2020

SECURITIES LAW SEMINAR

Public Investors Advocate Bar Association
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2020 PIABA Securities Law Seminar

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2020 PIABA Securities Law Seminar Speaker Biographies

Miriam Baer, Esq.
Brooklyn Law School
Brooklyn, New York

Miriam Baer is a Professor of Law at Brooklyn Law School, and a Senior Fellow in the Carol and Lawrence Zicklin Center for Business Ethics Research at the Wharton School.

Baer writes and teaches in the areas of corporate and white-collar crime, and criminal law and procedure. In 2016, Professor Baer was elected a member of the American Law Institute, where she serves as an Adviser on the ALI's Principles of the Law of Compliance, Enforcement and Risk Management.

Prior to entering academia, Professor Baer served as an assistant general counsel for compliance with Verizon, and was an Assistant U.S. Attorney in the Criminal Division of the U.S. Attorney's Office for the Southern District of New York. She also practiced as a litigation associate with Cravath, Swaine & Moore and was a law clerk to Judge Jane Roth of the U.S. Court of Appeals for the Third Circuit.

Professor Baer's scholarship focuses primarily on the federal government's attempts to detect and punish corporate crime. Several of Baer's pieces examine the ways in which the federal government's enforcement policies impact individual incentives to violate the law; organizational incentives to detect and report such violations; and the ongoing relationship with government enforcers and organizational compliance personnel. Throughout her work, Baer raises the concern that society's instincts to punish corporate crime may crowd out more salutary regulatory responses.

Employing much of what she has learned from studying organizational compliance, Baer's work also examines wrongdoing among police and prosecutors, inquiring how certain structural interventions might improve police and prosecutors' compliance with procedural and constitutional rules. Here too, Baer warns that punitive responses may be less effective (or less effective on their own) than devices that remove the opportunity for wrongdoing in the first place.

Baer's most recent work turns to white collar crime's substantive laws and reveals the ways in the federal criminal code's failures to either fully define a crime (e.g., insider trading), or to statutorily grade it (e.g., fraud), collectively fuel competing narratives of overcriminalization and underenforcement, and undermine the criminal justice system's legitimacy and effectiveness. The articles and essays described above have been published in numerous journals and book chapters, including in the Columbia Law Review, Virginia Law Review, Texas Law Review, and Michigan Law Review, and the Yale Law Journal Forum. Baer's work has also been featured on the Columbia Blue Sky blog and NYU's Compliance and Enforcement blog, and has been cited or quoted in the New York Times, Bloomberg Business, and other media.

Joseph Borg, Esq.
Director, Alabama Securities Commission
Montgomery, Alabama

Joseph Borg has been Director of the Alabama Securities Commission (ASC) since 1994. Borg served as the only three term president of the North American Securities Administrators Association (NASAA). He served as a member on the NASAA Board of Directors, as Chair of the International Committee, Chair of Enforcement, Ombudsman and in several other capacities. He is also a member of the Board of Directors of the National White Collar Crime Center (NW3C), the Investor Protection Institute (IPI) and previously served as a member of the Board of Directors of the Investor Protection Trust (IPT). He has also served as a member of the SIPC Modernization Task Force and the FINRA Dispute Resolution Task Force.

Borg recently (June 2018) testified before the U.S. House Financial Services Committee, Capital Markets Subcommittee hearing entitled "Ensuring Effectiveness, Fairness, and Transparency in Securities Law Enforcement." He has previously testified before various committees of the U.S. Senate and U.S. House of Representatives including testimony on such areas as Microcap Fraud; Criminal Elements in the Financial Markets; Information Sharing among Financial Regulatory Agencies; Risks Posed to Everyday Investors from IPOs in Private Equity and Hedge Funds; Illegal Investment Sales' Practices Victimizing Senior Citizens; and SIPA and SIPC Modernization.

Borg served as a U.S. delegate to an Intergovernmental Expert Group for the United Nations Commission on International Trade and Law (UNCITRAL).

Borg previously served as in-house corporate counsel to First Alabama Bank (n/k/a Regions Bank, 1979-1984) and has been an adjunct professor of law at Faulkner University Jones School of Law teaching securities law and banking (1982-2002), and has been a Partner in the Montgomery law firm of Capouano, Wampold, Prestwood & Sansone (1984-1994).

He is admitted to practice in Alabama, Florida, New York, U.S. Federal District Courts in Alabama and Florida, the 5th and 11th Circuit Courts of Appeal and the U.S. Supreme Court.

Melanie Devoe, Esq.
U.S. Commodity Futures Trading Commission
Arlington, VA

Melanie Devoe is an Attorney Advisor in the Whistleblower Office at the Commodity Futures Trading Commission ("CFTC"). Prior to joining the Whistleblower Office, she was a Senior Trial Attorney for the CFTC's Division of Enforcement. She has also worked for the Federal Energy Regulatory Commission's Division of Enforcement and in private practice.

Benjamin P. Edwards, Esq.
William S. Boyd School of Law
Las Vegas, Nevada

Benjamin Edwards is an Associate Professor of Law at the University of Nevada, Las Vegas. He researches and writes about securities and corporate law.

Scott Eichhorn Esq.
University of Miami
Investor Rights Clinic
Coral Gables, Florida

Scott Eichhorn is the Associate Director of the University of Miami School of Law Investor Rights Clinic, where he teaches the substantive law and practical skills of securities arbitration claims and supervises Clinic representation of investors of modest means in claims for investment losses and FINRA arbitration proceedings. Mr. Eichhorn is a regular participant on panels and contributor to written materials for securities-related conferences. He currently serves as co-chair of the PIABA Securities Law Seminar Committee.

Prior to joining the University of Miami, he was in private practice at Fowler White Burnett, P.A., practicing in commercial litigation and specializing in securities litigation in state and federal courts and FINRA arbitration. Mr. Eichhorn received his J.D. from Northwestern University Pritzker School of Law and his B.S. in Journalism from the University of Florida.

Elissa Germaine, Esq.
Director, Investor Rights Clinic, Elisabeth Haub School of Law, Pace University
Adjunct Professor of Law
White Plains, New York

Elissa Germaine is the Director of the Investor Rights Clinic at the Elisabeth Haub School of Law at Pace University. The Pace Investor Rights Clinic represents investors of modest means, who are unable to obtain legal representation because of the small amount of their claims, in disputes with their brokers in FINRA arbitration. She is also the Executive Director of John Jay Legal Services, which operates the law school's clinic and externship programs. She serves on the SEC's Investor Advisory Committee and as a public member of FINRA's National Arbitration and Mediation Committee.

Professor Germaine previously taught in the legal skills and legal writing programs at Pace Law and New York Law School. Before entering legal education, she practiced securities litigation, white collar defense and investigations, and complex commercial litigation at Latham & Watkins LLP in San Francisco. She served as a law clerk for the Honorable John S. Rhoades, Sr. in the United States District Court, Southern District of California.

She received her JD from Northwestern University Pritzker School of Law and her BA from Dartmouth College.

Christopher Gerold, Esq.
Chief, New Jersey Bureau of Securities
Newark, New Jersey

Christopher W. Gerold is the Chief of the New Jersey Bureau of Securities ("Bureau") and, pursuant to N.J.S.A. 49:3-66(a), acts as its principal executive officer. As the Bureau Chief, Mr. Gerold is responsible for the administration and enforcement of the New Jersey Uniform Securities Law and regulations. The primary mission of the Bureau is the protection of New Jersey investors. The Bureau regulates the offer and sale of securities in New Jersey through its registration of securities offerings, financial professionals and companies, as well as its examination authority and enforcement actions. Mr. Gerold is also the current President of the North American Securities Administrators Association (“NASAA”) and former Chair of NASAA’s Enforcement Section. Organized in 1919, the NASAA is the oldest international organization devoted to investor protection. Its membership includes the securities regulators in the 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands; the provinces and territories of Canada; and Mexico.

Mr. Gerold started his legal career as a Deputy Attorney General in the Securities Fraud Prosecution Section of the New Jersey Division of Law, where from 2005 to 2010 he represented the Bureau during investigations and was a lead trial attorney in litigated matters. Mr. Gerold represented the Bureau in some of its most complex and contentiously litigated matters, including cases involving suitability, Ponzi schemes, penny stock fraud, failures to supervise, and registration. Before returning to public service, Mr. Gerold was an attorney with the law firm of Chiesa, Shahinian & Giantomasi PC ("CSG"). While at CSG, Mr. Gerold was a member of the firm's Securities Litigation and Enforcement Group, where he conducted internal investigations for broker-dealers. Mr. Gerold also represented financial professionals and companies during regulatory investigations and enforcement actions by the U.S. Securities and Exchange Commission (SEC), the Financial Industry Regulatory Authority (FINRA), and various state securities regulators. Mr. Gerold received his J.D. degree from Seton Hall Law and his B.S. degree in finance from Villanova University. Prior to attending law school, Mr. Gerold was a registered representative, having passed the Series 7 and 63 securities exams. Mr. Gerold is admitted to the bar in New Jersey and New York.

Sandra Grannum, Esq.
Faegre Drinker Biddle & Reath LLP
Florham Park, New Jersey

Sandra Dawn Grannum is a Partner in the Business Litigation Group at Faegre Drinker Biddle & Reath LLP where she serves on the Firm’s governing board and is co-chair of the Firm’s nationwide Securities and Financial Services Litigation Team. Sandy is a fellow of the American College of Trial Lawyers and concentrates her practice on securities, broker/dealer arbitration, litigation, mediation and regulatory defense. Sandy has written and lectured widely on securities and ethics issues. She assists in preparing clients for SEC Regulation Best Interest and Interpretation RIA. She chairs the full-day PLI Securities Arbitration Seminar conducted annually in New York City and regularly speaks at the SIFMA C&L Annual Conference, ABA Conferences and on other CLE programs addressing securities and employment law. Sandy was one of 13 individuals on the FINRA Dispute Resolution Task Force. FINRA impaneled this group to collaborate and suggest strategies to enhance the transparency, impartiality, and efficiency of FINRA's securities dispute resolution forum for all participants. On December 16, 2015, the task force issued its recommendations detailed in the Final Report and Recommendations of the FINRA Dispute Resolution Task Force. Sandy earned her law degree from Harvard Law School and her bachelor’s degree from New York University. She began her career as a litigation associate at the New York law firm of Cravath, Swaine & Moore before moving to Tenzer Greenblatt to practice securities litigation. Sandy moved in-house to be an Associate General Counsel handling securities litigation at PaineWebber (now UBS Financial Services) in 1997. In November 2001, she became Senior Vice President and Senior Associate General Counsel in UBS’s Employment Law Unit. In 2003, she formed her own firm, Davidson & Grannum, with a former PaineWebber/UBS colleague. She joined Drinker in January 2016 and that firm merged to become Faegre Drinker in February 2020.

Nicole Iannarone, Esq.
Assistant Professor of Law
Drexel University Thomas R. Kline School of Law

Nicole Iannarone is a scholar and leader in the practice community whose work focuses on an array of issues including regulation of financial intermediaries, the consumer's experience in resolving securities disputes, professional ethics, and law and technology.

Before joining the faculty in 2019, Professor Iannarone directed the Investor Advocacy Clinic at Georgia State University College of Law. There, she oversaw students' representation of consumer investors with small claims against their brokers before the Financial Industry Regulatory Authority (FINRA), their efforts to educate investors, and their work representing the voice of retail investors in evaluating and commenting on FINRA and SEC rule proposals.

Previously, Professor Iannarone taught at Mercer Law School and at Vanderbilt Law School.

Professor Iannarone has published extensively on an array of topics that includes financial technology, regulation of financial intermediaries, resolution of securities disputes, technology and ethics in legal practice, as well as experiential education. Her articles have appeared in the *Tennessee Journal of Business Law*, *Chicago Kent Law Review*, and the *University of Toledo Law Review*. Her article, "Finding Light in Arbitration's Dark Shadow," is forthcoming in the *University of Nevada Las Vegas Law Forum*.

She testified about fraudulent schemes targeting retail investors before the U.S. Securities & Exchange Commission Division of Trading and Markets Roundtable on Combating Retail Investor Fraud in 2018 and on the role of security arbitration clinics in ensuring economic justice before the commission's Dodd-Frank Investor Advisory Committee in 2017.

Before entering academe, Professor Iannarone practiced at Bondurant, Mixson & Elmore, where she was deputy general counsel and her practice focused on complex litigation.

Professor Iannarone is the chair-elect of the AALS Section on Employee Benefits and Executive Compensation and a member of the Section on Professional Responsibility. She is also a member of the FINRA National Arbitration and Mediation Committee. The immediate past president of the Atlanta Bar Association, Professor Iannarone previously served on numerous committees and held diverse leadership roles during her years in Georgia. She is a fellow of the American Bar Foundation.

From 2017-2019, she served as chair of the State Bar of Georgia's Professionalism Committee and as a liaison to the Georgia Chief Justice's Commission on Professionalism.

She received her JD from Yale Law School, where she served on the *Yale Journal on Regulation*.

Christine Lazaro, Esq.
St. John's University School of Law
Queens, New York

Christine Lazaro is a Professor of Clinical Legal Education and the Director of the Securities Arbitration Clinic at St. John's University School of Law. Professor Lazaro is also Of Counsel to the Law Offices of Brent A. Burns, LLC, where she consults on securities arbitration and regulatory matters. Professor Lazaro has been a member of PIABA since 2008. She served as its President from October 2018 through October 2019, and currently serves on its Board of Directors. She is currently co-chair of the Association's Fiduciary Standards Committee. Professor Lazaro also serves on the FINRA Investor Issues Advisory Committee, and is a member of the Editorial Advisory Board of the Securities Arbitration Commentator, and occasionally contributes to its Arbitration Alerts. Professor Lazaro speaks and writes regularly on the topics of securities arbitration and the duties of brokers and brokerage firms.

Ron Long, Esq.
Wells Fargo, Head of Aging Client Services
St. Louis, Missouri

Ronald C. Long currently is the Head of Wells Fargo Aging Client Services. In this role, he works with all of Wells Fargo's business units to help them stay abreast of the changing regulatory environment on issues related to the aging client. Ron has visited regulators and agencies in all 50 states and the District of Columbia ensuring that they are aware of the challenges facing the older banking and brokerage client, and helping promote solutions that will help protect them from elder financial abuse. With his leadership, Ron is helping all business lines focus on day-to-day needs for aging clients and their families.

He has been a panelist on regulatory issues and is very active in industry organizations, chairing SIFMA's State Legislation and Regulation Committee in 2015. He was the lead author of a number of comment letters and white papers in the aging area. Since 2006, Ron has taken a leading role in the securities industry in reviewing how it engages its older clients. He has spoken at numerous conferences including the Institutes of Medicine, American Society on Aging, International Association of Gerontology and Geriatrics, and the White House Conference on Aging to name a few. He has given numerous interviews on elder financial abuse to the financial media and other mainstream publications. He is a recipient of the Barbara McGinity Service to Seniors Award presented by the National Adult Protective Services Association and he was chosen as one of 12 Influencers in Aging for 2019 by the publication Next Avenue.

Prior to his current position, Ron worked in Wachovia Securities' Legal Department starting in June 2002, heading up the team focused on regulatory inquiries. Before joining Wachovia Securities, Ron was District Administrator of the Securities and Exchange Commission's Philadelphia District Office from March 1997 to June 2002. Ron is a graduate of Williams College and received his law degree from Georgetown University Law Center.

Mark Pugsley, Esq.
Ray Quinney & Nebeker
Salt Lake City, Utah

Mark Pugsley is a trial attorney whose practice is focused on financial services litigation, FINRA arbitrations, and whistleblower cases filed with the SEC, CFTC and IRS. He frequently handles civil enforcement actions and regulatory investigations brought by the U.S. Securities and Exchange Commission (SEC), the Utah Division of Securities, the Commodity Futures Trading Commission (CFTC) and the Financial Industry Regulatory Authority (FINRA) involving individuals, brokers, brokerage firms and investment advisors.

Joe Savage, Esq.
Vice President and Counsel
FINRA Office of Regulatory Analysis
Washington, DC

Joe Savage is Vice President and Associate General Counsel in FINRA's Office of General Counsel. Mr. Savage specializes in a broad range of securities regulatory matters, including investment management, investment company, advertising and broker-dealer issues, and regularly appears at conferences regarding these issues. Prior to joining FINRA, he was an Associate Counsel with the Investment Company Institute and an attorney with the law firms of Morrison & Foerster LLP and Hunton & Williams. Mr. Savage also served as a judicial law clerk for United States District Judge John P. Vukasin of the Northern District of California. Mr. Savage holds a bachelor's degree from the University of Virginia, a master's degree in public policy from the University of California, Berkeley, and a J.D. from the University of California, Hastings College of the Law, where he served as Note Editor of the Hastings Law Journal.

Jordan Thomas, Esq.
Labaton Sucharow, LLP
New York City, New York

Jordan A. Thomas is the Chair of the Whistleblower Representation Practice at Labaton Sucharow, which is the first and only national practice that is exclusively devoted to the representation of whistleblowers with information about possible violations of the federal securities laws. Jordan is widely regarded as one of the top SEC Whistleblower advocates as has been profiled in the New York Times and on NPR. To date, he has won the largest SEC Whistleblower award for a client, over $83 million. He also successfully represented the first officer of a public company to win an SEC whistleblower award, the first SEC Whistleblower to receive criminal immunity and the first SEC whistleblower to receive an award because his company retaliated against him. Among other high-profile successes, his clients are responsible for the recent $307 million JPMorgan and the fifth largest SEC whistleblower award, over $17 million.

Prior to joining Labaton Sucharow, he served as a Trial Attorney at the Department of Justices and an Assistant Director in the Division of Enforcement at the SEC. During his tenure at the Commission, he had a leadership role in the development of the SEC Whistleblower Program and was assigned to many of its highest-profile matters such as those involving Enron, Fannie Mae, UBS, and Citigroup. His cases have resulted in monetary relief for harmed investors in excess of $35 billion.

Teresa J. Verges, Esq.
Director, Investors Rights Clinic, University of Miami School of Law
Miami, Florida

Teresa J. Verges joined the University of Miami School of Law faculty in the fall of 2011. She is the founding director of Miami Law's Investor Rights Clinic, which launched in January 2012. The Clinic represents investors who have claims against their brokers in arbitration proceedings before FINRA, but whose claims are too small for them to be able to find legal representation. Professor Verges supervises the students at the Clinic and teaches a seminar on the substantive law of securities arbitration, broker-dealer regulation, professional responsibility and practical skills allowing the students to undertake all aspects of client representation.

Prior to joining the School of Law's faculty, Professor Verges served as Assistant Director of Enforcement for the Securities and Exchange Commission at the Miami Regional Office, where she led investigations of potential violations of the federal securities laws, including cases involving financial fraud, pay-to-play and municipal securities offerings, market manipulation, insider trading, offering fraud, violations by broker-dealers and investment advisers, and violations of the Foreign Corrupt Practices Act. Before her appointment as Assistant Director, Professor Verges served as Regional Trial Counsel, where she supervised litigation of civil injunctive actions and administrative proceedings instituted by the SEC's Miami Office. While at the Commission, Professor Verges led the investigative or litigation teams on some of the most significant cases brought by the SEC, and received awards and recognition for her work, including the SEC's 2011 Arthur F. Matthews Award. Ms. Verges has been recognized as one of "The Top Government Attorneys" in *South Florida Business Guide,* 2004-2009 is a 2009 Recipient of noted "Florida Legal Elite Government Attorney" in *Florida Trend*. Ms. Verges was also selected for *Women of Color* Magazine's 2010 Top Women in Finance.

