first day of each new Congress, including the amount of time allocated for debate on the bill. Typically, the bill is read section by section and Members are given the opportunity to propose amendments and debate the bill’s content.

Voting

When debate is over, the Speaker asks “shall the bill be engrossed and read a third time?” If the Members agree, the bill is read by title only.

If deemed necessary by the Speaker, voting on a bill may be delayed up to two days. There are three methods for voting:

- Viva voce (voice vote): The Speaker asks the Members who support the bill to say “aye” and those who oppose to say “no.”
- Division: The Speaker says “those in favor, rise and stand to be counted,” and then again for those who oppose to stand and be counted.
- Recorded: The most common way to collect votes, Members either slide their electronic voting cards into the electronic voting machine and select “yea,” “nay,” or “present,” or complete a paper ballot which is handed to the tally clerk to be recorded.

The votes are tallied and, if a majority of the House has voted in favor of the legislation, it passes and is sent to the U.S. Senate. If the bill fails, yet the Speaker feels the bill should become a law, it may be sent back to committee for further research and updates. Otherwise, the bill dies.

Senate Action

If a bill passes in the U.S. House of Representatives, an exact copy is sent to the U.S. Senate. The bill is sent to a Senate committee for review and discussion before proceeding to the Senate floor for a vote. The Senate, like the House, considers each amendment separately before the bill is voted on. Unlike the House, the Senate typically votes by voice.

The Bill Returns to the House

If the bill is passed by the Senate, both the House and Senate bills are returned to the House with a note indicating any changes. If the Senate has made amendments, the House must vote on the bill again as both Chambers of Congress must agree to identical legislation in order for it to become law. If the Speaker of the House decides the Senate amendments require further research, the bill can be sent back to committee before the House votes again.

The Bill Is Enrolled

When both Chambers have passed identical legislation, the enrolling clerk prepares the final document for presentation to the President of the United States. The enrolled bill is printed on parchment paper and certified by the Clerk of the House. The Clerk reviews the bill to ensure it is accurate and sends it to the Speaker to be signed. The Speaker then passes the document to the President of the Senate for signature.

Presidential Action

Once the leaders of both Chambers have signed-off, the Clerk of the House delivers the bill to a clerk at the White House and obtains a receipt. When the President receives the bill, he has three options:

- Pass: If the President approves the bill he signs it and, usually, writes “approved” and the date, although the Constitution only requires his signature.
- Veto: If the President does not approve the bill, he must return it to its Chamber of origin with his objections within 10 days.
- Pocket Veto: If the President receives the bill and does not sign or return it to Congress with objections within 10 days—excluding Sundays—it becomes law as long as Congress remains in session. If Congress recesses before the 10 days have passed, the bill dies.

Back to Congress

If the President vetoes the bill, it is sent back to the U.S. House of Representatives. From here, the Speaker may decide not to pursue the bill further, send it back to committee for further consideration, or return to the bill to the House floor for a vote. In order to override the President’s veto, the bill will need to pass by two-thirds majority in both Chambers of Congress.

How a bill becomes law when it originates in the Senate[7]

1. Have an Idea

The first step in creating a new law -- or revising an existing law -- is to have an idea of how we can make our country stronger or better. This idea can come from anywhere, including from you!

2. Write a Bill

After identifying the problem, Members of Congress work to create a law that provides a solution. Sometimes, they will work together to jointly introduce legislation with other Senators. Senators can also collaborate with members of the House of Representatives on legislation so that identical or very similar bills are introduced in both the House and the Senate. The Senator or Senators who introduce the bill are known as sponsors and they are the primary champions of the legislation. Other Senators, who did not introduce the legislation themselves but who also want to express strong support for the bill, can sign on as a cosponsor. After being introduced, the bill is sent to the Senate Parliamentarian who assigns it to a specific committee or committees for further deliberation.