Prior to joining the Commission in 1998, Ms. Verges was in private practice for 8 years in Chicago and Miami. Ms. Verges has an undergraduate degree from Elmhurst College (1985) and a law degree with highest honors from DePaul University College of Law, Chicago, Illinois (1989).

Ms. Verges has published articles and participated on panels discussing securities arbitration, SEC investigations and enforcement, regulation of financial intermediaries and ethical issues in securities litigation and arbitration. She served on FINRA's National Arbitration and Mediation Committee from 2014-2018, and currently serves on FINRA's Discovery Task Force

Geraldine "Gerri" M. Walsh, Esq.
President, FINRA Investor Education Foundation
Senior Vice President, Investor Education, FINRA

Gerri Walsh is Senior Vice President of Investor Education at the Financial Industry Regulatory Authority (FINRA). In this capacity, she is responsible for the development and operations of FINRA's investor education program. She is also President of the FINRA Investor Education Foundation, where she manages the Foundation's strategic initiatives

to educate and protect investors and to foster financial capability for all Americans, especially underserved audiences. She joined FINRA in May 2006. Prior to joining FINRA, Ms. Walsh was Deputy Director of the Securities and Exchange Commission's Office of Investor Education and Assistance (OIEA) and, before that, Special Counsel to the Director of OIEA. She also served as a senior attorney in the SEC's Division of Enforcement, investigating and prosecuting violators of the federal securities laws. Before that, she practiced law as an associate with Hogan Lovells in Washington, D.C. Ms. Walsh was the founding executive sponsor of FINRA's Military Community Employee Resource Group and leads FINRA's Corporate Social Responsibility efforts. She serves on the Advisory Council to the Stanford Center on Longevity and represents FINRA on IOSCO's standing policy committee on retail investor education, the Jump$tart Coalition for Personal Financial Literacy, NASAA's Senior Investor Advisory Council and the Wharton Pension Research Council. Ms. Walsh received her J.D. from N.Y.U. School of Law and her B.A., magna cum laude, from Amherst College. She is a member of the New York and District of Columbia bars.

Philip M. Aidikoff, Esq., *Director Emeritus*
Aidikoff, Uhl & Bakhtiari
Beverly Hills, California

Philip M. Aidikoff is a partner in the law firm of Aidikoff, Uhl & Bakhtiari and exclusively represents clients in securities arbitration and litigation. Mr. Aidikoff graduated from the University of California at Berkeley in 1969 where he was on the Dean's List and obtained his Juris Doctor degree from Southwestern University School of Law in 1975 where he was a member of Law Review. He is a past President and Director Emeritus of the Public Investors Arbitration Bar Association (PIABA). He served a five-year term (with three years as chair) on the National Arbitration and Mediation Committee of FINRA (formerly the NASD) which provides recommendations on rules, regulations and procedures governing arbitrations, mediations and dispute resolution. He served as one of three public members of the Securities Industry Conference on Arbitration (SICA), which was created with the support of the Securities and Exchange Commission to help protect the interests of public investors in securities arbitration. He also served as one of two investor advocates on the Securities Investor Protection Corporation (SIPC) Modernization Task Force. He served as a member of the FINRA Arbitration Task Force (2014- 2015) which provided recommendations aimed at improving the transparency, impartiality and efficiency of securities arbitration. Mr. Aidikoff was recognized as a 2005, 2006, 2007, 2008, 2009, 2010, 2011, 2012, 2013, 2014, 2015, 2016, 2017, 2018 and 2019 Southern California Super Lawyer and was profiled in the February 2012 issue of Southern California Super Lawyers Magazine. He was also named by the National Law Journal as one of the 50 Litigation Trailblazers & Pioneers (2014). His legal rating as an attorney is the highest available "AV".

Mr. Aidikoff has spoken before numerous professional and lay groups on the topic of stockbroker abuse and the handling of arbitration and litigation involving brokers and firms. He has authored or co-authored a number of articles including: Broker Abuse: Recovering for your Client, Los Angeles Trial Lawyers Advocate (1993); Take it or Leave it: Case Evaluation and Retention, Practicing Law Institute Securities Arbitration Handbook (1995); Recognizing and Evaluating Stockbroker Liability, Consumer Attorneys Association of Los Angeles Convention (1995); The Brave New World of Banks Selling Securities: Offline and Online, Practicing Law Institute Securities Arbitration Handbook (1996); Stockbrokerage Firm Liability: A Pre-Litigation Analysis, Consumer Attorneys Association of Los Angeles Advocate (1996), reprinted in the Arizona Trial Lawyer Association Advocate (January 1997); Recognizing and Guarding Against Fiduciary Abuse, National Guardianship Association Annual Convention (1996); Control Person Liability in the Securities Industry: A Legal Overview and Practical Applications, Practicing Law Institute Securities Arbitration Handbook (1997); Liability of Control Persons at Second Tier Firms, Public Investors Arbitration Bar Association (1997); Clearing Firm Liability: A Forward Looking Analysis, Practicing Law Institute Securities Arbitration Handbook (1998); Why Shouldn't Clearing Firms be Liable, Public Investors Arbitration Bar Association (1998); Motion Practice in Securities Arbitration: A Claimant's Point of View, Public Investors Arbitration Bar Association (1999); Selective Recession and the Offset Defense in Securities Cases: A Survey of the Law, Public Investors Arbitration Bar Association (2000); After the Correction: Are Your Losses Recoverable?, American Pathology Foundation (2001); 2001: An Update On Best Execution and Suitability Standards For Online Trading, Public Investors Arbitration Bar Association (2001); Arbitration: Can It Be Waived?, Practicing Law Institute Securities Arbitration Handbook (2002); Comments on The Claimant's Bar On Proposed Changes In The Expungement Process, The Association of the Bar of the City of New York (2002); Due Diligence or Don't: Pre-Filing Considerations and Claim Drafting, Public Investors Arbitration Bar Association (2003); Confidentiality and Compliance Manuals: The Fight for Unfettered Access, Public Investors Arbitration Bar Association (2004), republished in the Practicing Law Institute (2005); From Wall Street to Main Street: A Guide to Litigation Over Hedge Funds Sold by Brokerage Firms to Retail Investors, Public Investors Arbitration Bar Association (2005); I Didn't Say That / Oh Yes, You Did: The Use of Court Reporters in Securities Arbitration, Public Investors Arbitration Bar Association (2005); Third Party Money Managers: Brokerage Firms' Duty to Monitor and Resulting Liability, Practicing Law Institute (2005); A Practical Guide To The New NASD Code of Arbitration Procedure For Customer Disputes, Practicing Law Institute Securities Arbitration Handbook (2006); republished Public Investors Arbitration Bar Association (2006); Trying Asset/Mortgage Backed Securities Cases: A Practical Guide, Public Investors Arbitration Bar Association (2007); Wall Street Does It Again: The Auction Rate Securities Fraud, Public Investors Arbitration Bar Association (2008); The Prospectus Defense: Defeating It As A Matter of Fact and Law, PIABA Bar Journal, Vol. 16, No. 4 (2009); Discovery of Regulatory Documents: Debunking the Myth of the "SEC" Privilege in Securities Arbitration, Public Investors Arbitration Bar Association (2010); Arbitrators Misclassified: Looking Back to Move Forward, PIABA Bar Journal Vol. 18, No. 1 (2011); Discoverability Of Wells Submissions: What They Are And How To Get Them, PIABA Bar Journal Vol. 19, No. 2 (2012); FINRA Six–Year Eligibility Rule 12206: The Purchase Date is Often Not the Triggering "Occurrence or Event Giving Rise to a Claim", PIABA Bar Journal Vol. 20, No. 1 (2013); Market Adjusted Damages in the FINRA Forum, PIABA Bar Journal Volume 21, No. 2 (2014), reprinted in the Consumer Attorneys Associations for Southern California Advocate (April

2016); and most recently published The Use of Third Party Subpoenas to Determine a Brokerage Firm's Pre-Hiring Due Diligence and Post-Hiring Supervision, Public Investors Arbitration Bar Association (2015).

Mr. Aidikoff has served on the faculty of the Practicing Law Institute (1996, 1997, 2002), NASD Fall Securities Conference (2002, 2004, 2005, 2006), NASAA Enforcement Conference (2002, 2004), NASAA Attorney/Investigator Training Conference (2006), University of Cincinnati School of Law Symposium-Twenty Years after Shearson v. McMahon (2007), SCMA Conference (2005), NERA Securities Litigation Seminar (2004), New York City Bar Securities Arbitration program (2002), Los Angeles County Bar Association Securities Arbitration program (2006, 2011, 2013 and 2015), the NASD faculty for training of discovery arbitrators, and on the JAMS faculty for training of securities arbitrators. He was a member of the NASD Neutral Roster Task Force (2005-2006), the FINRA Arbitrator Training Task Force (2009- 2010), FINRA Discovery Guide Task Force (2010–2013) and National Roundtable on Consumer and Employment Dispute Resolution, Pepperdine University 2012. He has appeared on CNBC, CNN/fn, PBS Nightly Business Report, National Public Radio, CBS Radio, and the Business Channel addressing investor rights topics, and has been quoted on securities matters in the Wall Street Journal, the Dow Jones News Service, Newsweek, Reuters, Fortune Magazine, Business Week, Money Magazine, Bloomberg News Service, Forbes, Medical Economics, Registered Representative, The New York Times, USA Today, The Los Angeles Times, The Washington Post and other national and local press. For five years he wrote a weekly column in the Palm Springs Desert Sun on issues of interest to investors. (www.securitiesarbitration.com)

Robert S. Banks, Esq., *Director Emeritus*
Banks Law Office, P.C.
Portland, Oregon

Bob Banks has been practicing law for 36 years. He represents individuals and businesses in disputes with financial advisors, legal malpractice cases, and in business tort and minority shareholder rights cases. Mr. Banks has been an adjunct professor at Lewis and Clark Law School in Portland, Oregon. He practices at Banks Law Office PC in Portland, Oregon.

Honors

- 2017 Investor Champion Award, given by the North American Securities Administrators Association (NASAA)
- Distinguished Service Award, Public Investor Arbitration Bar Association (PIABA), 2016
- Distinguished Service Award, Federal Bar Association, Oregon Chapter
- Director Emeritus, PIABA
- PIABA President's Award," For Leadership Efforts In Protecting Investors Throughout the Country"
- Oregon Super Lawyers, 2006 – 2019, every year that it has existed in Oregon
- Chambers Best Lawyers In America
- Best Lawyers in America – Securities Law
- Martindale Hubbell Law Directory, Highest Rating
- Multi-Million Dollar Advocates Forum

Bar Leadership Positions

- Past President and 10-year board member, PIABA
- Past Chair, Oregon State Bar Securities Regulation Section
- Past Chair, Oregon State Bar Alternative Dispute Resolution Section
- Past President, Federal Bar Association, Oregon Chapter
- Past Chair, FINRA Arbitrator Training Committee Task Force, 2008-2009

Current Bar Committees

- Investor Representative Member, FINRA National Arbitration and Mediation Committee (NAMC)
- Chair, Rules and Procedures Subcommittee for FINRA's NAMC
- Member, National Federal Judicial Selection Committee, American Constitution Society

Selected Publications

- "Securities Arbitration" Chapter in Oregon State Bar Manual on Arbitration and Mediation, to be published in 2019
- PIABA Bar Journal Vol. 21, No. 3 2014, Muzzling the Claimant: Due Process Denied in FINRA Expungement Hearing
- Northwest Securities Institute CLE, Investment Portfolio and Brokerage Statement Danger Signals, July 2013 osbar.inreachce.com
- Practicing Law Institute, 1 Securities Arbitration 2006 at 225, The NASD's Explained Awards Rule Filing

· Practicing Law Institute, 1 Securities Arbitration 2003 at 253, Clearing Firms and the 2002 Uniform Securities Act: What You Didn't Know Could Have Hurt You
· Practicing Law Institute, Securities Arbitration 2001 at 565, Clearing Firms, The Uniform Securities Act, and Koruga v. Fiserv Correspondent Services, Inc.
· Practicing Law Institute, Securities Arbitration 2000 at 995, Investor Protection-Not! SIPC and The Securities Investor Protection Act of 1970
· Practicing Law Institute, Securities Arbitration 2008 A Comment On the Financial Industry Regulatory Authority's Proposed Rules On Motions To Dismiss.

Selected Speaking Engagements
· "Challenges in Administering a Large Receivership" National Association of Federal Equity Receivers (NAFER) Seattle, Washington, (January, 2019)
· "Recent Developments at FINRA" Northwest Securities Institute, Seattle (May 2018)
· "View From the Claimant's Perspective" CNA Insurance Broker-Dealer Conference, Tampa (March 2018)
· "Becoming a FINRA Arbitrator," with FINRA Executive Vice President and Director of Dispute Resolution, Richard Berry (April 2017)
· "Ethics Issues for Securities Lawyers" Oregon State Bar 35th Annual Northwest Securities Institute (April 2015)
· "What Every Securities Lawyer Should Know About Arbitration, Forum Selection, and Choice of Law Provisions" Oregon State Bar Securities Regulation Section Meeting (January 2014)
· "Remedies and Recompense: An Examination of Securities Arbitration and Class Actions" North American Securities Administrators Association (NASAA), Washington D.C., (October 7, 2013)
· "Detecting Anomalies in Investment Statements" Oregon State Bar seminar (July 16, 2013)
· "Recent Developments at FINRA," 3rd Annual Northwest Securities Institute seminar (May 2013)
· "Securities Arbitration Cases" Oregon Trial Lawyers Association Business Litigation Section Meeting (February 2011)

Selected Court Decisions
· Brown v. Price, WL 3207235 2017 (D. Or. 2017) Representing Aequitas Investors
· Amerivest v. Maloof, Oregon Court of Appeals, No. A144457 (Pending) Representing North American Securities Administrators Association as Amicus Curiae
· Boyer v. Salomon Smith Barney, Inc. 344 Ore. 583 (2008) Representing Public Investors Arbitration Bar Association as Amicus Curiae)
· Houston v. Seward & Kissel, LLP, 2008 U.S. Dist. LEXIS 23914 (March 27, 2008)
· Marshall, et al. v.McCown DeLeeuw, 391 F. Supp. 2d 880 (D. Idaho 2005)
· Estate of Aguirre v. Koruga (I) 2002 U.S. App. LEXIS 14632 (9th Cir. 2002)
· Koruga v. Fiserv Correspondent Services, Inc., 183 F. Supp.2d 1245 (D.Or. 2001), 2002 U.S. App. LEXIS 6439 (9th Cir. 2002)

Prior Clients
Bob has served a broad array of individuals, organizations and groups, including physicians, teachers, gas pipeline workers, attorneys, judges, investment advisors, accountants, NBA basketball players, a former US Congressman, FINRA (opposing broker expungement), North American Securities Administrators Association and Public Investors Arbitration Bar Association (as amici curiae), retirees, and many others who have been victims of negligent investment advice and
fraudulent conduct.

Educational Background
Reed College, B.A. 1977
University of Wisconsin Law School, J.D. 1982

Bar Memberships
Oregon, Washington.

Other
Finra Arbitrator Since 1989
Arbitration Services of Portland Arbitrator

Personal
Bob was born in New Jersey and grew up in upstate New York. He moved to Portland to attend Reed College and has considered himself to be an Oregonian for 40 years. He has completed 10 marathons, (2:46 PR), backpacked

throughout the NW, and is an avid fly fisherman. He is married to Valerie Banks (25 years) and they have two adult sons.

Hugh D. Berkson, Esq.
McCarthy, Lebit, Crystal & Liffman
Cleveland, Ohio

Hugh Berkson is a Securities Attorney with McCarthy, Lebit, Crystal & Liffman, Co. LPA. Hugh is rated AV® Preeminent™ by Martindale-Hubbell® and has been selected as a Super Lawyer from 2013 through 2020. He obtained a business degree in Finance from the University of Texas at Austin in 1989, and is a 1994 graduate of Case Western Reserve University School of Law, where he was a member of the Order of the Barristers and received both the American Jurisprudence Award, (National Mock Trial) in 1993 and the Jonathan M. Ault Mock Trial Prize for 1993-1994. Hugh later served as an Adjunct Professor of Law at the CWRU School of Law, where he taught trial practice from 1995-2004.

After gaining extensive trial experience in both business and personal injury litigation, Hugh decided in 2000 to focus on the representation of injured investors. Hugh tries and arbitrates investment cases and also puts his finance background to good use by performing much of the technical analysis required for his cases. Hugh is a past President of the Public Investors Arbitration Bar Association and was just re-elected to PIABA's Board of Directors, where he has served as a director since 2011.

Scot D. Bernstein, Esq., *Director Emeritus*
Law Offices of Scot D. Bernstein
Folsom, California

Mr. Bernstein has practiced law in California since 1980. For more than a dozen years, he has concentrated his practice on representing plaintiffs in class actions. He has been named class counsel in more than 25 cases, including both employment (wage-and-hour) and privacy class actions. He has been co-counsel in successful appeals that resulted in published decisions as well. He also has served as counsel in cases involving securities and franchise law violations, unfair competition, unlawful business practices and false advertising. And he has handled numerous arbitration matters, including one that resulted in an unusual judgment that is viewable on his website.

Mr. Bernstein studied engineering and economics at UCLA, where he received his bachelor's degree Magna Cum Laude in 1977 and was an officer of the UCLA chapter of Tau Beta Pi, the engineering honors society. He was a member of Omicron Delta Epsilon (economics honors society) and Phi Beta Kappa as well. He received his Juris Doctor degree at Boalt Hall School of Law, University of California at Berkeley, in 1980.

Mr. Bernstein is a member of the board of directors of the California Employment Lawyers Association ("CELA"), an association of more than 1,200 attorneys dedicated to representing employees in employment disputes. He currently co-chairs CELA's Legislative Committee and serves on its Wage and Hour Committee as well.

Mr. Bernstein served for eleven years as a director of the Public Investors Arbitration Bar Association ("PIABA"), a national association of attorneys dedicated to representing investors in disputes with the securities industry. He has published numerous articles in the PIABA Bar Journal and its predecessor, The PIABA Quarterly. Since 2008, he has worked hard to help PIABA defeat multiple attempts to pass legislation that would have created a broad new exemption for securities sold through general solicitation and general advertising in California. More recently, he has negotiated with the sponsors of those prior bills to arrive at a bill, supported by PIABA, which would be beneficial to investor protection. Mr. Bernstein has given continuing legal education lectures to PIABA, the North American Securities Administrators Association, CELA and other professional groups on investors' rights and remedies and on employees' rights under the wage and hour laws. He is a member of the National Employment Lawyers Association ("NELA") as well.