3. Debate in Committee

When a bill is introduced, the Senate Parliamentarian is responsible for deciding which Committee should review the legislation. The chair of the committee may decide to hold a hearing in order to examine the legislation. During a hearing, committee members invite policy experts, agency representatives, and other stakeholders to testify on how the bill will affect the country. After holding a hearing or hearings, the chair of the committee can decide to hold a "markup" during which committee members debate, modify, and ultimately vote for or against the bill. If the majority of the committee members vote favorably for the bill, it is advanced to the Senate floor, where every Senator has an opportunity to review and debate the legislation. Sometimes, less controversial pieces of legislation will be included in related larger bills as amendments in order to help speed up the legislative process.

4. Debate on the Senate Floor

After being voted upon favorably by a committee, the bill is referred to the full Senate for a vote. Here, the Majority Leader of the Senate is responsible for deciding when to bring up a piece of legislation for a vote and what type of vote it needs. Sometimes, a non-controversial bill will be “hotlined”, which means the Majority Leader and Minority Leader -- after consulting with their Senate colleagues -- agree to pass the legislation by unanimous consent and without a roll-call vote in order to save time by moving legislation more quickly. Often times, though, legislation requires more debate and must be discussed in-depth on the Senate floor. During the floor debate, every Senator is given the opportunity to speak for or against a bill and multiple votes are taken to move the bill through the legislative process. After much debate and consideration, the Majority leader may schedule a vote with all the Senators. If this route is taken, a series of votes must be taken in order for a bill to pass the Senate. First,

[7]*How A Bill Becomes A Law*, Tom Carper, U.S. Senator for Delaware. https://www.carper.senate.gov/public/index.cfm/how-a-bill-becomes-a-law#B3576BA3-BFB9-4320-96ED-57E4CFFE7892

the Senate must agree to consider the legislation by voting on a "Motion to Proceed" which indicates the start of debate. After all Senators have had the opportunity to discuss the legislation, a “Motion to End Debate” or a "Cloture Vote" is made, which then brings the Senate to one final vote on the legislation.

5. Work with House Colleagues

Meanwhile, the House of Representatives is responsible for introducing and voting on a companion bill of its own. Just like in the Senate, when a bill is introduced in the House, the House Parliamentarian is responsible for assigning that legislation to a specific House committee or committees for further deliberation. Sometimes the House authors will give the bill a different title and sometimes the House Parliamentarian will give the legislation a different bill number than its Senate companion. Ultimately, a law can only be passed if both the Senate and the House of Representatives introduce, debate, and vote on similar pieces of legislation.

6. Negotiate Compromises in Conference

Often times, the Senate bill and the House bill will have minor differences in their respective bills that have to be worked out before each chamber can approve the final legislative text and then send it to the President to be signed into law. When this happens, a special conference committee made up of members from both the Senate and the House will work together to come to consensus about the different provisions in the bill.

7. Send it to the President for a signature

After the conference committee resolves any differences between the House and Senate versions of the bill, each chamber must vote again to approve the final bill text. Once each chamber has approved the bill, the legislation is sent to the President. The President then makes the decision of whether to sign the bill into law or not. If the President signs the bill, it becomes a law. If the President refuses to sign it, the bill does not become a law. When the President refuses to sign the bill, the result is called a veto. Congress can try to overrule a veto. To do this, both the Senate and the House must vote to overrule the President’s veto by a two-thirds majority. If that happens, the President's veto is overruled and the bill becomes a law.

8. Reauthorization

Some laws, especially laws that appropriate funding to new programs, include provisions that require Congress to decide, after a set period of time, whether the legislation is effective and should be renewed, or “reauthorized”. To do this, a new bill must be introduced that renews the provisions of the law, makes any necessary changes to the original law, and offers a new timeline for how long it is active.

Congress creates and passes bills. The president then signs those bills into law. Federal courts may review these laws and strike them down if they think they do not agree with the U.S. Constitution.

Find Federal Laws

The United States Code contains the general and permanent federal laws of the United States. It does not include regulations, decisions, or laws issued by:

- Federal agencies
- Federal courts
- Treaties
- State and local governments

New public and private laws are published in each edition of the United States Statutes at Large.

Federal Regulations

Regulations are issued by federal agencies, boards, or commissions. They explain how agencies intend to carry out laws. Regulations are published yearly in The Code of Federal Regulations.

The Rulemaking Process

Federal regulations are created through a process known as rulemaking. If an agency wants to make, change, or delete a rule, the agency will publish the proposal in the Federal Register and seek public comments.

After the agency considers the public's comments and changes the rule if necessary, it publishes the rule's final version in the Federal Register, along with a description of the comments received, the agency's response to those comments, and the date the rule goes into effect.

Federal Court Decisions

Although federal courts do not write or pass laws, they may establish individual "rights" under federal law through their interpretations of federal and state laws and the U.S. Constitution. For example, the U.S. Supreme Court's decision in *Brown v. Board of Education of Topeka* held that state laws which segregated public school students by race were unconstitutional, because they violated the 14th Amendment to the Constitution. In striking down those state laws, the Supreme Court determined that "separate but equal" educational facilities instilled a sense of inferiority in minority children that undermined their educational opportunities.

State Laws and Regulations

State legislatures make the laws in each state. State courts may review these laws and remove them if they think they do not agree with the state's constitution.

Executive Orders and Other Presidential Actions

The president creates many documents to issue orders and make announcements. These executive or presidential actions can include:

- Executive orders
- Presidential memoranda
- Proclamations

Executive Orders

An executive order has the power of federal law. Presidents can use executive orders to create committees and organizations. For example, President John F. Kennedy used one to create the Peace Corps. More often, presidents use executive orders to manage federal operations.

Congress may try to overturn an executive order by passing a bill that blocks it. But the president can veto that bill. Congress would then need to override that veto to pass the bill. Also, the Supreme Court can declare an executive order unconstitutional.

Presidential Memoranda

Presidential memoranda are like executive orders. The president can use memos to direct government operations. But executive orders are numbered and published in the Federal Register. Presidential memos are not.

Presidential Proclamations

Presidential proclamations are statements that address the public on policy matters. They are mainly symbolic and are usually not enforced as laws.

Find Presidential Actions

The White House posts presidential actions issued by the current president. The National Archives and Records Administration (NARA) maintains older executive orders. These date back to 1937.

There are potentially 10 steps a bill can go through before becoming a law. Below is a description of each step in the process, using the Genetic Information Non-Discrimination Act of 2003 (S. 1053), as an example.

Steps to a Bill Becoming a Law[8]

There are potentially 10 steps a bill can go through before becoming a law. Below is a description of each step in the process, using the Genetic Information Non-Discrimination Act of 2003 (S. 1053), as an example.

Step 1: A Bill Is Born
Anyone may draft a bill; however, only members of Congress can introduce legislation, and, by doing so, become the sponsor(s). The president, a member of the cabinet or the head of a federal agency can also propose legislation, although a member of Congress must introduce it.

On May 13, 2003, Senator Olympia Snowe (R-Maine) introduced the Genetic Information Non-Discrimination Act of 2003 (S. 1053).

S. 1053 was referred to the Senate Committee on Health, Education, Labor and Pensions (HELP).

Step 2: Committee Action
As soon as a bill is introduced, it is referred to a committee. At this point the bill is examined carefully and its chances for passage are first determined. If the committee does not act on a bill, the bill is effectively "dead."

Step 3: Subcommittee Review
Often, bills are referred to a subcommittee for study and hearings. Hearings provide the opportunity to put on the record the views of the executive branch, experts, other public officials and supporters, and opponents of the legislation.

On May 21, 2003, the Senate HELP Committee held a mark up of S. 1053. Senator Judd Gregg (R-N.H.), chair of the HELP Committee, offered an amendment to the bill.

Step 4: Mark up
When the hearings are completed, the subcommittee may meet to "mark up" the bill; that is, make changes and amendments prior to recommending the bill to the full committee. If a subcommittee votes not to report legislation to

[8]*How A Bill Becomes Law, example*. (2012, March 12). National Human Genome Research Institute. https://www.genome.gov/12513982/.

the full committee, the bill dies. If the committee votes for the bill, it is sent to the floor.

On July 2, 2003, Senator Gregg presented a dynamic argument for the protection of genetic privacy. "In the years since Crick and Watson's discovery ... there have been reservations with what we will do with this new information we are uncovering. Unlocking our genetic code unleashes new power. And power produces new responsibilities in protecting the privacy of our genetic information."