Reported Cases. Mr. Bernstein has served as co-counsel in successful federal and state appeals:
Kirby v. Immoos Fire Protection, Inc. (2012) 53 Cal.4th 1244 (co-counsel for successful appellants);
Stop Youth Addiction v. Lucky Stores, 17 Cal.4th 553, 950 P.2d 1086, 71 Cal.Rptr.2d 731 (1998) (attorney for amicus curiae in support of successful appellant);
Lippitt v. Raymond James Financial Services, et al., 340 F.3d 1033 (9th Cir. 09/22/2003)
(co-counsel for successful appellant);
Lazarin et al. v. Total Western, Inc. (2010) 188 Cal.App.4th 1560, 116 Cal.Rptr.3d 596, review denied, Jan. 19, 2011, S188164 (co-counsel for successful appellant).

Mr. Bernstein has been recognized as a Northern California Super Lawyer® every year from 2010 through 2019.

Steven B. Caruso, Esq., *Director Emeritus*
Maddox Hargett & Caruso, P.C.
New York, New York

Steven B. Caruso, the Resident Partner in the New York City office of Maddox Hargett & Caruso, P.C. (www.investorprotection.com), concentrates his practice on the representation of individual, high net worth and institutional investors in securities arbitration and litigation proceedings.

Mr. Caruso is the Chairman and a public member of the National Arbitration and Mediation Committee ("NAMC") of the Financial Industry Regulatory Authority ("FINRA"); former Chairman of the Discovery Task Force Committee of FINRA; former member of the Nasdaq OMX BX Arbitration Committee; former member of the Securities Investor Protection Corporation (SIPC) Modernization Task Force; Director Emeritus and former President of the Public Investors Arbitration Bar Association ("PIABA"); testified before the U.S. House of Representatives, Committee on Financial Services, Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, in March 2012 and September 2010; and has served as a judge for the Yale University Mock Trial Invitational Tournament and for Invest-Write, the national investment strategy writing competition sponsored by the Securities Industry & Financial Markets Association (SIFMA) Foundation.

Among the publications that Mr. Caruso has authored are ***An Introduction to FINRA's National Arbitration and Mediation Committee***, The Neutral Corner, FINRA Dispute Resolution, Vol. No. 1 (2018); *Post-Settlement Expungements: An Investor Protection Problem that Continues to Wait for a FINRA Solution*, Practising Law Institute, Securities Arbitration (September 2017); *Non-Attorney Representatives – Do They Present a Clear & Present Danger to the Integrity of FINRA Arbitration*, Association of the Bar of the City of New York, New York, N.Y. (May 2017); *Arbitrator Disclosures: Requests for Additional Information*, The Neutral Corner, FINRA Dispute Resolution, Vol. No. 4 (December 2016); *Ethical Implications of the Phantom Designation of Expert Witnesses in FINRA Securities Arbitration Proceedings*, Practising Law Institute, Securities Arbitration (September 2016); *Definition of a FINRA Customer: To Be or Not To Be – That Is the Ultimate Question*, Practising Law Institute, Securities Arbitration (July 2015); *Discovery in FINRA Arbitration*, The Neutral Corner, FINRA Dispute Resolution, Vol. No. 2 (2015); *FINRA Six-Year Eligibility Rule 12206: The Purchase Date is Often Not the Triggering Occurrence or Event Giving Rise to the Claim*, PIABA Bar Journal, Volume 20, No. 1 (September 2013); *All Public Arbitrator Panels: A More Level Playing Field*, Practising Law Institute, Securities Arbitration (August 2013); *Arbitrator Challenges Under the FINRA Code of Arbitration Procedure for Customer Disputes*, Practicing Law Institute, Securities Arbitration (August 2010); *The Mandatory Industry Arbitrator: An Endangered Species on the Precipice of Extinction*, Practising Law Institute, Securities Arbitration (August 2009); *Sunshine May be the Best Disinfectant for What Ails Securities Arbitration: A Discussion of the 2008 SICA Empirical Study of Fairness*, Practising Law Institute, Securities Arbitration (August 2008); *Effective Closing Statements From the Perspective of Counsel for the Customer-Claimant*, New York State Bar Association, Securities Arbitration 2007 (November 2007); *Essential Principles for Honorable Arbitrators*, Practising Law Institute, Securities Arbitration (August 2007); *Motions to Dismiss: A Predatory Tactic That Must be Extinguished*, Association of the Bar of the City of New York, New York, N.Y. (June 2007); *Ethical Standards for Securities Arbitrators: A Statistical Perspective of Potential Partiality (Bias)*, Practising Law Institute, Securities Arbitration (August 2006); *Arbitrator Training in the Securities Dispute Arena*, The Review of Securities & Commodities Regulation (January 2005); *Discovery Objections Which are Irrelevant, Unduly Burdensome and are Reasonably Calculated to Lead to the Concealment of Admissible Evidence*, New York State Bar Association, Securities Arbitration 2004 (October 2004); *Model Arbitrator Instructions: Luxury or Emerging Necessity*, Practising Law Institute, Securities Arbitration (August 2004); *Ethical Considerations in Settlement Agreements*, Association of the Bar of the City of New York, New York, N.Y. (June 2004); *Examination of the Adverse Broker: Unimpeachable Questions with an Internet Twist*, Practising Law Institute, Securities Arbitration (August 2001); *On-Line Trading: The New Frontier*, Practising Law Institute, Securities Arbitration (July 1999); and *NASD Arbitration Discovery Procedures : Knowing Your Customer From the Securities Professional Perspective*, American Bar Association, Section of Litigation, Committee on Securities Litigation (August 1995).

Jason Doss, Esq., *Director Emeritus*
The Doss Firm, LLC
Marietta, Georgia

Jason Doss has represented investors in NASD and FINRA arbitrations for approximately sixteen (16) years. The Doss Firm, LLC, established by Jason Doss in January 2009, is a successful law firm primarily devoted to representing aggrieved consumers across the United States against financial services companies for mismanaging investments and engaging in financial fraud. The attorneys of the firm have represented almost 1000 clients and have a combined 45 years of experience representing individual retail investors, institutional investors, and businesses in

financial fraud litigation, securities arbitrations, and collective and class actions. Jason Doss has represented dozens of investor clients in disputes with broker-dealers involving the unsuitable recommendations of life insurance products including but not limited to fixed-indexed and variable annuities. Since its inception, The Doss Firm has recovered tens of millions of dollars for investors and consumers.

In 2018, Jason Doss was selected by a federal court to serve as one of twelve attorneys to lead the Equifax Data Breach case on behalf of all consumers and small businesses across the country. The case is currently pending in the United States District Court, Northern District of Georgia.

Jason Doss was primarily responsible for originating a nationwide consumer class action consisting of approximately 420,000 policyholders in equity-indexed annuities against Allianz Life Insurance Company, *Linda L. Mooney et. al. v. Allianz Life Insurance Company of North America*, 06-cv-545, United States District Court of Minnesota. His former law firm Page Perry, LLC was co-lead counsel with two other firms.

Jason Doss has co-authored two books, Doss, J. and Frankowski, R., *A Practitioner's Guide To Securities Arbitration* (2013), American Bar Association (225 pages) and Armstrong, F. and Doss, J., *The Retirement Challenge: Will You Sink or Swim?* (Jan. 2009), FT Press, Prentice Hall Publishing (266 pages). *A Practitioner's Guide To Securities Arbitration* is used by law schools and practitioners across the country as a resource to help navigate the FINRA arbitration process. *The Retirement Challenge: Will You Sink or Swim?* is in bookstores across the country and is designed to help consumers avoid the pitfalls of investing and avoid becoming a victim of financial fraud.

Jason Doss is a past-President of the Public Investor Arbitration Bar Association (PIABA), a bar association of attorneys that represent investors in FINRA arbitrations. He also founded The PIABA Foundation, a Foundation devoted to preventing investment abuse, and currently serves as its President. In addition, Jason Doss helped create the Investor Advocacy Clinic at Georgia State University College of Law, a law clinic that represents investors *pro bono* in FINRA arbitration with investment losses too small for them to hire a private attorney.

Over the last ten years, Jason Doss has been quoted many times by major publications and news organizations about topics involving financial fraud including USA Today, The Wall Street Journal, The New York Times, Reuters, The Associated Press, Bloomberg, AARP Magazine, The Street, and The Atlanta Journal Constitution.

Michael S. Edmiston, Esq.
Jonathan W. Evans & Associates
Studio City, California

Michael S. Edmiston is an attorney at Jonathan W. Evans & Associates in Studio City, California. He has practiced with the firm since 2006. Prior to entering private practice, Michael served as a Senior Staff Attorney with NASD Dispute Resolution (now FINRA) in Los Angeles, California (1997-2001), and as a Business Manager with JAMS in Dallas, Texas and Orange, California (2001-2005).

His practice focuses on representing investors before FINRA, private commercial arbitration forums, and in state and federal court. His work continues to result in successful recoveries for clients by way direct negotiation, mediation, and contested arbitrations. Michael volunteers his time to Community Legal Aid SoCal working with senior citizens in a variety of civil and administrative matters.

In 2015, Michael became a Director of PIABA and will be serving as its EVP for 2020-2021. He previously served as the organization's Treasurer, Secretary, and as chair and co-chair of various committees. Michael has and continues to serve with the PIABA Bar Journal, including stints as Editor (2011-2012), Managing Editor (2013), Editor in Chief (2014-2015), and Advisor (2016 to present). He also authored and/or co-authored several articles and other materials for the Bar Journal and other publications.

Michael is a 1994 graduate of Whittier College, with B.A.s in both Business Administration and Economics. In 1997, he obtained his J.D. from Pepperdine University School of Law, and was admitted to the California Bar later that same year. He received his Master's Degree in Dispute Resolution from Pepperdine in 2001.

Benjamin P. Edwards, Esq.
William S. Boyd School of Law
Las Vegas, Nevada

Benjamin Edwards is an Associate Professor of Law at the University of Nevada, Las Vegas. He researches and writes about securities and corporate law.

Samuel B. Edwards, Esq.
2020 PIABA President
Shepherd, Smith & Edwards, LLP
Houston, Texas

Sam Edwards is a Houston based Securities Litigation and Arbitration attorney with a national practice. Sam and his firm, Shepherd, Smith, Edwards & Kantas, focus primarily on representing investors who have been injured. That has included the representation of individual investors, small hedge funds, community banks, pension plans and municipalities, including state governments. Sam received his BA from the University of Texas at Austin and his law degree from the University of Houston Law Center. Sam began working on investment disputes while still in law school and joined his current firm shortly after graduation. Wanting to become even more specialized in this area of law, Sam made the seemingly insane decision to continue his education, earning an LL.M. from Georgetown University Law Center in 2015 in Securities Law and Financial Regulation. Sam received the Thomas Bradbury Chetwood Prize at Georgetown, an award given to the student with the highest grade point average in the LL.M. program.

Sam was previously has been a member of FINRA's National Arbitration and Mediation Committee, where he worked with other attorneys, both claimants and respondents attorneys, to help make better rules and procedures for FINRA arbitration participants. Sam has also been a member of PIABA for almost 20 years, serving on numerous committees, was formerly the editor-in-chief of the PIABA Bar Journal and has been on the PIABA Board of Directors since 2013. Sam is the current President of PIABA.

Adam Gana, Esq.
2020 PIABA Secretary
Gana LLP
New York City, New York

Adam Gana is the managing partner of Gana Weinstein LLP. His practice focuses on all aspects of securities arbitration, complex commercial and business litigation. As a seasoned trial lawyer, Mr. Gana's experience includes litigation in both State and Federal Courts as well as in various alternative dispute resolution venues. As lead counsel, he has tried more than forty cases to verdict before the state and federal trial and appellate courts, AAA, JAMS, NFA and FINRA and has settled hundreds more cases through mediation and direct negotiation.

Mr. Gana was named in the New York *Super Lawyers Rising Stars*® for eight straight years (an honor given to the top 5% of attorneys), ranked AV® Preeminent™ by Martindale - Hubbell™ (the highest honor offered), and ranked by the National Trial Lawyers as one of the Top 100 attorneys in the state of New York.

Scott Ilgenfritz, Esq., *Director Emeritus*
Johnson, Pope, Bokor, Ruppel & Burns, LLP
Tampa, Florida

Scott C. Ilgenfritz is a partner in the law firm of Johnson, Pope, Bokor, Ruppel & Burns, LLP, and practices in the firm's Tampa, Florida, office. Scott has spent his entire thirty-four year legal career with Johnson, Pope. Over the years, Scott has had a varied commercial and business litigation practice, which has included securities arbitration and litigation, commercial tort litigation, professional malpractice litigation, corporate litigation, real estate-related litigation, and contract litigation. Since 1997, Scott has been Board certified by The Florida Bar as a Business Litigation Lawyer. Since 1997, Scott has been Board certified by The Florida Bar as as Business Litigation Lawyer. In 1992, Scott began representing investors in claims against broker/dealers, stockbrokers, investment advisors, and other financial professionals. Since the late 1990's, a primary focus of Scott's practice has been representing investors in securities arbitration and litigation matters. Scott has been a member of the Public Investors Arbitration Bar Association ("PIABA") since 1997. He served on PIABA's Board of Directors from 2008 until 2017. Scott served as President of PIABA from November, 2012, through October, 2013. During his term as President, he authored PIABA's expungement study. In 2017, Scott was recognized by PIABA as a Director Emeritus. Scott has been regularly recognized by his peers through inclusion in such publications as Florida's Super Lawyers (2007-2014) and Best Lawyers in America (2012-2017).

Marnie C. Lambert, Esq.
Lambert Law Firm, LLC
Columbus, Ohio

Marnie C. Lambert is a 1992 graduate of the Pepperdine University School of Law in Malibu, California. She has spent the past 15 years representing investors across the country in securities disputes with firms and representatives licensed by FINRA, the SEC and various states' securities divisions. She has represented investors in arbitration cases processed by FINRA, JAMS and AAA, as well as in court cases on a state and federal level.

Ms. Lambert has been an active member of the Public Investors Advocate Bar Association ("PIABA") since 2005, serving on the Board of Directors for the past 8 years (as Treasurer, Executive VP/President Elect and President from 2014-2017). She has participated in several panels over the years at PIABA Annual Meetings and she was panelist at the Practising Law Institute's Securities Arbitration Programs in New York City in 2017 and 2018. She has been an appointee to the Ohio State Bar Association ("OSBA") Annual LGBTQ (and Allies) Diversity and Inclusion Conference Planning Committee since 2011 (serving as Co-Chair in 2016) and she was an appointee to the OSBA's Litigation Section Council from 2005-2012.

Ms. Lambert has a reputation for her no-nonsense approach to cases and she is well-respected by clients, co-counsel, opposing counsel, arbitrators, mediators, and judges alike. She is licensed to practice law in the states of Ohio and California and in all United States District Courts in Ohio and California.

Christine Lazaro, Esq.
St. John's University School of Law
Queens, New York

Christine Lazaro is a Professor of Clinical Legal Education and the Director of the Securities Arbitration Clinic at St. John's University School of Law. Professor Lazaro is also Of Counsel to the Law Offices of Brent A. Burns, LLC, where she consults on securities arbitration and regulatory matters. Professor Lazaro has been a member of PIABA since 2008. She served as its President from October 2018 through October 2019, and currently serves on its Board of Directors. She is currently co-chair of the Association's Fiduciary Standards Committee. Professor Lazaro also serves on the FINRA Investor Issues Advisory Committee, and is a member of the Editorial Advisory Board of the Securities Arbitration Commentator, and occasionally contributes to its Arbitration Alerts. Professor Lazaro speaks and writes regularly on the topics of securities arbitration and the duties of brokers and brokerage firms.

Seth Lipner, Esq., *Director Emeritus*
Bernard M. Baruch College
New York, New York

Seth E. Lipner is a Professor of Law at the Zicklin School of Business of Bernard M. Baruch College in New York City, and a member of the firm Deutsch & Lipner in Garden City, New York. Mr. Lipner is the author of numerous scholarly articles and law books on fields as diverse as international trade law, securities arbitration and law and technology. As a member of Deutsch
& Lipner, Mr. Lipner focuses his practice on representing investors, employees and other individuals with grievances against providers of financial services.

Mr. Lipner served as President of the Public Investors Arbitration Bar Association (PIABA) in 2000-01 as well as in 1994-95 and served as Secretary to the organization and on its Board of Directs since the organization's inception in 1990 until 2006, and now holds the title "Director Emeritus." He has appeared on CNN, NPR, BBC and the Wall Street Journal Report, and is often quoted in publications such as Forbes, Business Week, Newsweek, the Wall Street Journal, the New York Times, Newsday, the New York Law Journal and the National Law Journal. Mr. Lipner speaks often to bar groups, and in continuing legal education programs, including the New York State Bar Association, Association of the Bar of the City of New York, Practicing Law Institute and PIABA. Mr. Lipner served on the National Arbitration and Mediation Committee of the NASO from 1998 to 2002, and was at one time a member of the Board of Editors at Securities Arbitration Commentator.

Mr. Lipner publishes extensively on various aspects of arbitration, particularly those involving NASO and NYSE member firms. The text of many articles is accessible at DeutschLipner.com. Mr. Lipner's treatise, Securities Arbitration Desk Reference (written together with Emeritus Professor Joe Long (deceased) and Professor William Jacobson) is available from Thomson/West. His essay, "The Case Against Restitution," was published on the Op-Ed page of The New York Times on May 2, 2003.

Mark E. Maddox, Esq., *Director Emeritus*
Maddox Hargett & Caruso, P.C.
Fishers, Indiana

Mark E. Maddox is a founding partner of Maddox Hargett & Caruso, P.C., one of the nation's largest legal practices concentrating on the representation of securities investors. He has concentrated his career representing investors in disputes with stockbrokers and their firms.

From 1989 - 1991, Mr. Maddox served as the Securities Commissioner for the State of Indiana. During his tenure, he also served on the Indiana Governor's Initiative on Economic Development Policy Panel. Mr. Maddox also led the International Enforcement Committee of the North American Securities Administrators Association as its Chairperson. He served on the Board of Directors of the Public Investor Arbitration Bar Association from 1994 - 2002 and from 2014-2017, and was its President from 1998 - 2000. Mr. Maddox was also a public representative on the NASD Regulation's National Arbitration and Mediation Committee from 1996 - 1998 and 2003 – 2005, and was appointed its Chair for the 2004 – 2005 term. He was admitted to practice before the U.S. Supreme Court in February 1995.

In 1991, Mr. Maddox opened his current private practice that concentrates in the representation of investors in securities arbitration, litigation and regulation. He is a member of the Indianapolis Bar Association and the Indiana State Bar Association where he is a Past Chair of the Securities Sub-Committee. He is an adjunct professor at Butler University where he teaches Business Law to undergraduates.
Mr. Maddox is a graduate of Wabash College (magna cum laude), and earned his J.D. from Vanderbilt University in 1986. He has been a speaker and lecturer for various Continuing Legal Education and securities-related seminars and has been published extensively, most notably the book *Investor Rights for the 21st Century* (2001).

Thomas D. Mauriello, Esq.
Mauriello Law Firm, APC
San Clemente, California

Tom Mauriello founded the Mauriello Law Firm, APC in 1996 after working at a large national plaintiffs' securities class action form and several small firms. Tom focuses on investment and consumer disputes, with customer FINRA arbitrations constituting a large part of his practice. He also handles business litigation, consumer class actions, and appeals.