Step 5: Committee Action to Report a Bill
After receiving a subcommittee's report on a bill the full committee votes on its recommendation to the House or Senate. This procedure is called "ordering a bill reported."

The Senate voted on S. 1053 on Oct. 14, 2003. It passed by a vote of 95 to 0.

Step 6: Voting
After the debate and the approval of any amendments, the bill is passed or defeated by the members voting.

Step 7: Referral to Other Chamber
When the House or Senate passes a bill, it is referred to the other chamber, where it usually follows the same route through committee and floor action. This chamber may approve the bill as received, reject it, ignore it, or change it.

S. 1053 was referred to the House of Representatives where it now waits for action.

Step 8: Conference Committee Action

When the actions of the other chamber significantly alter the bill, a conference committee is formed to reconcile the differences between the House and Senate versions. If the conferees are unable to reach agreement, the legislation dies. If agreement is reached, a conference report is prepared describing the committee members' recommendations for changes. Both the House and Senate must approve the conference report.

Step 9: Final Action

After both the House and Senate have approved a bill in identical form, it is sent to the president. If the president approves of the legislation, he signs it and it becomes law. Or, if the president takes no action for ten days, while Congress is in session, it automatically becomes law.If the president opposes the bill he can veto it; or if he takes no action after the Congress has adjourned its second session, it is a "pocket veto" and the legislation dies.

Step 10: Overriding a Veto

If the president vetoes a bill, Congress may attempt to "override the veto." If both the Senate and the House pass the bill by a two-thirds majority, the president's veto is overruled and the bill becomes a law.

Glossary

The definitions provided in this glossary relate to words as used on Ben's Guide to the U.S. Government.[9] There may be other definitions for these words.

Act: Legislation that has passed both Houses of Congress and has been either approved by the President or passed over his veto, thus becoming law. Also used technically for a bill that has been passed by one House of Congress.

Amend: To change the wording or meaning of a motion, bill, Constitution, etc. by formal procedure. For example, Congress may amend the Constitution.

Amendment: A proposal by a Member (in committee or floor session of the respective Chamber) to alter the language or provisions of a bill or act. It is voted on in the same manner as a bill. The Constitution of the United States, as provided in Article 5, may be amended when two-thirds of each House of Congress approves a proposed amendment and three-fourths of the states thereafter ratify it.

Bicameral: The quality of having two branches, chambers, or houses, such as the United States Congress, which is made up of the Senate and the House of Representatives.

Bill: Formally introduced legislation. Most legislative proposals are in the form of bills and are designated as H.R. (House of Representatives) or S. (Senate), depending on the House in which they are introduced. They are numbered in the order in which they are introduced during each Congress. Public Bills deal with general questions and become Public Laws, or Acts, if they approved by Congress and signed by the President. Private Bills deal with individual matters such as claims against the Federal Government, immigration and naturalization cases, land titles, and so on, and become Private Laws if approved and signed.

Bill of Rights: The first ten amendments to the United States Constitution.

Calendar: A list of bills, resolutions, or other matters to be considered before committees or on the floor of either House of Congress.

Committee: A group of Members of Congress appointed to investigate, debate, and report on legislation.

Congress: The seat of legislative power. There are 535 members of the U.S. Congress: 435 in the House of Representatives and 100 in the Senate. See also House of Representatives and Senate.

Congressional District: A division or part of a state based on population; each district elects one person to Congress.

Constituent: A person who is part of a larger group. In politics, a constituent is represented by an elected official.

Elastic Clause: A statement in the U.S. Constitution granting Congress the power to pass all laws necessary and proper for carrying out the list of powers it was granted (Article I, Section 8).

[9]*Ben's Guide*. https://bensguide.gpo.gov/glossary.

Hearing: A meeting or session of a committee of Congress, usually open to the public, to gather information and opinions on proposed legislation, conduct an investigation, or oversee a program.

Hopper: A box attached to the side of the Clerk's desk in the House of Representatives into which a proposed legislative bill is dropped and in so doing is officially introduced.

House of Representatives: Along with the Senate, it is one of the two Houses of the U.S. Congress. Members are granted to each state based upon population and each representative serves a two-year term. There are currently 435 members in the House of Representatives.