Tom is a member of the California, New Jersey and Pennsylvania bars. He received his BA from Brown University in 1983 and JD from the University of San Diego School of Law in 1988. Prior to law school, he worked as a paralegal in New York City for a law firm registering securities offerings with the SEC and state securities agencies. Following law school, Tom served as a judicial clerk to Judge Robert E. Cowen of the U.S. Court of Appeals for the Third Circuit.

Tom serves on the Administration of Justice Committee and the Mandatory Fee Arbitration Committee (as an attorney-client fee arbitrator) with the Orange County Bar Association. He also serves on the PIABA Legislation Committee and participated in PIABA's "Hill Day" in March 2016. From 2012 through 2015, Tom served as Co-Chair of the Legal Committee of the Angeles Chapter of the Sierra Club.

When he is not working, Tom enjoys spending time with his 17-year old daughter, surfing, wine tasting, fitness boot camp, traveling, and playing keyboards in several rock bands.

David P. Meyer, Esq.
2020 Executive Vice President/President Elect
Meyer Wilson Co., LPA
Columbus, Ohio

David P. Meyer is the managing principal of Meyer Wilson, a national law firm with offices in Ohio, Michigan and California.

Since starting the law firm in 1999, David has earned a national reputation for successfully representing investors who are victims of investment fraud. He has represented more than 1,000 individual investors from all across the country in securities arbitration and litigation. Meyer Wilson has also been appointed lead and co-lead counsel in numerous consumer class actions across the country. The firm also represents hundreds of clients who suffered serious injuries from dangerous drugs and defective medical devices. His firm has recovered more than $350,000,000 for its clients.

David is currently President-Elect of the Public Investors Advocate Bar Association (PIABA), a national association of lawyers who represent individual investors in cases of investment fraud. He is also President-Elect of the Ohio Association of Justice, the statewide bar of trial lawyers in the state of Ohio.

David P. Neuman, Esq.
Israels & Neuman PLC
Bellevue, Washington

David Neuman is an attorney who has been representing the interests of investors and consumers for over a decade. Before co-founding Israels & Neuman in the Summer of 2014, Mr. Neuman worked for over seven years at a law firm in Chicago which focused its practice on representing aggrieved and defrauded investors, mostly in FINRA arbitration. Throughout his years of experience, Mr. Neuman has recovered millions of dollars in hundreds of FINRA and court cases, on behalf of clients from over 40 states, as well as investors from the international community. In addition to representing investors in FINRA Arbitration, Mr. Neuman has represented investors in numerous courts throughout the U.S., as well as represented persons deceived by their insurance brokers and parties in shareholder disputes.

Mr. Neuman is currently on the Board of Directors of PIABA. He is currently the co-chair of the Membership Committee and has chaired several other committees. He is also an arbitrator with FINRA Dispute Resolution. David Neuman is admitted to practice law in Illinois, Washington, and Florida, as well as several federal courts.
Mr. Neuman graduated with Honors from the University of Illinois in December 2001 with a B.S. in Finance. He attended the Northern Illinois University College of Law and graduated Magna Cum Laude in May 2005. While at the NIU College of Law, Mr. Neuman was on Law Review and was an Associate Justice for the Moot Court Society. In addition, during his time at the NIU College of Law, he also was a research assistant for Professor David Gaebler and researched various areas of contract, commercial, and consumer law.

Timothy J. O'Connor, Esq.
The Law Offices of Timothy J. O'Connor
Albany, New York

Timothy J. O'Connor maintains a private practice of law in Albany, New York and is licensed in New York and Florida. He has been representing investors in securities brokerage customer claims since 1985. Mr. O'Connor has been a solo practitioner since 2005, after having been affiliated with Ainsworth Sullivan for 21 years.

A graduate of Middlebury College (A.B. Economics, 1980) and the University of Denver College of Law (J.D. 1984), Mr. O'Connor was nominated in the Fall of 2003 as the Inaugural Visiting Clinical Instructor for the Investor Rights Project Securities Arbitration Clinic of Albany Law School of Union University in Albany, New York, funded through the efforts of New York State Attorney General, Eliot Spitzer, from the proceeds of a settlement obtained against several national securities brokerage firms involving allegations of analyst fraud and wrongdoing. Mr. O'Connor served in this adjunct position through 2005.

In addition to his private practice, he is currently an Adjunct Lecturer at State University of New York at Albany, teaching courses in Law in Financial Market Regulation and Technology in Financial Market Regulation.

He has also widely written on a number of topics relating to the topic of investors rights. Most recently, "Trends in Supervisory and Clearing Firm Liability"(New York State Bar Association Continuing Legal Education Department – "Securities Arbitration and Mediation 2017: The Courage to Simplify" – April 6, 2017).

Darlene Pasieczny, Esq.
2020 Treasurer
Samuels Yoelin Kantor, LLP
Portland, Oregon

Darlene Pasieczny (pronounced "Pah-shetch-nee") is a securities and fiduciary litigator, and leads the Investor Defenders practice group at Samuels Yoelin Kantor LLP, based in Portland, Oregon. Darlene works all stages of securities litigation and FINRA arbitration, fiduciary litigation in trust and estate disputes, elder financial abuse, complex civil litigation, and related appeals. She represents investors nationwide to recover investment losses caused by financial advisor misconduct or defective securities products. Previously, Darlene worked at Banks Law Office PC, where she developed her concentration on securities litigation and FINRA arbitration.

Darlene serves on the Board of Directors of the Public Investors Arbitration Bar Association (PIABA) and is a frequent speaker on FINRA arbitration, trust and estate matters, and elder financial abuse prevention, recognition, and recovery. Other professional affiliations include the Oregon State Bar, Washington State Bar, U.S. District Court for the State of Oregon, Multnomah Bar Association, and the Gus J. Solomon American Inn of Court. Darlene earned a B.A. from Reed College, *Phi Beta Kappa*, an M.A. from Columbia University, and J.D. from Lewis and Clark Law School, *magna cum laude*. www.InvestorDefenders.com

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Joseph C. Peiffer, Esq.
Peiffer Wolf Carr Kane & Conway, APLC
New Orleans, Louisiana

Joe is the Managing Shareholder of Peiffer Wolf Carr Kane & Conway, APLC. Based in the firm's New Orleans office, Joe has a wide-ranging practice focusing on cases that change lives. His practice consists of representing families affected by IVF clinic malfeasance, representing individuals and institutions that have been harmed by investment banks and brokerage firms, prosecuting ERISA class actions, and representing victims of labor trafficking, unscrupulous drug companies and those who have suffered catastrophic injury.
Joe currently represents many families that have had their dreams of having biological children taken from them due to the carelessness of IVF clinics. He is passionate about this work and understands the devastation that this causes individuals and families, who have lost eggs or embryos due to the malfeasance of these clinics.

In his financial services practice, Joe has represented hundreds of individual retirees against their brokers in FINRA arbitration. The highlights of this practice include representing 32 Exxon retirees in a 90-day FINRA arbitration against Securities America that resulted in a $22 million verdict – one of the largest ever awarded by a FINRA arbitration panel. He has also represented hundreds of Xerox and Kodak retirees against their brokers resulting from the brokers' fraudulent advice to retire and subsequent unsuitable investments. He has represented hundreds of families in cases involving private placements and Ponzi schemes.

His financial services fraud practice included representing approximately 25 municipalities and hospitals around the country in cases involving their issuance of auction rate securities. He also has litigated several ERISA class actions against large financial services firms regarding their imprudent investments of retirement money and conflicts of interest.

Joe has an active practice representing those who have been harmed by pharmaceutical products. He has represented or currently represents hundreds of clients in cases involving serious injuries sustained by drugs such as Pradaxa, Nuvaring, Invokana, Onglyza, and Essure. He represents approximately 800 clients in cases concerning harm caused by Xarelto.

Finally, Joe represents victims of human trafficking and labor exploitation. In one such case, his clients allege that the defendants have failed to pay overtime, improperly deducted for employee housing, and wrongfully held the plaintiffs' passports while in the United States. He has travelled extensively to the Philippines for this case and another involving a rig explosion.

The co-author of a treatise published by Thompson West, Litigating Business and Commercial Tort Cases, which is updated yearly since 2011. Joe teaches and lectures extensively throughout the country. He created and/or taught law school classes ranging from The Basics of Arbitration and Trial Advocacy, to Storytelling and Advocacy. He has spoken at many national conventions on a variety of topics, including prosecuting large and multi-client claims, brokers' deficient advice to retire, and voir dire and ERISA class actions and FINRA arbitration.

Joe is frequently quoted by national publications regarding FINRA arbitrations and mismanagement of retirement accounts. He has appeared in the USA Today, Wall Street Journal, Associated Press, New York Times, New York Daily News, Los Angeles Times, Business Week, Investment News, Reuters, and many other publications. He also has appeared on CNN.

Joe has received various awards and accolades. He was one of three Louisiana lawyers ranked by Chambers USA for securities litigation in 2011. He was named as one of the fifty Leaders in Law by New Orleans City Business Magazine. In 2014 Joe has been selected by his peers for inclusion in the 21st Edition of The Best Lawyers in America in the practice area of Commercial Litigation.

Joe is a leader of several national bar associations. He twice served as the chairman of the Business Torts Section of the American Association for Justice. He serves on the Board of Directors of PIABA – a nationwide bar association of lawyers who represent individuals and institutions in arbitrations to recover money lost by investment banks and brokerage firms. He was elected President of PIABA and will serve PIABA as its President until October 2015. Joe

graduated from Tulane School of Law, cum laude, in 1999. While at Tulane, he served on the Tulane Law Review and was involved with the Tulane Legal Assistance Program. Prior to attending Tulane, he graduated from Bowling Green State University in 1996, with a major in communications. While at Bowling Green, he worked as the General Manager of the campus radio station and City Editor of the daily newspaper.

Brian N. Smiley, Esq., *Director Emeritus*
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Brian Smiley is a partner in the firm of Smiley Bishop & Porter LLP. He was born in Augusta, Georgia, and grew up in Atlanta. He attended Emory College, where he was initiated into Phi Beta Kappa and from which he graduated with highest honors in 1975. Following graduation, he attended Emory University School of Law, where he served on the Board of Editors of the Emory Law Journal and was initiated into the Order of the Coif.

Upon graduation (with distinction) in 1978, Mr. Smiley received an appointment as a Trial Attorney in the United States Department of Justice. While at the Justice Department, Mr. Smiley acted as counsel for the Government in numerous cases that were deemed by the Attorney General to be of unusual importance to the United States, including Nixon v. United States, various constitutional cases and litigation involving the NATO treaty.

In 1981, Mr. Smiley returned to Atlanta from Washington, and entered into the private practice of law. As a litigator, Mr. Smiley has handled constitutional and civil rights suits, products liability claims, personal injury litigation, commercial controversies, shareholders' derivative suits, fidelity bond and RICO suits, and securities litigation and arbitration. For over 20 years, Mr. Smiley has concentrated in the securities field, primarily representing investors in FINRA arbitrations.

Mr. Smiley is the author of numerous articles including: "Stockbroker-Customer Disputes-Making a Case for Arbitration," (Georgia State Bar Journal, May 1987); "Spotting Common Forms of Stockbroker Misconduct" (The Verdict, Jan. - Feb. 1991); and, "The Law and Ethics of Witness Preparation" (Practicing Law Institute, 1998). He has spoken at numerous seminars sponsored by the Public Investors Arbitration Bar Association and has been quoted on securities matters in the national press.

Mr. Smiley is a frequent lecturer on the topics of stockbroker misconduct, the handling of litigation and arbitration involving stockbrokers, and legal ethics. He has testified as an expert at special hearings about the "penny stock" industry conducted by the Secretary of State of Georgia. Mr. Smiley testified before the United States Senate Committee on Banking, Housing and Urban Affairs, Securities Subcommittee, on the topics of "penny stock" fraud and securities industry arbitration.

In 2002, Mr. Smiley was appointed to the National Arbitration and Mediation Committee (NAMC). The 13 members of the NAMC advise the Board of Directors of FINRA, which is the world's largest forum for handling arbitration and mediation of disputes between clients and brokerage firms. The NAMC is actively involved in the drafting of arbitration rules and the recruitment, training and evaluation of arbitrators.

He has been elected to serve on the Board of Directors of PIABA for three terms and was honored to act as PIABA's President in 2008-2009.

Jeffrey R. Sonn, Esq.
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Jeffrey Sonn focuses his practice principally on securities litigation and arbitration matters, as well as business litigation, and class actions. Mr. Sonn is the managing partner of Sonn & Erez, and has handled over 1,000 of securities cases in his career. Mr. Sonn is "AV" rated by Martindale Hubbell, the highest rating for ethics and legal ability available by this independent ratings organization.

Mr. Sonn regularly lectures on the topic of securities litigation and securities fraud. Presently, Mr. Sonn is a lecturer at the Miami Dade County Police College on the subject of financial advisor fraud. Mr. Sonn has also served as a guest lecturer on securities fraud at the University of Miami Securities Law Clinic.

Mr. Sonn serves as a Director of the Public Investor Arbitration Bar Association (PIABA). Mr. Sonn is the author of many securities related articles, including Top *Ten Things to Do During a Final Hearing* (PIABA), *Top Ten Mistakes to Avoid in a Final Hearing* (PIABA), *Elder Abuse and the Securities Industry* (PIABA), *Ponzi Schemes, Picking up the Pieces from a Fallen House of Cards* ("Securities Arbitration in the Meltdown Era" Practicing Law Institute, 2009),

The ABC's of Mortgage Backed Securities (PIABA), *The Broker Went Bankrupt—Now What*?(PIABA), *Survey of Arbitrator Misconduct, Group Arbitration Techniques (PIABA), How CPAs Can Detect Stockbroker Fraud,* and *Top Ten Mistakes To Avoid In an Arbitration Hearing,* as well as other securities-related publications.

During his career, Mr. Sonn has litigated numerous cases to successful resolution, recovering hundreds of millions of dollars for victims of investment fraud. He won a $50 million final judgment in Katz v. MRT Holdings, one of the few cases under Private Securities Litigation Reform Act passed in 1995 to yield a final judgment on the merits. Mr. Sonn also served on the Plaintiffs' Steering Committee that successfully negotiated a $70 million dollar settlement for hundreds of investors who were the victims of the Medical Capital and Provident Shale Royalties Ponzi Schemes.

Mr. Sonn has acted as trial counsel to verdict in a number of successful cases, including First Union vs. the FDIC and Hollywood Associates (a $16 million dollar verdict), Madhany v. Citgroup ($11.1 million verdict), Regas v. Painewebber (a $2.2 million dollar verdict), and Tartell v. Krieger Financial ($1.7 million dollar verdict).

Mr. Sonn has also represented United States Bankruptcy Trustees and Court appointed receivers as counsel in securities fraud and Ponzi scheme cases. Mr. Sonn has also served as an expert witness in securities fraud cases on issues involving attorneys fees.

Prior to founding the Firm in 1995, Mr. Sonn was associated with the Miami-based securities-litigation firm Gilbride Heller & Brown; and the bankruptcy law firm of Mishan, Sloto, Hoffman and Greenberg.

Mr. Sonn has served as a legal correspondent and commentator on securities fraud and Ponzi schemes for CNBC, CBS, BBC Radio, ABC and MSNBC. Mr. Sonn served as a CNBC legal contributor on the Bernard Madoff Ponzi Scheme for the CNBC shows "On the Money" and the documentary "Scam of the Century, Bernie Madoff and the $50 Billion Dollar Heist."

Mr. Sonn also appeared in the television show "American Greed" on CNBC, about representing victims of the $1 Billion Dollar Ponzi Scheme by convicted Fort Lauderdale attorney Scott Rothstein. Sonn & Erez represented victims in the Rothstein case and pushed the Rothstein law firm into bankruptcy when the fraud was discovered.

Mr. Sonn graduated from the University of Florida in 1984 and from University of Miami Law School in 1988. Mr. Sonn was an Associate Editor of the University of Miami InterAmerican Law Review.

Mr. Sonn is admitted to practice law in the State of Florida, the United States District Courts for the Southern and Middle Districts of Florida, and the 11th Circuit Court of Appeals.

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Andrew Stoltmann, attorney and investor advocate, exclusively concentrates his practice in representing investors who are the victims of investment fraud. He has represented over one thousand individuals in lawsuits and securities arbitration actions against brokerage firms like LPL, Merrill Lynch, Morgan Stanley Dean Witter, Wachovia, Linsco, Prudential, Baird, Edward Jones, AG Edwards and Smith Barney and has tried approximately 80 cases. Previous to opening the Stoltmann Law Offices P.C. he was a partner in a law firm concentrating its practice in the representation of investors in lawsuits, arbitration claims and class actions against brokerage firms.

Mr. Stoltmann is currently an adjunct securities law professor at Northwestern University School of Law in Chicago. Mr. Stoltmann was the Editor-In-Chief of the PIABA (Public Investor Arbitration Bar Association) Bar Journal, a law journal for the national association of securities attorneys who represent investors in claims against brokerage firms and stockbrokers, from 2001 through 2005. Mr. Stoltmann is also the co-author of the book "Investor Rights for the Year 2000 and Beyond."

After graduating from the University of Wisconsin (Madison) with a Bachelor of Business Administration degree, Mr. Stoltmann worked as a licensed stockbroker for Olde Discount and Merrill Lynch. While in law school at DePaul University, Mr. Stoltmann clerked at the Chicago NASD Dispute Resolution office, where 95% of securities arbitration cases are decided.

Mr. Stoltmann has appeared as a guest providing legal opinions, commentary and analysis on CNN, CNBC, BBC, CBC, CBS, CNN-FN, Bloomberg TV and National Public Radio. Mr. Stoltmann has been quoted in various publications worldwide including the Wall Street Journal, Christian Science Monitor, Business Week, Forbes, Fortune, USA Today, Chicago Tribune, Los Angeles Times, Kiplinger's, Jerusalem Post, London Post, London Free Press,

The Guardian (UK), Daily Telegraph of London, Montreal Gazette, MaClean's, Calgary Herald, Toronto Globe & Mail, Toronto Star, Mainichi Daily News (Tokyo), China Daily (Beijing), Mail & Guardian (Johannesburg), National Post, and The Scotsman (Edinburgh).

Mr. Stoltmann is a member of PIABA (Public Investors Arbitration Bar Association), ATLA (Association of Trial Lawyers of America), the Chicago Bar Association, Illinois State Bar Association and is admitted to the United States District Court for the Northern District of Illinois and the Eastern District of Wisconsin.

ARBITRATION LAW UPDATE: 2019-2020

Scott Eichhorn & Elissa Germaine*

This article summarizes leading arbitration cases during the last year that are of particular relevance to the securities arbitration practitioner, as well as cases on the horizon for the coming year. The decided cases focus on class arbitration, arbitrability, customer identification, discovery abuse, grounds to modify arbitration awards, enforceability of arbitration agreements, and challenges to Regulation Best Interest. The upcoming cases focus on class arbitration and arbitrability.

I. Class arbitration

Jock v. Sterling Jewelers, 942 F.3d 617 (2d Cir. 2019)

The Second Circuit held that an "arbitrator's determination that the [arbitration] agreement permits class arbitration binds the absent class members because, by signing the [arbitration] agreement, they, no less than the parties, bargained for the arbitrator's construction of that agreement with respect to class arbitrability."[1]

In 2008, Laryssa Jock filed suit against her employer, Sterling Jewelers, alleging that she and other females sales employees were paid less than their male counterparts, on account of their gender, in violation of Title VII of the Civil Rights Act of 1964.[2] All Sterling Jewelers employees were required to sign an arbitration agreement as a condition of employment.[3] The arbitrator issued an initial award in favor of the named plaintiffs, construing the arbitration agreement to permit classwide arbitration.[4] The district court vacated the initial award, and Sterling appealed.[5] Since then, this matter has been before the Second Circuit four times.[6]

In its current decision, the Second Circuit recognized the "extremely deferential standard of review" in motions to vacate arbitration awards.[7] The court cited its own precedent to note that the focus of its inquiry under Section 10(a)(4) of the FAA is "whether the arbitrator had the power,

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[1] *Jock v. Sterling Jewelers*, 942. F.3d 617, 620 (2d Cir. 2019).

[2] *Id.*

[3] *Id.*

[4] *Id.*

[5] *Id.*

[6] *Id.*

[7] *Id.* at 622.

based on the parties' submissions or the arbitration agreement, to reach a certain issue, not whether the arbitrator correctly decided that issue."[8]

In reaching its decision, the court noted that "[a]lthough the absent class members have not affirmatively opted in to this arbitration proceeding, by signing the [arbitration] agreement, they consented to the arbitrator's authority to decide the threshold question of whether the agreement permits class arbitration."[9] The court reasoned that the arbitration agreement incorporated the American Arbitration Association (AAA) Rules [National Rules for Resolution of Employment Disputes of the AAA].[10] It noted that the AAA Supplementary Rules for Class Arbitration apply to any dispute arising out of an agreement that provides for arbitration pursuant to AAA Rules where a party submits an arbitration on behalf of a class, and that the Supplementary Rules provide that the arbitrator shall determine whether the applicable arbitration clause permits the arbitration to proceed on behalf of a class.[11] The arbitration agreement's incorporation of the AAA Rules demonstrates agreement to have the arbitrator decide the question of class arbitrability.[12]

In addition, the arbitration agreement "provides that questions of arbitrability and procedural questions shall be decided by the arbitrator."[13] The Supreme Court has suggested, and the Second Circuit has assumed without deciding, that the availability of classwide arbitration is a question of arbitrability.[14] The parties in this case have at times assumed that the availability of class procedures is a procedural question.[15] Either way, the court determined the availability of class procedures is a question for the arbitrator to decide under the terms of the arbitration agreement in question.[16]

Under these circumstances, "[b]ecause the absent class members, no less than the parties, thus bargained for the arbitrator's construction of their agreement" with respect to class arbitrability, the arbitrator acted within her authority in purporting to bind the absent class members to class procedures."[17] The court also distinguished its reasoning in this case from *Lamps Plus*, where the Supreme Court held that "an ambiguous agreement cannot provide the necessary contractual basis for compelling class arbitration."[18] First, the parties in *Lamps Plus* agreed that a court, not

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[8] *Id.* (internal quotations and citations omitted).

[9] *Id.* at 623.

[10] *Id.* at 623, 620.

[11] *Id.* at 623.

[12] *Id.* at 623-24.

[13] *Id.* at 624 (internal quotations omitted).

[14] *Id.* (citing *Oxford Health Plans LLC v. Sutter*, 569 U.S. 564, 569 (2013) (internal quotation marks omitted)).

[15] *Id.* at 624.

[16] *Id.*

[17] *Id.* (citing *Oxford Health Plans LLC v. Sutter*, 569 U.S. 564 (2013)).

[18] *Id.* at 626 (citing *Lamps Plus v. Varela*, 139 S. Ct. 1407 (2019)).

an arbitrator, should resolve the question of class arbitration; thus, that class arbitrability decision was subject to de novo scrutiny rather than the deferential standard of review that circumscribes courts' review of arbitrators' decisions.[19] Second, *Lamps Plus* leaves undisturbed the proposition that an arbitration agreement may be interpreted to include implicit consent to class procedures.[20]

***Sun Coast Resources, Inc. v. Conrad*, 956 F.3d 225 (5th Cir. 2020)**

The Fifth Circuit held that the arbitrator acted within his authority in ordering collective/class arbitration of federal labor law claims where the agreement did not expressly exclude class arbitration, affirming the decisions of the arbitrator and the district court.[21]

Conrad is an hourly fuel technician and driver for Sun Coast Resources, who brought a Fair Labor Standards (FLSA) overtime claim in arbitration on behalf of a class of similar employees.[22] Like the Second Circuit in *Jock*, the parties agreed that the AAA rules for employment disputes would govern arbitration; the Fifth Circuit also noted that those rules permit class proceedings through the Supplementary Rules for Class Arbitrations.[23]

The court reviewed the order confirming the arbitration award de novo, using the same standards used by the district court.[24] The Fifth Circuit noted that the district court's refusal to vacate the arbitration award is proper if the award has *some* basis in the arbitration agreement; the correctness of the arbitrator's interpretation is irrelevant as long as it was an interpretation.[25] Here, the award shows that the arbitrator interpreted the agreement, as he noted that the breadth of claims the agreement covered (compared to the few it exempted) suggested that the parties chose not to exclude class arbitration; that the agreement authorized all remedies available in court; and that the parties agreed to the AAA Rules for employment disputes, which permit class proceedings in the Supplementary Rules.[26] The court also found that the arbitration agreement here appears to assign the question of class arbitrability to the arbitrator rather than the court, overcoming the presumption that it is a gateway issue for the courts to decide.[27]

***Catamaran Corp. v. Towncrest Pharmacy*, 946 F.3d 1020 (8th Cir. 2020)**

The Eighth Circuit held that there was no contractual basis to conclude that the parties implicitly authorized class arbitration where "the agreements are not inconsistent with individual arbitration

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[19] *Id.* at 626.

[20] *Id.*

[21] *Sun Coast Resources, Inc. v. Conrad*, 956 F.3d 225 (5th Cir. 2020).

[22] *Id.* at 337.

[23] *Id.*

[24] *Id.*

[25] *Id.* (citing *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662, 671 (2010) and *Oxford Health Plans LLC v. Sutter*, 569 U.S. 564, 572 (2013)).

[26] *Id.* at 337.

[27] *Id.* at 338.

and do not support the conclusion that the parties intended class arbitration and believed the intent was so evident from the terms of the written agreement that it was unnecessary to express that intent within the agreements themselves."[28]

This is the second time that this case has appeared before the Eighth Circuit, this time after remand to the district court to consider whether a contractual basis for class arbitration exists between the parties.[29] On remand, the district court granted Catamaran's motion for summary judgment, finding no contractual basis in the agreements.[30] The Eighth Circuit affirmed, and reviewed de novo the district court's order granting summary judgment.[31]

The underlying case involved a dispute between a group of pharmacies seeking class arbitration regarding reimbursements for prescription drugs to plan members and their pharmacy benefit manager seeking to prevent class arbitration.[32] The agreements in question provide for binding arbitration in accordance with the Rules for Conduct of Arbitration of the American Arbitration Association (AAA).[33] The court pointed out that the agreements in question do not use the word class or refer to class arbitration.[34] It also noted that in its prior decision in this case, it held that "the question of whether the agreements provide for class arbitration is a substantive question of arbitrability, and thus presumptively a question for the court to decide, and the agreements did not otherwise commit the question to an arbitrator."[35]

The Eighth Circuit cited to the Supreme Court's decision in *Stolt-Nielsen* that "a party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party *agreed* to do so."[36] It then references the Supreme Court's recent decision in *Lamps Plus* that "an ambiguous agreement cannot provide the necessary contractual basis to conclude that the parties agreed to class arbitration."[37]

Thus, the Eighth Circuit determined that there must be "an affirmative contractual basis" to conclude that the parties agreed to permit class arbitration.[38] It rejected the pharmacies'

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[28] *Catamaran Corp. v. Towncrest Pharmacy*, 946 F.3d 1020, 1024 (8th Cir. 2020).

[29] *Id.* at 1021.

[30] *Id.* at 1021-22.

[31] *Id.* at 1022.

[32] *Id.*

[33] *Id.*

[34] *Id.*

[35] *Id.*

[36] *Id.* at 1022-23 (citing *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662, 684 (2010)).

[37] *Id.* at 1023 (citing *Lamps Plus, Inc. v. Varela*, 139 S.Ct. 1407, 1416-17 (2019) ("Neither silence nor ambiguity provides a sufficient basis for concluding that parties to an arbitration agreement agreed to undermine the central benefits of arbitration itself.")

[38] *Id.* at 1023.

arguments that the agreements implicitly authorize class arbitration.[39] As such, the Eighth Circuit comes closer to a rule that that parties' consent to permit class arbitration must be express and explicit in an arbitration agreement.

The Second Circuit in *Jock* and the Fifth Circuit in *Sun Coast* referenced AAA's rules for employment disputes. However, the Eighth Circuit in *Catamaran*, which did not involve an employment dispute, refers to the "Rules for the Conduct of Arbitration of the American Arbitration Association." It is not clear from the decisions if the same underlying language existed in the versions of the AAA rules in each case or, if different, if the rules referenced in *Catamaran* included the Supplementary Rules on Class Arbitration.

II. Arbitrability

Citadel Servicing Corp. v. Castle Placements, LLC, 431 F.Supp.3d 276 (S.D.N.Y. 2019)

The Southern District of New York held that the question of arbitrability of claims by a non-signatory purported agent to an arbitration agreement is properly determined by the arbitrator, when the agreement is broadly worded and incorporates FINRA arbitration rules.[40]

Plaintiff Citadel Services Corporation (respondent in the underlying FINRA arbitration), a lender and servicer of non-prime home mortgage loans, entered into a placement agreement with non-party StoneCastle Securities LLC, pursuant to which StoneCastle would locate investors for Citadel in exchange for compensation.[41] The placement agreement required that "all controversies between them [Citadel] and StoneCastle and/or any of their agents arising out of or concerning this agreement, the services provided hereunder, or any related matter shall be determined by arbitration in accordance with the rules of the Financial Industry Regulatory Authority (FINRA)."[42] When a dispute arose over money owed under the placement agreement, defendants in the court case (claimants in the underlying FINRA arbitration), who were non-signatories to the agreement and claimed to be agents (successors, assigns, personal representatives, wholly-owned subsidiaries) of StoneCastle, filed a FINRA arbitration claim against Citadel (respondent in the underlying FINRA arbitration).[43]

FINRA initially declined jurisdiction in a deficiency notice to Castle, noting that the arbitration provision was between StoneCastle and Citadel.[44] The Castle entities responded that they were entitled to invoke the arbitration provision as agents of StoneCastle.[45] FINRA accepted this jurisdictional argument (which the court notes was done without giving Citadel notice or an opportunity to respond), notified Citadel that Castle filed a claim in arbitration, and directed Citadel

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[39] *Id.* at 1023-24.

[40] *Citadel Servicing Corp. v Castle Placements, LLC*, 431 F.Supp.3d 276 (S.D.N.Y 2019).

[41] *Id.* at 278-79.

[42] *Id.* at 280.

[43] *Id.* at 279-82.

[44] *Id.* at 281-82.

[45] *Id.* at 282.

to answer.[46] Citadel filed the current action, seeking a judgment that the claims asserted in the FINRA arbitration were not arbitrable, as well as dismissal of the arbitration or a stay pending the court's decision on arbitrability.[47] The court noted that while this motion was pending, FINRA issued interim orders directing Citadel to comply with seemingly expensive and time-consuming requirements.[48] For the reasons stated below, the court issued an order compelling arbitration.

The court referenced three legal principles informing its analysis of issues of arbitrability.[49] First, there is a general presumption that courts decide issues of arbitrability.[50] This includes the question of whether an arbitration agreement binds non-signatories.[51] Second, to rebut that presumption, parties to an arbitration agreement may provide that the arbitrator, not the court, will decide whether an issue is arbitrable.[52] Third, parties must delegate threshold questions of arbitrability to the arbitrator by clear and unmistakable evidence, as by doing so parties surrender the right to have a court decide a legal dispute.[53] Despite these principles, the court notes that arbitration agreements rarely state whether the arbitrator or the court should decide any given issue of arbitrability.[54] It points out that clear and unmistakable evidence of an intent to arbitrate can be inferred from broad language expressing an intent to arbitrate all aspects of all disputes, incorporation by reference of arbitration rules that empower arbitrators to determine issues of arbitrability, and waiver of the right to seek remedies in court.[55]

Here, the question is whether the court or the arbitrator should determine whether Castle is an agent of StoneCastle entitled to enforce the arbitration provision.[56] The court found that the placement agreement in question shows the signatories' intent that the arbitrator should decide this issue, as it refers to "all controversies" and "any related matter" to arbitration, reflecting a broad grant of power to the arbitrators to assess arbitrability.[57] Moreover, the signatories provided clear and unmistakable evidence of an intent to delegate the determination of agency, as a "related matter," to the arbitrator.[58] Additionally, the placement agreement explicitly incorporates

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[46] *Id.*

[47] *Id.*

[48] *Id.*

[49] *Id.* at 284.

[50] *Id.*

[51] *Id.*

[52] *Id.*

[53] *Id.* at 285.

[54] *Id.*

[55] *Id.*

[56] *Id.* at 286.

[57] *Id.*

[58] *Id.* at 287.

the FINRA rules in two separate places.[59] The court discounts the argument that the agreement permits going to court as a remedy for other types of claims that were not arbitrable, as that does not undercut the evidence in the agreement that the question of agency is arbitrable.[60]

III. Who is a Customer?

Raymond James Financial Services v. Armijos, No. 19-CIV-81692-RAR, 2020 WL 2026316 (S.D. Fla. Apr. 27, 2020)

In a case now on appeal to the Eleventh Circuit, the Southern District of Florida weighed in on the definition of "customer" when Raymond James Financial Services, Inc. ("RJFS") sought to enjoin claimants from FINRA arbitration.[61] The arbitration claims related to an alleged fraud involving sales of Biscayne Capital financial products. Frank Chatburn, an owner and investment advisor with Biscayne Capital, was also a registered broker with RJFS for a period of five months in 2008.[62] Were the purchasers of Biscayne Capital investments customers of RJFS? The court concluded they were, even though the investors did not have agreements with RJFS, and some of the purchases occurred after Chatburn was no longer registered with RJFS.[63]

In reaching this conclusion, the court reviewed a lengthy and complex factual record. Some key facts are that the investors signed agreements with Raymond James & Associates, Inc. ("RJA") – not RJFS – on letterhead that read "Raymond James."[64] RJA is a FINRA member firm that served as the clearing firm for Biscayne Capital, a British Virgin Islands-based broker-dealer.[65] Chatburn's agreement with RJFS authorized him to sell RJA products. Chatburn sold the Biscayne Capital investments to investors in Ecuador between 2008 and 2015, representing himself as a "Raymond James" employee.[66] Chatburn told his "finder" in Ecuador that "Raymond James" had vetted and approved the investment products and provided her with Raymond James' branded marketing material to solicit clients.[67] Although RJFS terminated Chatburn in August 2008, neither Chatburn nor any Raymond James entity notified the investors of the departure of Chatburn, who continued to represent himself as a Raymond James advisor.[68]

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[59] *Id.* at 288.

[60] *Id.* at 289.

[61] *Raymond James Fin. Servs., Inc. v. Armijos*, No. 19-CIV-81692-RAR, 2020 WL 2026316 (S.D. Fla. Apr. 27, 2020).

[62] *Id.* at *1-2.

[63] *Id.* at *1.

[64] *Id.* at *2.

[65] *Id.* at *1.

[66] *Id.* at *3.

[67] *Id.* at *2.

[68] *Id.* at *3.

The issue before the court arose when the investors amended their FINRA arbitration proceeding to add RJFS as a party in addition to RJA. The arbitrators found that RJFS was a proper party to the arbitration, despite the fact that the investors had no agreement with RJFS.[69] Because no written agreement to arbitrate existed, the arbitrators relied on Rule 12200 requiring FINRA arbitration of eligible claims when "[r]equested by the customer" and "[t]he dispute is between a customer and a member or associated person of a member." In its declaratory action in court, RJFS alleged that it and RJA are entirely separate companies under the same parent company and that the Biscayne Capital investors were never customers of RJFS.[70] The court concluded that, in order to prevail, RJFS was required to show either (1) that the investors were not customers of RJFS, or (2) that Chatburn was not an associated person of RJFS.[71]

On the first question, the court noted the broad definition of "customer" under the FINRA Code and the Second Circuit holding that a customer is one who either "(1) purchases a good or service from a FINRA member, or (2) has an account with a FINRA member."[72] In deciding that the investors were customers of RJFS, the court relied on the facts that Chatburn had solicited investors to sign agreements with RJA while he was registered with RJFS and continued to hold himself out as a "Raymond James" representative after his termination from RJFS. The court noted that a "selling away" relationship where an associated person sells financial products of an affiliated company is sufficient to establish a customer relationship.[73] In concluding that the investors were customers of Chatburn (and presumably RJFS) for purposes of Rule 12200, the court rejected RJFS's argument that the FINRA Code required a direct relationship through either (1) a written customer agreement with RJFS or (2) a direct purchase from RJFS.[74]

On the second question, RJFS argued that Chatburn could only be deemed an "associated person" during the time of his registration with RJFS. The court rejected this argument, again relying on the facts that although not all transactions took place in the few months Chatburn was registered with RJFS, Chatburn solicited the investors to open RJA accounts during the time he was registered with RJFS, and much of the investment activity occurred while Chatburn continued to represent himself as affiliated with Raymond James.[75] The court also relied on the language in Rule 12100(u) that "a person formerly associated with a member is a person associated with a member." Thus, the court concluded, Chatburn was an associated person of RJFS for purposes of Rule 12200.[76]

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[69] *Id.*

[70] *Id.* at *4.

[71] *Id.* at *5.

[72] *Id.* (citing *Citigroup Global Markets, Inc. v. Abbar*, 761 F.3d 268, 275 (2d Cir. 2014)).

[73] *Id.*

[74] *Id.* at *6.

[75] *Id.*

[76] *Id.* at *7.

Under the court's interpretation of the law, RJFS could not show a substantial likelihood of prevailing on the merits of its claim, and the court thus denied RJFS's motion for a preliminary injunction seeking to enjoin the FINRA arbitration proceeding against RJFS.[77]

IV. Discovery Abuse

Torres v. Morgan Stanley Smith Barney LLC, No. 19-22977 (S.D. Fla. Apr. 8, 2020)

In another case now on appeal to the Eleventh Circuit, the Southern District of Florida confirmed a FINRA arbitration award including $3,000,000 in discovery sanctions, denying Morgan Stanley Smith Barney's ("MSSB") motion to vacate in the process.[78]

The discovery dispute centered around emails and agreements relating to the termination of a registered representative. The arbitration panel ordered MSSB to produce documents by December 10, 2018. On the first day of hearings on January 14, 2019, counsel for the claimants learned for the first time that the terminated broker sent MSSB a demand letter and MSSB settled his claim for $250,000. The panel ordered MSSB to produce the settlement agreement and related documents. MSSB produced the settlement agreement the same day but did not produce any related emails. The following day the panel ordered MSSB to produce the emails, and MSSB objected based on attorney-client privilege. The panel overruled MSSB's privilege objection, and MSSB produced 37 pages of emails on January 16, 2019. On January 20, 2019, MSSB produced 240 pages of additional documents required by the panel's order. Counsel for the claimants then moved for sanctions in the amount of $50,000 per day since December 10, 2018, the original date by which the panel ordered MSSB to produce the subject documents.