Initiative: A process by which a particular number of voters may propose a statute, constitutional amendment, or ordinance, and compel a vote on its adoption.

Law: A system of rules of conduct established and enforced by the authority, legislation, or custom of a given community, state, or nation. Used in the singular to mean a specific law (a law protecting free speech) or in the plural to refer to a set of laws (the law of the land).

Legislative Day: A formal meeting of a House of Congress which begins with the call to order and opening of business and ends with adjournment. A legislative day may cover a period of several calendar days, with the House recessing at the end of each calendar day, rather than adjourning.

Legislation: A law or a body (set) of laws.

Line-item Veto: The power of an executive to disapprove or reject parts of a bill without having to reject the entire bill.

Motion: A formal suggestion or proposal that an action be taken related to the process of making a law.

Pocket Veto: The disapproval of a bill brought about by an indirect rejection by the President. According to the Constitution, the President is granted 10 days, Sundays excepted, to review a piece of legislation passed by Congress. If the President has not signed the bill after 10 days, it becomes law without his signature. But if Congress adjourns during the 10 day period, the bill does not become law.

Preamble: An introduction to a document.

Public Law: A bill or joint resolution (other than for amendments to the Constitution) passed by both Houses of Congress and approved by the President. Bills and joint resolutions vetoed by the President, but then overridden by the Congress also become Public Law. Public Laws affect society as a whole, and most laws passed by Congress are Public Laws. Public Law citations include the abbreviation, Pub.L., the Congress number (e.g. 107), and the number of the law. For example: Pub.L. 107-006.

Private Law: A law that affects an individual, family, or small group and is enacted to help citizens that have been injured by government programs or who are appealing an executive agency ruling such as deportation. Private Laws citations include the abbreviation, Pvt.L., the Congress number (e.g. 107), and the number of the law. For example: Pvt.L. 107-006.

Ratify: To sign or officially approve an agreement, treaty, contract, amendment, or similar document.

Ratification: In U.S. Government, this can be the act of approval of a proposed constitutional amendment by the legislatures of the States; it can also refer to the Senate process of advice and consent to treaties negotiated by the President.

Referendum: A general or direct vote by the people on a political issue.

Report: The printed record of a committee's actions, including its votes, recommendations, and views on a bill or question of public policy or its findings and conclusions based on oversight inquiry, investigation, or other study. Senate committees usually publish a committee report to accompany the legislation they have voted out; these are numbered consecutively in the order in which they are filed in the Senate. Committee reports discuss and explain the purpose of measures and contain other, related information. The term can also refer to the action taken by a committee ("report the legislation") to submit its recommendations to the Senate.

Representative: A person appointed, chosen, or elected to act on another's behalf. In Congress, Representatives are granted to each state based upon population and each Representative serves a two-year term. There are currently 435 members in the House of Representatives.

Resolution: A proposal approved by either or both Houses of Congress which, except for joint resolutions signed by the President, does not have the force of law.

Senate: Along with the House of Representatives, it is one of the two Houses of the U.S. Congress. There are two Senators granted to each state and each Senator serves a six-year term. There are currently 100 members in the Senate.

Senator: The Constitution requires that a Senator be at least 30 years old, a citizen of the United States for at least nine years, and an inhabitant of the state from which he or she is elected. A person elected or appointed to the Senate and duly sworn is a Senator. There are currently 100 members in the Senate.

Separation of Powers: The system of dividing power and authority; in the United States, it is divided among the legislative, executive, and judicial branches of the Government.

Tabling Motion: A motion to stop action on a pending proposal and to lay it aside until further notice. When the Senate or House agrees to a tabling motion, the measure which has been tabled is effectively defeated.

Unanimous Consent: An agreement among members of Congress to set aside a specified rule of procedure to expedite proceedings.

Veto: The procedure, as allowed by the Constitution, by which the President refuses to approve a bill or joint resolution and thus prevents its enactment into law. A regular veto occurs when the President returns the legislation to the originating House without approval. It can be overridden only by a two-thirds vote in each House. A pocket veto occurs after Congress has adjourned and is unable to override the President's action.