After briefs on the motion for sanctions at the conclusion of the arbitration proceeding, the panel issued an award including $3,000,000 in sanctions against MSSB. MSSB filed a motion to vacate the award based on two grounds: (1) evident partiality based on failure to make required disclosures of two of the arbitrators, and (2) that the panel exceeded its powers by awarding a greater amount of sanctions than the claimants requested.

On the first ground, MSSB alleged that one arbitrator had failed to disclose information relating to a medical malpractice lawsuit and that another arbitrator had failed to disclose a foreclosure action. As to the medical malpractice lawsuit, MSSB argued that the arbitrator failed to disclose that some of her claims were dismissed based on the Puerto Rico statute of limitations, a defense raised in the arbitration. MSSB argued that the other arbitrator failed to disclose the initiation of a foreclosure proceeding against her by CitiMortgage, an affiliate of Citigroup Global Markets, which MSSB alleged was a key entity in the arbitration as part of a joint venture with MSSB.

The court ruled that neither failure to disclose would lead a reasonable person to believe a potential conflict exists, noting that the court proceedings at issue occurred years before the initiation of the arbitration. This contrasted with another Southern District of Florida case in which the arbitrator failed to disclose that he was "currently embroiled" in a legal dispute giving rise to a potential conflict.[79] The court found that the statute of limitations defense asserted in the

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[77] *Id.*

[78] *Torres v. Morgan Stanley Smith Barney LLC*, No. 19-22977 (S.D. Fla. Apr. 8, 2020).

[79] *Id.* (citing *Citigroup Global Markets, Inc. v. Berghorst*, 2012 WL 5989628 (S.D. Fla. Jan. 20, 2012)).

arbitration had no personal impact on the arbitrator. In regards to the other arbitrator, the court relied on the fact that the bank had filed a foreclosure action but entered into a loan modification before the case proceeded.

On the second ground, MSSB argued that the arbitrators exceeded their powers by awarding $3,000,000 in sanctions when the claimants requested only $2,050,000 in sanctions and that the award of sanctions was excessive and punitive. The court disagreed, ruling that the sanctions award was compensatory rather than punitive in nature, citing to the arbitration panel's statements in the award that the sanctions were based on the effect of MSSB's noncompliance with discovery orders on achieving a fair arbitration hearing and the prejudice to counsel for the claimants in preparing the case for hearing. The court also rejected MSSB's argument that the arbitration panel exceeded its powers in awarding the sanctions because the amount awarded was more than that requested by the claimants, distinguishing this from a case in which an arbitration panel awarded damages on an issue that had not been raised during the arbitration proceeding.[80]

V. Grounds for Modification of Arbitration Award

Mid Atl. Capital Corp. v. Bien, 956 F.3d 1182 (10th Cir. 2020)

The Tenth Circuit opinion arises from the challenge of a FINRA arbitration award against Mid Atlantic Capital Corporation ("Mid Atlantic") on claims regarding non-traded REITs.[81] During the arbitration hearing, the claimants' expert presented to the arbitrators two alternative ways to measure damages: net-out-of-pocket losses in the amount of $292,411 and market-adjusted damages in an amount between $484,684 and $618,049. During closing arguments, the claimants requested only market-adjusted damages.[82] In its award, the arbitration panel ordered Mid Atlantic to pay "initial investment loss" damages $292,411 and "compensatory damages" of $484,683 for a total amount of $777,094.[83]

Mid Atlantic moved to modify the arbitration award under § 11(a) of the FAA and argued that the panel had awarded the claimants a "double recovery" of two damages amounts that their own expert presented as alternative measures of damages. In support of its argument, Mid Atlantic also noted that the claimants had requested only market-adjusted damages in their closing argument.[84] The district court deemed the arbitration award "disturbing," but nonetheless denied the motion to modify the award, which the court acknowledged gave the claimants a double recovery.[85]

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[80] *Id.* (citing *Totem Marine Tug & Barge, Inc. v. N. Am. Towing, Inc.*, 607 F.2d 649 (5th Cir. 1979)).

[81] *Mid Atl. Capital Corp. v. Bien*, 956 F.3d 1182, 1186-87 (10th Cir. 2020).

[82] *Id.* at 1187.

[83] *Id.* at 1188.

[84] *Id.*

[85] *Id.* at 1189.

In reaching its decision, the district court determined that 9 U.S.C. § 11(a) permitted the court to correct "an evident material miscalculation of figures" only if the miscalculation appeared "on the face of the award." The court found that the miscalculation appeared only upon looking to the arbitration record and, for that reason, ruled that the FAA did not authorize it to modify the award.[86] On appeal, Mid Atlantic argued that the district court erred in reading a face-of-the-award limitation into § 11(a).[87]

The Tenth Circuit recognized the issue as a question of first impression in the circuit and, agreeing with the district court, concluded that § 11(a) embodied a face-of-the-award limitation on miscalculations. The Tenth Circuit first looked to the plain meaning of § 11(a), which authorizes modification of an award containing "an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award." Based on dictionary definitions of the terms, the court found that "miscalculation" refers to mathematical, not legal, errors.[88]

The Tenth Circuit next found that the context of § 11(a) supported a reading of the term "evident" to include a face-of-the-award limitation. The court found this interpretation to further the purpose of the FAA in ensuring enforcement of private arbitration agreements and preserving the parties' agreement to have arbitrators, rather than judges, resolve their dispute. To read the term "evident" otherwise would allow courts to search the arbitration record to find miscalculations, leading to the kind of legal and evidentiary appeal that parties to an arbitration agreement have contracted to avoid.[89] The Tenth Circuit also found the history and structure of the FAA to support its reading.[90]

The court rejected Mid Atlantic's argument that the only way to determine whether a miscalculation is "material" is to analyze the arbitration record.[91] Mid Atlantic also argued that the face-of-the-award limitation would produce arbitrary results dependent on whether the arbitrators "showed their work" to arrive at calculations in the award. The Tenth Circuit countered that the precise intention of Congress in enacting the FAA was to limit courts to review of arbitration awards, not arbitration records, overriding any policy considerations advanced by Mid Atlantic's argument. The court also wrote that Mid Atlantic could have contracted for an explained arbitration award if it wanted to avoid the chance that an arbitration panel would not show its work.[92]

In support of its face-of-the-award limitation, the Tenth Circuit cited persuasive authority from the Fourth and Sixth Circuits and declined to follow the reasoning of a Seventh Circuit case with very similar facts.[93] In *Eljer Manufacturing, Inc. v. Kowin Development Corp.*, the Seventh Circuit

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[86] *Id.*

[87] *Id.* at 1191.

[88] *Id.*

[89] *Id.* at 1193.

[90] *Id.* at 1194.

[91] *Id.* at 1195.

[92] *Id.* at 1196.

[93] *Id.* at 1197-1200.

looked to the damages section of a post-hearing brief to find that the arbitration award mistakenly included $1.25 million in damages that had already been paid.[94] Based on this error found beyond the face of the award, it determined that such a "[d]ouble recovery constitutes a materially unjust miscalculation which may be modified under section 11."[95] The Tenth Circuit acknowledged that its face-of-the-award limitation was "admittedly in some tension with the Seventh's Circuit decision in *Eljer*," but found that circuit's reasoning unpersuasive.[96] Given the conflicting law between the Tenth and Seventh Circuits, as well as arguably conflicting law from other jurisdictions, the face-of-the-award limitation may be ripe for U.S. Supreme Court review.

VI. Enforceability of Arbitration Agreements

***Roberts v. AT&T Mobility*, No. 18-15593 (9th Cir. Feb. 20, 2020)**

Plaintiffs filed a class action lawsuit against AT&T alleging slowed mobile data speeds in plans offering "unlimited" data and seeking public injunctive relief under the California Consumer Legal Remedies Act ("CLRA"), among other California statutes providing public injunctive relief as a remedy. In 2017, the Ninth Circuit affirmed a district court ruling that compelled arbitration. Plaintiffs then requested reconsideration from the district court after a later 2017 decision. In *McGill v. Citibank*, the California Supreme Court held that an agreement that waives public injunctive relief as a remedy in any forum is contrary to California public policy and unenforceable ("the *McGill* rule") and that the FAA did not preempt the McGill rule under the U.S. Supreme Court's *Concepcion* decision.[97] The district court granted reconsideration and denied AT&T's motion to compel arbitration. In February 2020, the Ninth Circuit affirmed the district court rulings.[98]

The Ninth Circuit agreed with the district court on reconsideration on the ground that there was an "intervening change in the controlling law."[99] On the merits of compelling arbitration, the Ninth Circuit noted that it had ruled in a 2019 case with similar facts, *Blair v. Rent-A-Ctr., Inc.*, that the FAA does not preempt the *McGill* rule, a contract defense that fell within the FAA's savings clause at the first step of the preemption analysis.[100] Bound by its decision in *Blair*, the Ninth Circuit held the arbitration agreement unenforceable and affirmed the district court's order denying AT&T's motion to compel arbitration.[101]

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[94] 14 F.3d 1250 (7th Cir. 1994).

[95] *Id.* at 1254.

[96] *Bien*, 956 F.3d at 1200.

[97] *McGill v. Citibank N.A.*, 2 Cal. 5th 945, 952 (2017).

[98] *Roberts v. AT&T Mobility*, No. 18-15593 (9th Cir. Feb. 20, 2020).

[99] *Id.* (citing *Kona Enters., Inc. v. Estate of Bishop*, 229 F.3d 877, 890 (9th Cir. 2000) (*quoting 389 Orange St. Partners v. Arnold*, 179 F.3d 656, 665 (9th Cir. 1999))).

[100] *Id.* (citing *Blair v. Rent-A-Ctr., Inc.*, 928 F.3d 819 (9th Cir. 2019)).

[101] *Id.*

In the underlying order affirmed by the Ninth Circuit, the district court explained that "public injunctive relief" is "injunctive relief that has the primary purpose and effect of prohibiting unlawful acts that threaten future injury to the general public" and that benefits the general public but benefits the plaintiff only incidentally – if at all – as a member of the general public.[102] Private injunctive relief rights individual wrongs but benefits the public only incidentally – if at all.[103] The AT&T arbitration agreement at issue included a provision that the arbitrator could only award injunctive relief in favor of an individual. It also stated that the entire arbitration provision would be null and void if that specific provision were found to be unenforceable. The district court found this "poison pill" provision rendered the entire arbitration agreement unenforceable.[104]

VII. Regulation Best Interest

XY Planning Network, LLC v. United States Sec. & Exch. Comm'n, No. 19-2886-AG, 2020 WL 3482869 (2d Cir. June 26, 2020)

On September 10, 2019, two suits were filed in the Second Circuit against the SEC, challenging the Regulation Best Interest rulemaking ("Reg BI"). The first was filed by XY Planning Network, LLC and Ford Financial Solutions, LLC (Docket No. 19-2886). The second was filed by the States of New York, California, Connecticut, Delaware, Maine, New Mexico, and Oregon, and the District of Columbia (Docket No. 19-2893). On November 5, 2019, the cases were consolidated under Docket No. 19-2886. On December 27, 2019, the Petitioners filed their briefs. On March 3, 2020, the SEC filed its responsive brief. The Second Circuit heard oral argument on June 2, 2020, and ruled in favor of the SEC on June 26, 2020.[105] In its ruling, the Second Circuit also held that the States lacked standing because the argument that the conflicted advice permitted by Reg BI would cause lower tax revenues was too conjectural.[106]

In their briefs, the Petitioners argued that the SEC acted in excess of its statutory authority and contrary to the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") when it adopted Reg BI. The position of the Petitioners was that the SEC may not proceed with rulemaking under section 913(f), while disregarding section 913(g). In its brief, XY Planning argued that the rulemaking authority granted in section 913(f), to "commence a rulemaking, as necessary or appropriate in the public interest…to address the legal or regulatory standards of care for broker-dealers, investment advisers, and associated persons when providing personalized financial advice" is procedural. According to XY Planning, Section 913(g) provided the permissible substantive content of the rulemaking: that the standard for brokers be the same as for investment advisers.

The SEC argued that Dodd-Frank section 913 subsections (f) and (g) gave two different paths to rulemaking, asserting that subsection (f) is a broad grant of discretionary authority, separate from

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[102] *Id.* (citing *McGill*, 2 Cal. 5th at 951, 955).

[103] *Id.*

[104] *Id.*

[105] *XY Planning Network, LLC v. United States Sec. & Exch. Comm'n*, No. 19-2886-AG, 2020 WL 3482869 (2d Cir. June 26, 2020).

[106] *Id.* at *5.

the permissive authority set forth in subsection (g).[107] The Second Circuit agreed with the SEC, ruling that section 913(g) did not narrow the scope of section 913(f). Rather, section 913(g) provided separate rulemaking authority that permitted the SEC to promulgate a uniform fiduciary standard, which the SEC chose not to do.[108] Thus, the SEC lawfully promulgated Reg BI.[109]

The Petitioners further argued that the SEC acted arbitrarily and capriciously when it failed to apply a uniform standard to brokers and investment advisers offering personalized investment advice to retail investors. The Petitioners challenged the SEC's interpretation of the broker-dealer exclusion in the Investment Advisers Act. Under the Investment Advisers Act, broker-dealers who offer investment advice are subject to the Act unless such advice is "solely incidental" and the broker-dealer receives no "special compensation." The State Petitioners argued that both Dodd-Frank and the Investment Advisers Act require that broker-dealers who provide investment advice as a substantial part of their business should be subject to a fiduciary duty.

The SEC argued that Reg BI does not contravene the broker-dealer exclusion of the Advisers Act, and that its understanding of the terms "solely incidental" and "special compensation" within the exclusion are consistent with the Advisers Act's text and history.[110] The Second Circuit ruled that the SEC's interpretation of the broker-dealer exclusion was not so "fundamental" to Reg BI to make the rule arbitrary and capricious, noting that the phrase "special compensation" does not appear in Reg BI.[111] Thus, the Second Circuit concluded, the Petitioners failed to explain how the SEC's interpretation could make Reg BI arbitrary and capricious.[112]

The Petitioners further argued that the SEC did not address investor confusion with the rulemaking. They argued that the rulemaking exacerbates the existing confusion between broker-dealers and investment advisers by requiring that broker-dealers and investment advisers use identical disclosures, and that the Dodd-Frank studies demonstrated that disclosure is not effective in overcoming this confusion. Notwithstanding the evidence, the SEC relied heavily on the effectiveness of disclosure throughout the rulemaking and made conclusory statements regarding the benefits of disclosure.

In its brief, the SEC argued that its adoption of a tailored standard of conduct for broker-dealers was not arbitrary and capricious, asserting that Reg BI was intended to enhance protections for investors while preserving access to advice.[113] Noting that the SEC reviewed thousands of comment letters and issued a 173-page Adopting Release explaining its decision, the Second Circuit found that the SEC considered evidence of consumer confusion and gave adequate

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[107] Christine Lazaro, *Financial Planning Group and States Sue in the Second Circuit to Overturn Reg BI*, Securities Arbitration Commentator, Securities Arbitration Alert 2020-05 (Feb. 5, 2020).

[108] *XY Planning Network*, 2020 WL 3482869 at *6.

[109] *Id.* at *7.

[110] Lazaro, *supra*.

[111] *XY Planning Network*, 2020 WL 3482869 at *8.

[112] *Id.*

[113] Lazaro, *supra*.

reasons for adopting Reg BI, including the SEC's view that a uniform fiduciary standard would raise the costs of investment advice and reduce investor choice.[114]

In further explanation of its position that Reg BI is not arbitrary and capricious, the Second Circuit stated that "Petitioners' preference for a uniform fiduciary standard instead of a best-interest obligation is a policy quarrel dressed up as an [Administrative Procedure Act] claim."[115]

VIII. On the Horizon

Cases on the horizon for next year involve class action arbitration and arbitrability.

A. Class action arbitration

***Laver v. Credit Suisse Securities (USA), LLC*, 2018 WL 3068109 (N.D. Cal. 2018) (currently on appeal to 9th Circuit, 18-16328 Christopher Laver v. Credit Suisse Securities (USA))**

The Ninth Circuit heard oral argument on February 13, 2020 in an appeal challenging a district court's decision upholding class action waivers in employment arbitration agreements. In the underlying case, Christopher Laver, a former Credit Suisse financial advisor, sued Credit Suisse on behalf of a group of financial advisors regarding deferred compensation.[116] The district court's ruling enforced Laver's employment agreement (post-*Epic Systems*, which held that arbitration agreements in which an employee agrees to arbitrate any claims against his employer individually rather than collectively are enforceable), and agreed with Second Circuit precedent in *Cohen* that FINRA Rule 13204 does not bar contractual predispute waivers of class action procedures.[117]

On appeal, the main questions before the Ninth Circuit were 1) whether FINRA Rule 13204 bars the class action waiver, and 2) whether the FINRA rules and policies override the Federal Arbitration Act ("FAA").[118] Oral argument included a discussion of the fact that there is no FINRA rule barring the use of class action waivers in employment pre-dispute arbitration agreements, compared to customer agreements.[119] The *Schwab* case came up several times, with Credit

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[114] *XY Planning Network*, 2020 WL 3482869 at *8-9.

[115] *Id.* at *7.

[116] *Laver v. Credit Suisse Securities (USA), LLC*, 2018 WL 3068109, *1 (N.D. Cal. 2018).

[117] *Id.* at *7-8 (citing *Epic Systems Corp. v. Lewis*, 138 S.Ct. 1612 (2018) and *Cohen v. UBS Fin. Services, Inc.*, 799 F.3d 174 (2d Cir. 2015)).

[118] George H. Friedman, *Ninth Circuit Hears Oral Argument in Case Challenging FINRA's Class Action Waiver in Employment*, Securities Arbitration Commentator, SAC Blog (Feb. 20, 2020), available at http://www.sacarbitration.com/blog/ninth-circuit-hears-oral-argument-in-case-challenging-finras-class-action-waiver-prohibition-in-employment/.

[119] *Id.*

Suisse's counsel noting that FINRA policies and Rule 2268 bar class action waivers in customer pre-dispute arbitration agreements, but not employee arbitration agreements.[120]

B. Arbitrability

Henry Schein, Inc. v. Archer and White Sales, Inc., Case No. 19-963, 2020 WL 3146679 (2020)

On June 15, 2020, the United States Supreme Court agreed to consider this appeal from the Fifth Circuit on the question of "whether a provision in an arbitration agreement that exempts certain claims from arbitration negates an otherwise clear and unmistakable delegation of questions of arbitrability to an arbitrator."[121] Courts have been divided on this issue. The Supreme Court resolved another circuit split in 2019 in this same case, holding that when parties to an arbitration agreement have agreed to delegate questions of arbitrability to an arbitrator, the court must abide by the parties' decision, even if it thinks the arbitration agreement applies to a dispute that is "wholly groundless."[122]

[120] *Id.* (citing *Department of Enforcement v. Charles Schwab & Co.*, No. 2011029760201, 2014 FINRA Discip. LEXIS 5 (FINRA Bd. of Governors Apr. 24, 2014) (holding that Schwab violated FINRA rules when it used a class action waiver in customer agreements)).

[121] *Henry Schein, Inc. v. Archer and White Sales, Inc.*, Case No. 19-963, 2020 WL 3146679 (2020).

[122] *Henry Schein, Inc. v. Archer & White Sales, Inc.*, 139 S.Ct. 524 (2019).

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 (I) Regulation Best Interest: The Broker-Dealer Standard of Conduct;[1] (II) Form CRS Relationship Summary and Amendments to Form ADV;[2] (III) the SEC Interpretation Regarding Standard of Conduct for Investment Advisers;[3] and (IV) the SEC Interpretation Regarding the "Solely Incidental" Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser.[4] Each of these four releases is summarized below. Additionally, FINRA has issued its own rules changes in response to the adoption of Regulation Best Interest. FINRA's changes are also discussed below.

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] Put simply, 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 that 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

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[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 Fe. 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, for example, 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 that the Supreme Court articulated in *Basic v. Levinson*.[15]

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 services the brokerage firm will offer, including any limitations on those services.[16]

Regardless of whether the firm and individual are 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. See also Basic, Inc. v. Levinson*, 485 U.S. 224 (1988).

[16] 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.[17]

With respect to fees and costs, the SEC expects that brokerage firms will build on the disclosure of fees and costs that are set forth in Form CRS (to be discussed in further detail below).[18] 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.[19] Brokerage firms may also satisfy this part of their disclosure obligations by providing mandated disclosure documents, such as prospectuses, and trade confirmations.[20]

With respect to the type of services the brokerage firm offers, the firm must disclose whether it monitors transactions and strategies.[21] As part of this disclosure, the brokerage firm must be specific as to the frequency and duration of the services offered.[22] The brokerage firm may rely on information disclosed in the Form CRS (as will be discussed below), but it will likely need to expand on that information to meet this disclosure obligation.[23] However, the brokerage firm may rely on other documents, including account agreements, to make these disclosures.[24] As part of this disclosure, brokerage firms must also disclosure whether they require any account balance minimums.[25]

The brokerage firm must also disclose any limitations on its offerings.[26] Limitations include for example, if the brokerage firm only offers proprietary products.[27] Additionally, if the brokerage firm is dually registered but the broker is not, the broker must disclose that he cannot offer advisory services.[28]

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

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

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

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

[20] *Id.*

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

[22] *Id.*

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

[24] *Id.*

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

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

[28] *Id.*

compensation arrangements create.[29] These conflicts need not be disclosed on a recommendation by recommendation basis.[30]

While the disclosure obligation requires that the disclosures be made in writing, the SEC recognizes that it may be necessary to supplement, clarify, or update written disclosures with oral disclosures.[31] If the brokerage firm does supplement the written disclosures, however, the brokerage firm must keep a record of the fact that an oral disclosure was provided.[32]

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.[33]

The first prong is similar to the "reasonable basis" obligation under the FINRA Suitability Rule.[34] 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.[35] The SEC sets forth factors that 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

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

[30] *Id.*

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

[32] *Id.*

[33] 17 C.F.R. §240.15l-1(a)(2)(ii) (2019).

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

[35] 84 Fed. Reg. at 33,375 – 33,376.

conditions; the expected return of the security or investment strategy; as well as any financial incentives to recommend the security or investment strategy."[36]

The SEC has included "costs" as a factor in evaluating securities or strategies because it recognizes that cost will always be a relevant factor.[37] "Costs" includes both costs associated with purchasing a security, as well as future costs associated with exchanging or selling a security.[38] However, the SEC cautions that cost is not a dispositive factor. The Rule does not require that a broker recommend the lowest cost option.[39]

The second prong incorporates the "customer specific" prong of the FINRA Suitability Rule,[40] but enhances it by replacing "suitable" with a best interest standard.[41] 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.[42] This is the same information that firms must currently consider as part of the investor's profile under the FINRA Suitability Rule.[43] 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.[44]

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.[45] The broker need not recommend the "best" of all possible alternatives.[46] The Rule also does not require that the broker be familiar with every product available by the brokerage firm.[47] 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.[48]

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

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

[38] *Id.*

[39] *Id.*

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

[41] 84 Fed. Reg. at 33,377.

[42] 17 C.F.R. §240.15l-1(b)(3) (2019).

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

[44] 84 Fed. Reg. at 33,379.

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

[46] *Id.*

[47] *Id.*

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

For dually registered brokers, the options with respect to account type must be considered as reasonably available alternatives.[49] If the broker may only offer brokerage accounts, the broker must consider the customer's objectives before recommending a brokerage account.[50] For example, if the customer is requesting that the broker have unlimited discretion, a brokerage account would not be appropriate.[51]

When recommending a rollover, 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."[52] A broker may not just consider whether the rollover may offer additional options beyond the customer's current plan.

The final component is similar to the "quantitative suitability" requirement,[53] except that the "control" element has been eliminated.[54] This component is intended to prevent trading that is so excessive that a positive return is virtually impossible.[55]

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.[56] The obligation further requires that a brokerage firm mitigate or eliminate certain types of conflicts.[57]

With respect to the content of the policies and procedures, the SEC contemplates that brokerage firms will have the flexibility to design policies and procedures that are risk-based rather than requiring a detailed review of each recommendation.[58] The SEC suggests certain components that 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

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

[50] *Id.*

[51] *Id.*

[52] *Id.*

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

[54] 84 Fed. Reg. at 33,384.

[55] *Id.*

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

[57] *Id.*

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

> 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, 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.[59]

Under this obligation, the brokerage firm has a duty to, at a minimum, disclose all conflicts of interest.[60] 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.[61]

Brokerage firms also 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.[62] The SEC has primarily chosen to limit the duty to mitigate to broker-level conflicts, allowing the brokerage firms to generally deal with firm-level conflicts through disclosure.[63] 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.[64] Accordingly, the requirement does not create an obligation with respect to private securities transactions.[65] 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.[66]

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.[67]

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;

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

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

[61] *Id.*

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

[63] *Id.*

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

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

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

[67] *Id.*

- 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 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; are 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.[68]

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'.[69] The SEC considers that recommending only proprietary products, products with revenue sharing arrangements, or a specific asset class would be material limitations.[70] The SEC recommends that brokerage firms offering limited menus consider establishing a "product review process" that 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.[71]

Certain practices are completely prohibited pursuant to this obligation. For example, 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."[72] Non-cash compensation includes merchandise, gifts and prizes, travel expenses, meals and lodging.[73] 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.[74] It likely will not capture contests or other incentives tied to total products sold or asset accumulation and growth.[75]

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

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

[70] *Id.*

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

[72] 17 C.F.R. §240.15l-1(a)(2)(iii)(D) (2019).

[73] 84 Fed. Reg. at 33,396.

[74] *Id.*

[75] *Id.*

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.[76]

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.[77] 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."[78] 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."[79]

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.[80] The SEC will require that brokerage firms and investment advisers create and deliver a relationship summary to prospective and existing customers. The relationship summary and the firms' delivery obligations are described in this section.

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.[81] For example, firms will be able to describe their services, investment offerings, fees, and conflicts of interest.[82] Firms will be required, however, to use prescribed headings, conversation starters, and statement describing their standard of conduct when providing investment advice.[83]

The SEC requires that headings be in the form of prescribed questions, in a set order.[84] The relationship summary may not exceed four pages for a dual registrant that includes both its

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[76] *Id.*

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

[78] *Id.*

[79] *Id.*

[80] 84 Fed. Reg. 33,492.

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

[82] *Id.*

[83] *Id.*

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

brokerage and advisory services in a single summary.[85] Otherwise, the relationship summary may not exceed two pages for brokerage firms and investment advisers that are describing one of their services.[86]

The SEC is encouraging the use of graphics to facilitate comprehension, including charts, graphs, tables, text colors, and graphical cues such as dual-column charts.[87] Additionally, firms may include QR codes and hyperlinks to facilitate layered disclosure.[88] However, a firm may not satisfy its disclosure obligations of the relationship summary through the use of "incorporation by reference."[89]

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.[90]

ii. Relationships and Services

Following the introduction, firms must summarize the relationships and services that they offer under the heading, "What investment services and advice can you provide me?"[91] Additionally, firms must include any material limitations on the services that they offer to investors.[92] In the description of services, firms must address (i) monitoring; (ii) investment authority; (iii) limited investment offerings; and (iv) account minimums and other requirements.[93]

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.[94] If an investment adviser accepts discretionary authority, the firm must describe how the authority will be exercised.[95] For example, if the firm requires investor input before exercising discretion in certain

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

[86] *Id.*

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

[88] *Id.*

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

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

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

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

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

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

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

circumstances, the firm must explain that.[96] Both investment advisers and brokerage firms that offer non-discretionary services must explain that the investor is the ultimate decision-maker.[97] If a firm has a limited menu of offerings, such as only proprietary products or a specific asset class, the firm must explain those limitations.[98] Firms must also disclose whether there are any required minimums to open an account or place a trade, or if there is a tiered fee schedule.[99]

In the relationship and services section of the form, firms must also provide additional information that further explains the firms' services.[100] 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.[101] This section of the disclosure may be layered, providing hyperlinks or other ways of directing the investor to the source of the information.[102]

The relationship and services section will also contain three conversation starters.[103] 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?"[104] 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?"[105]

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?"[106]

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[96] *Id.*

[97] *Id.*

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

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

[100] *Id.*

[101] *Id.*

[102] *Id.*

[103] *Id.*

[104] *Id.*

[105] *Id.*

[106] *Id.*

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?"[107] 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.[108] Additionally, firms must describe other fees and costs associated with their services or investments, whether paid directly or indirectly.[109] The SEC provides some 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.[110]

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."[111]

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?"[112]

Following the fees and costs discussion, firms must discuss the standard of conduct that applies, using prescribed language.[113] Additionally, this section must include a summary of certain firm-level conflicts.[114]

The disclosure that a firm has 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

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

[108] *Id.*

[109] *Id.*

[110] *Id.*

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

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

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

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

> advice] we provide you. Here are some examples to help you understand what this means.[115]

Following the prescribed wording, a firm must summarize the following ways that the firm makes money that involve conflicts: (i) from proprietary products; (ii) from third-party payments; (iii) by revenue sharing; and (iv) by principal trading.[116] If the firm does not have any of these conflicts, it must describe one material conflict of interest that will affect retail investors.[117]

In this section, firms must include the following conversation starter: "How might your conflicts of interest affect me, and how will you address them?"[118] 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.[119]

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.[120] 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.[121] 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.[122]

This section must also include the following conversation starter: "As a financial professional, do you have any disciplinary history? For what type of conduct?"[123]

v. Additional Information

The final section of the relationship summary will state where the investor can find additional information.[124] This section will also include the following conversation starters: "Who is my

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

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

[117] *Id.*

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

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

[120] *Id.*

[121] *Id.* at 33,537 – 33,538.

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

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

[124] *Id.*

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?"[125] 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.[126]

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.[127] Additionally, firms must make the forms available on their own websites.[128]

Firms may deliver the relationship summary electronically, so long as the firm complies with the SEC's rules regarding electronic delivery.[129] 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.[130]

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.[131] Investment advisers must deliver the relationship summary before or at the time of entering into an investment advisory contract with an investor.[132]

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.[133] This last item contemplates recommendations for investments such as direct-sold mutual funds or insurance products.[134]

Finally, firms must update the relationship summary within 30 days whenever the relationship summary becomes materially inaccurate.[135] At that time, the revised relationship summary must

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

[126] *Id.*

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

[128] *Id.*

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

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

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

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

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

[134] *Id.*

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

be filed with the SEC and posted to the firm's website.[136] Firms will have 60 days to deliver the revised relationship summary to existing clients.[137] When delivering the revised relationship summary, firms must highlight any changes by either marking the revised text or including a summary of the changes.[138]

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.[139] The SEC recognized that the investment adviser's fiduciary duty follows the contours of the relationship with the client.[140] 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.[141] The specific duties that an investment adviser owes to a client will depend on the services that the adviser has agreed to perform for the client.[142] However, an investment adviser cannot have a client waive the fiduciary duty.[143]

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.[144]

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.[145] 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.[146] Further, the investment adviser must

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[136] *Id.*

[137] *Id.*

[138] *Id.*

[139] 84 Fed. Reg. 33,669.

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

[141] *Id.*

[142] *Id.*

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

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

[145] *Id.*

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

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.[147]

Next, the investment adviser must conduct a reasonable investigation into the investment being recommended.[148] 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, time horizon, and cost of exit.[149] This duty applies to advice about investment strategy, engaging a sub-adviser, and account type.[150] 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.[151]

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.[152]

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.[153] However, if the investment adviser has been engaged for a limited duration, the investment adviser is unlikely to have a duty to monitor.[154]

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.[155] As part of this duty, the investment adviser must make full and fair disclosure of any material facts relating to the advisory relationship.[156]

Additionally, the investment adviser must eliminate or at least expose through full and fair disclosure all conflict of interest that might incline an adviser to render advice that is not disinterested.[157] For disclosure to be full and fair, the disclosure must be specific enough so that

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[147] *Id.*

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

[149] *Id.*

[150] *Id.*

[151] *Id.*

[152] *Id.*

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

[154] *Id.*

[155] *Id.*

[156] *Id.*

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

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.[158]

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.[159] 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.

Investment advisers do not have to determine whether the client actually understood the disclosure that was made.[160] The investment adviser merely has to put the client into the position to be able to understand the disclosure.[161] 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.[162]

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.[163]

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."[164] 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."[165] However, discretion that is limited in scope would not necessarily turn a brokerage firm into an investment adviser.[166]

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

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[158] *Id.*

[159] *Id.*

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

[161] *Id.*

[162] *Id.*

[163] *Id.*

[164] 84 Fed. Reg. 33,681.

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

[166] *Id.*

securities transactions.[167] It would not turn the brokerage relationship into an advisory relationship.

V. FINRA Changes and Guidance

On June 19, 2020, FINRA issued Regulatory Notice 20-18, "Reg BI-Related Changes to FINRA Rules."[168] FINRA has explained that FINRA Rule 2111 (the "Suitability Rule") will not apply to recommendations subject to Regulation Best Interest.[169] FINRA also explained that there remained certain recommendations to which Regulation Best Interest would not apply.[170] For example, Regulation Best Interest only applies to recommendations to retail customers seeking advice for personal, family, or household purposes. Accordingly, the Suitability Rule would continue to apply to recommendations to entities and institutions, such as pension funds.[171] The Suitability Rule will also apply to recommendations made to natural persons who will not be using the investment recommendation for personal, family, or household purposes, such as small business owners or charitable trusts.[172] In those instances when the Suitability Rule would apply, FINRA has modified the quantitative suitability component to remove the control element, thereby making it consistent with Regulation Best Interest.[173]

Finally, certain FINRA rules restrict, but permit, the payment and receipt of non-cash compensation in connection with the sale and distribution of certain types of securities, including direct participation programs, variable insurance contracts, and investment company securities.[174] As discussed above, Regulation Best Interest requires firms to eliminate non-cash compensation that is based on the sales of specific securities or specific types of securities within a limited time. Accordingly, to the extent the referenced FINRA rules permit non-cash compensation, FINRA makes it clear that such compensation must be consistent with the requirements of Regulation Best Interest.[175] The changes set forth in the Regulatory Notice were effective on June 30, 2020, the same date Regulation Best Interest became effective.

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

[168] FINRA Regulatory Notice 20-18, "Reg BI-Related Changes to FINRA Rules" (June 19, 2020) ("Reg. Notice 20-18"), available at https://www.finra.org/sites/default/files/2020-06/Regulatory-Notice-20-18.pdf.

[169] *Id.* at 2. *See also* FINRA Rule 2111.08.

[170] Reg. Notice 20-18 at 2.

[171] *Id.* at note 3.

[172] *Id.*

[173] *Id.* at 2. *See also* FINRA Rule 2111.05(c).

[174] *See* FINRA Rules 2310, 2320, 2341, and 5110.

[175] Reg. Notice 20-18 at 2. *See also* FINRA Rules 2310(c)(2), 2320(g)(4), 2341(l)(5), 5110(h)(2).

HAVE NO FEAR, REG BI IS FINALLY HERE

Sandra D. Grannum[1] and Edward J. Scarillo

All things come to those that wait . . . even Regulation Best Interest (colloquially known as 'Reg BI'). In what now feels like a lifetime since the SEC adopted it (believe it or not it was only adopted on June 5, 2019) Reg BI has now passed its compliance date of June 30, 2020. This article aims to provide a brief overview of Reg BI and decipher its implications for brokers and broker-dealers. It will also provide an overview of a recent Risk Alert the SEC's Office of Compliance Inspections and Examinations (OCIE) drafted, and examine the SEC's and FINRA's review of Reg BI compliance.

The Question you Might Have Been Afraid to Ask: So, what is Reg BI?

Reg BI is the SEC's new standard of care for broker-dealers. It displaces the suitability standard and governs investment recommendations broker-dealers and their registered representatives make to retail customers. Namely, the broker-dealer must act in the best interest of the retail customer, without placing his or her financial interests ahead of the customer.

That Sounds Amorphous…

Like any general standard, it certainly does. Luckily, the SEC has provided some guidance. There are four general obligations a broker-dealer must satisfy to meet Reg BI's requirements: (1) the disclosure obligation; (2) the care obligation; (3) the conflict of interest obligation; and (4) the compliance obligation.[2] The broker-dealer must also comply with new record-making and record-keeping requirements.

Sunlight is the Best Disinfectant: The Disclosure Obligation The broker must—prior to the, or at the time of the recommendation—provide a written disclosure of: (a) all material facts relating to the scope and terms of his or her relationship with the customer; and (b) all material facts concerning conflicts of interest relating to their recommendation.
Let's Break that Down.

"Scope and Terms of Relationship"

A proper disclosure should include: (a) all material fees and costs; (b) the type and scope of services to provide, including any material limitations; (c) a general basis for any recommendations; (d) risks concerning the recommendation; (e) whether there are any special

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[2] https://www.sec.gov/info/smallbus/secg/form-crs-relationship-summary. As it must, this article draws extensively from the SEC's guidance.

account requirements (i.e. a minimum account balance); and (f) any other unique material facts associated with that particular customer's investment.

"Conflicts of Interest"

A conflict of interest is "an interest that might incline a broker, dealer, or a natural person who is an associated person of a broker or dealer—consciously or unconsciously—to make a recommendation that is not disinterested.[3]" Conflicts of interest include receiving payments from third parties. Brokers should actively examine their individual situations to make such a determination.

Care Obligation A broker needs to utilize reasonable diligence, care, and skill when making a recommendation. The care requirement has three essential features, as outlined below. As is evident, none of these features are particularly groundbreaking, and it is likely that most brokers already consider them.

1. Understand Potential Risks, Rewards and Costs Associated with Recommendation

Among other things, the broker must consider the investment strategy's objectives, characteristics, liquidity, volatility, likely performance, and expected return.

2. Have a reasonable basis to believe the recommendation is in the customer's best interest based on their investment profile and the potential risks, rewards, and costs

The broker must consider the customer's investment profile, which includes a litany of considerations. Age, other investments, liquidity needs, tax status, risk tolerance, experience, investment experience, time horizon, should all be considered. This standard seems familiar because it is similar to FINRA's present Customer Suitability Rule.[4]

3 Have a reasonable basis to believe that a series of recommended transactions, is not excessive

While this rule appears similar to the existing FINRA Quantitative Suitability Rule[5] it differs because it does not require a broker to have "actual or *de facto* control over a customer's account" at issue. To satisfy this, brokers should consider the particular recommended trade in light of other trades the customer has been making. The recommendation cannot be viewed in isolation. This is especially true if a broker is recommending a riskier product. The idea here is that brokers should—but not only—view the recommended product within the series of proposed investments. In other words, the broker should examine each investment in isolation and also as a whole.

[3] *Id*.

[4] *See* FINRA Rules 2111 Supplemental Material .05 which can be found at www.finra.org/rules-guidance/rulebooks/finra-rules/2111#the-ruleand FINRA Rules & Guideline: Key Topics which can be found at www.finra.org/rules-guidance/key-topics/suitability

[5] *Id.*

Conflict of Interest Obligation

A broker-dealer must create and enforce a series of written policies to address conflicts of interest. This is *solely* the responsibility of the broker-dealer. To this end, the written policies must: (i) identify and disclose all conflicts of interest; (ii) identify and mitigate conflicts of interest where a broker-dealer has incentive to place its interest before the client; (iii) identify any material limitations a broker-dealer has, such as if they only offer a limited products menu; (iv) identify and eliminate certain sales practices—like quotas or bonuses—that are predicated on a broker's sale of specific securities.

There are a number of pitfalls that a broker-dealer should avoid. These include setting compensation thresholds that "disproportionately increase compensation through incremental increases in sales" and "minimizing compensation incentives for employees to favor one type of account over.[6]" The broker-dealer should also consider limiting the types of customers to whom a specific type of product is sold. Similarly, the broker-dealer might prefer to limit the number of brokers who sell certain types of products. While the broker-dealer is responsible for written supervisory procedures and the enforcement of those procedures, the broker is responsible for managing his personal conflicts of interest. Therefore, a broker-dealer could consider penalizing brokers who fail to properly manage conflicts of interest.

Compliance Obligation

Broker-dealers must keep and enforce written policies and procedures to comply with Reg BI as a whole. Like the conflict of interest obligation, this requirement only applies to broker-dealers. The SEC has been vague on exactly what is required, but firms should consider creating policies that "prevent violations from occurring, detect violations that have occurred, and correct promptly any violations that have occurred.[7]" As part of this obligation, firms should develop controls, training, and periodic review of the effectiveness of its policies.

Record-Making and Recordkeeping

Firms must also develop certain new (if not already in place) record practices. For example, firms must keep records of all customers to whom any securities recommendation is made. Firms would also have to keep a record of the individuals responsible for the account. These records need to be kept for at least six (6) years from the date (whichever is earliest) the account is closed, or information within the account is updated.

Don't Forget about Form CRS

Form Client Relationship Summary ("Form CRS") also has a scheduled compliance date of June 30th.[8] SEC registered investment advisers and broker-dealers will have to provide retail customers certain information about their firm. A firm's Form CRS must also be filed with the

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[6] *Id*.

[7] *Id*.

[8] *See* https://www.sec.gov/info/smallbus/secg/form-crs-relationship-summary

SEC. Form CRS must contain information about, among other things, its (a) relationship and services; (b) fees, costs, conflict and standard of conduct; (c) disciplinary history. Form CRS must be delivered to new clients and existing clients. Broker-dealers must file their initial relationship history with the SEC by no later than June 30, 2020.

Exam Time: The OCIE weighs in on Broker-Dealer's Compliance

On April 7, 2020, the OCIE issued a Risk Alert[9] providing guidance for the SEC's post June 30, 2020 examinations of firms' compliance with Reg BI. The Risk Alert advised that "OCIE is providing transparency into its plans regarding Regulation Best Interest examinations to empower broker-dealers to assess their level of preparedness as the compliance date nears." OCIE's alert and guidance aligns with Reg BI's four obligations. OCIE advised that it may assess specific disclosures regarding: (a) the capacity in which the recommendation is being made; (b) the material fees and costs that apply to transactions, holdings and accounts; and (c) material limitations on the securities or investment strategies.

OCIE specifically advised that it may review the following types of firm documents:

- Schedules of fees and charges assessed against retail customers and disclosures regarding such fees and charges, including disclosures regarding the fees and costs related to services and investments that retail customers will pay or incur directly and indirectly.
- The broker-dealer's compensation methods for registered personnel, including: (i) compensation associated with recommendations to retail customers; (ii) sources and types of compensation; and (iii) related conflicts of interest (e.g., conflicts associated with recommending proprietary products or with receiving payments for inclusion on a product menu).
- Disclosures related to monitoring of retail customers' accounts
- Disclosures on material limitations on accounts or services recommended to retail customers
- Lists of proprietary products sold to retail customers.

The OCIE also specifically addressed its efforts to assess compliance with the care obligation. Namely, the OCIE may review, among other things:

- Information collected from retail customers to develop their investment profiles;
- How the broker-dealer makes recommendations related to significant investment decisions and;
- The broker-dealer's process for having a reasonable basis to believe that the recommendations are in the best interest of the retail customer:
  - The factors the broker-dealer considers to assess the potential risks, rewards and costs of the recommendations in light of the retail customer's investment profile.
  - The broker-dealer's process for having a reasonable basis to believe that it does not place the financial or other interest of the broker-dealer ahead of the interest of the retail customer

Overall, OCIE stated that "[i]nitial examinations will focus on assessing whether firms have made a *good faith* effort to implement policies and procedures reasonably designed to comply with

[9] https://www.sec.gov/files/Risk%20Alert-%20Regulation%20Best%20Interest%20Exams.pdf

Regulation Best Interest, including the operational effectiveness of broker-dealers' policies and procedures.[10]" This "good faith" assessment is important and allows firms a reasonable explanation for any work impacted by the pandemic or perhaps other resource constraints to explain proactively to OCIE staff or in response to a finding or a significant deficiency.

So, what is the status of Reg BI?

On Friday, June 25, 2010, the Second Circuit Court of Appeals upheld Reg BI[11]. Living up to the quip that "marriages make strange bedfellows," challengers to Reg BI were investment advisers who were joined by several states attorneys' general. The investment advisers argued that Congress required the SEC to "harmonize" the investment adviser and broker-dealer regulatory regimes. The attorneys' general argued that Reg BI is contrary to law and exceeds the SEC's authority. The petitioners also articulated the view that Reg BI provides less protection than the suitability rule. The SEC countered by arguing that Dodd-Frank provided them with discretionary authority to develop its own set of standards and rules. In denying the challenge to Reg BI the Second Circuit held:

> Petitioners—an organization of investment advisers, an individual investment adviser, seven states, and the District of Columbia—now challenge Regulation Best Interest as unlawful under the Administrative Procedure Act ("APA"), 5 U.S.C. § 706(2). They argue that the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") requires the SEC to adopt a rule holding broker-dealers to the same fiduciary standard as investment advisers. But Section 913(f) of the Dodd-Frank Act grants the SEC broad rulemaking authority, and Regulation Best Interest clearly falls within the discretion granted to the SEC by Congress. Although Regulation Best Interest may not be the policy that Petitioners would have preferred, it is what the SEC chose after a reasoned and lawful rulemaking process.
>
> We thus hold that: (1) the individual investment-adviser petitioner has Article III standing to bring its petition for review, but the state petitioners do not; (2) Section 913(f) of the Dodd-Frank Act authorizes the SEC to promulgate Regulation Best Interest; and (3) Regulation Best Interest is not arbitrary and capricious under the APA. [Footnote omitted].[12]

The SEC's commissioner publically stated that he did intend to change the June 30th date. Nothing in the Second Circuit Court's opinion indicated a change would be necessary. And in fact, June 30th has come and gone and Reg BI enforcement date stayed firm.

In fact, true to its word, the SEC has begun examining for Reg BI compliance. It and FINRA are looking in to efforts made by Broker-Dealers to comply with Reg BI and are comparing what is

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[10] *Id*.

[11] *XY Planning Network, LLC, Ford Financial Solutions, LLC, State of New York, State of California, State of Connecticut, State of Delaware, State of Maine, District of Columbia, State of New Mexico And State of Oregon, v. United States Securities and Exchange Commission, Walter Clayton, In His Official Capacity As Chairman Of The United States Securities And Exchange Commission,* Case 19-2886, (argued June 2, 2020 and decided June 26, 2020). The Decision can be found at https://assets.documentcloud.org/documents/6958594/Xy-Main-Op.pdf

[12] *Id.*

being done today with what was historically done. They are reviewing written supervisory procedures and training programs and, of course, the disclosures made to the public. It is also likely over the next several months they will continue to look at compliance efforts and at efforts by Broker-Dealers to tweak their disclosure and training to better inform and service their clients.

REGULATION BEST INTEREST: FINRA AND SEC GUIDANCE

Cameron Michelson and Theodore Ryan[1]

On June 5, 2019, the SEC adopted Regulation Best Interest ("Reg BI"). The Regulation went into effect on June 30, 2020. As a result of the adoption of Reg BI, several FINRA rules were rendered superfluous. Accordingly, FINRA clarified how Reg BI impacted its rulebook and announced certain rule amendments. This article will discuss the changes and guidance announced by FINRA following the adoption of Reg BI. Additionally, the article will discuss the guidance the SEC has issued to help firms comply with their new obligations under Reg BI.

I. FINRA Guidance

a. FINRA Regulatory Notice 20-18

FINRA made several amendments to its existing rules in order to address any "potential inconsistencies" With Reg BI.[2] Before Reg BI went into effect, FINRA issued Regulatory Notice 20-18 on June 19, 2020, announcing amendments to several of its rules in response to Reg BI. FINRA amended FINRA Rule 2111 (Suitability), FINRA CAB Rule 211 (CAB Suitability), FINRA Rules 2310 (Direct Participation Programs), 2320 (Variable Contracts of an Insurance Company), 2341 (Investment Company Securities), and 5110 (Corporate Financing Rule – Underwriting Terms and Arrangements).[3] The SEC has already approved these changes which became effective on June 30, 2020, when Reg BI went into effect.

i. Suitability

Reg Notice 20-18 clarified a large potential inconsistency between FINRA Rule 2111 and Reg BI. FINRA Rule 2111 requires that a broker-dealer or associated person "have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the firm or associated person to ascertain the customer's investment profile."[4] The three main suitability obligations included in this rule are reasonable-basis, customer-specific and quantitative suitability.[5]

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[2] *Regulatory Notice 20-18: FINRA Amends Its Suitability, Non-Cash Compensation and Capital Acquisition Broker (CAB) Rules in Response to Regulation Best Interest*, FINRA (Jun, 19, 2020) https://www.finra.org/rules-guidance/notices/20-18.

[3] FINRA Rule 2111; FINRA CAB Rule 211; FINRA Rule 2310; FINRA Rule 2320; FINRA Rule 2341; FINRA Rule 5110.

[4] FINRA Rule 2111.

[5] *Id.*

However, Reg BI's Care Obligation, while addressing the "same conduct with respect to retail customers that is addressed by FINRA Rule 2111," does not employ a suitability standard.[6] Instead, Reg BI's Care Obligation employs a best interest standard. Without any changes this would mean that a broker-dealer would "be required to comply with both Reg BI and Rule 2111 regarding recommendations to retail customers."[7] FINRA did believe that in those situations compliance with Reg BI would result in compliance with FINRA Rule 2111. This is because compliance with the best interest standard under Reg BI by a broker-dealer would meet the suitability standard under FINRA Rule 2111.

As outlined in Reg Notice 20-18, FINRA made several amendments to its suitability rules. FINRA amended Rule 2111 to state "that it will not apply to recommendations subject to Reg BI."[8] FINRA did this in order to clarify which standard applies to "avoid unnecessary duplication."[9] Additionally, FINRA removed the element of control from the "quantitative suitability obligation" of FINRA Rule 2111 and conformed the CAB Rule 211 to the amendments made to FINRA Rule 2111.[10]

ii. Non-Cash Compensation

Another potential inconsistency between FINRA Rules and Reg BI that required clarification involved non-cash compensation. FINRA Rules 2310 (Direct Participation Programs), 2320 (Variable Contracts of an Insurance Company), 2341 (Investment Company Securities), and 5110 (Corporate Financing Rule – Underwriting Terms and Arrangements) all included provisions that restrict "the payment and receipt of non-cash compensation in connection with the sale and distribution of securities governed by those rules."[11]

To avoid potential inconsistencies FINRA amended the above rules to ensure that they "must also be consistent with the applicable requirements of Reg BI" regarding certain arrangements.[12] These arrangements include, as required in Reg BI's Conflict of Interest Obligation, that broker-dealers "establish, maintain, and enforce written policies and procedures reasonably designed to identify and eliminate any 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 period."[13]

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[6] *Regulatory Notice 20-18: FINRA Amends Its Suitability, Non-Cash Compensation and Capital Acquisition Broker (CAB) Rules in Response to Regulation Best Interest*, FINRA (Jun, 19, 2020) https://www.finra.org/rules-guidance/notices/20-18.

[7] *Id.*

[8] FINRA Rule 2111.

[9] *Regulatory Notice 20-18: FINRA Amends Its Suitability, Non-Cash Compensation and Capital Acquisition Broker (CAB) Rules in Response to Regulation Best Interest*, FINRA (Jun, 19, 2020) https://www.finra.org/rules-guidance/notices/20-18.

[10] FINRA Rule 2111; FINRA CAB Rule 211.

[11] FINRA Rule 2310; FINRA Rule 2320; FINRA Rule 2341; FINRA Rule 5110.

[12] FINRA Rules 2310(c)(2), 2320(g)(4), 2341(l) and 5110(h)(2).

[13] 17 CFR 240.15l-1(a)(2)(iii)(D).

b. FINRA FAQ about Advertising Regulations

FINRA has also further clarified whether a filing exclusion exists for improper use of the terms "advisor" and "adviser" in a retail communication filed with FINRA prior to the implementation of Reg BI.[14] Filing exclusions exist for non-material changes to previously filed retail communications. FINRA has stated that firms may revise the communication to remove such references without having to refile the new communication with FINRA. FINRA does not consider revisions such as these to be a material change.

II. SEC Guidance

The SEC has issued a number of frequently asked questions ("FAQs") related to both the components of Reg BI and the Form CRS. This section will summarize the FAQs for both.

a. SEC FAQs on Regulation Best Interest

i. Retail Customers

Reg BI applies to broker-dealers when it makes a recommendation to a retail customer about an investment strategy or a particular security. A customer's status as a retail customer is not determined by the individual's wealth or financial expertise. A broker-dealer must meet its Best Interest obligations to any retail customer, regardless of whether the customer is an accredited investor.[15] A retail customer must use the recommendation for Best Interest obligations to apply. The term "recommendation" is not limited to the specific advice to purchase a security or a specific portfolio of securities. A recommendation is used, when because of the recommendation by the broker-dealer the customer: "opens a brokerage account with the broker-dealer, regardless of whether the broker-dealer receives compensation"; "has an existing account with the broker-dealer and receives a recommendation from the broker-dealer, regardless of whether the broker-dealer receives or will receive compensation . . . as a result of that recommendation"; or "the broker-dealer receives or will receive compensation . . . as a result of the recommendation, even if that retail customer does not have an account at the firm."[16]

A broker-dealer will owe the retail customer a duty of Best Interest, even if the customer does not use the recommendation at the firm providing the recommendation.[17] If the customer uses the recommendation at the second firm without the input of that firm, Best Interest will not apply to that firm.[18] If the second firm discussed the possible purchase or sale with the client, and that

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[14] *Frequently Asked Question about Advertising Regulation, question C.2.7,* FINRA, https://www.finra.org/rules-guidance/guidance/faqs/advertising-regulation#c2 (last modified May, 20, 2020).

[15] *Frequently Asked Questions on Regulation Best Interest*, U.S. SEC. EXCH. COMM'N, https://www.sec.gov/tm/faq-regulation-best-interest (last modified Aug. 4, 2020).

[16] *Id.*

[17] *Id.*

[18] *Id.*

discussion met the definition of a recommendation, then the second firm will have to meet the Best Interest obligation.[19]

When making a recommendation for opening accounts, Reg BI applies to both general recommendations to open a certain type of account (brokerage account vs. advisory account) and more specific recommendations (education accounts vs. retirement accounts vs. specialty accounts). The type of account can make a material difference to the investment strategy determined by the associated person and the retail customer.[20]

A dually registered financial professional must determine which account is in the best interest of the retail customer between both advisory and brokerage accounts.[21] A recommendation to open a self-directed account will also be covered under Reg BI. While the associated person does not plan on providing any securities transaction advice, the recommendation to open the account must still meet their Best Interest obligations.[22] An associated person of a broker-dealer that is dually registered does not have to consider any advisory accounts when making an account recommendation if the associated person is not a supervised person of an investment advisor.[23] The associated person however needs to "have a reasonable basis to believe that the recommended account is in the best interest of the retail customer."[24]

A recommendation is determined by the content of the communication, "not on the location or setting of the communication."[25] A communication that "reasonably could be viewed as a 'call to action'" would more likely be considered a recommendation.[26] "The more individually tailored the communication to a specific customer or a targeted group of customers, the greater the likelihood that the communication may be viewed as a 'recommendation.'"[27] A simple conversation asking to talk later about working with the associated person would not be considered a recommendation. A communication that merely informs the client that the associated person is moving firms and would like to discuss the other firm's services at another time would also not be considered a recommendation.[28]

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[19] *Id.*

[20] *Id.*

[21] *Id.*

[22] *Id.*

[23] *Id.*

[24] *Id.*

[25] *Id.*

[26] *Id.*

[27] *Id.*

[28] *Id.*

ii. Disclosure Obligations

Normally all disclosures necessary to meet Best Interest obligations need to be made "prior to or at the time of the recommendation."[29] There are certain situations where a disclosure after the recommendation is made would still meet Best Interest obligations. Some situations include supplementing written disclosures orally when the information could not reasonably have been known at the time the disclosure was made.[30] Another potential situation is when regulations allow disclosures to be made after the recommendations, such as a prospectus being delivered.[31]

To document an updated disclosure, an associated person or firm must identify in writing the original disclosure and the means by which the disclosure was updated.[32] If a written disclosure is updated orally" prior to or at the time of the recommendation," the broker-dealer "must maintain a record of the fact that oral disclosure was provided to the retail customer."[33]

Best Interest Disclosure obligations are separate from disclosures made in the Relationship Summary (Form CRS). Whether or not the disclosures made in the Relationship Summary meet the Disclosure Obligation under Best Interest will "depend on the facts and circumstances."[34] Normally additional disclosures will be required that are not made through the Relationship Summary. Providing the Regulation BI disclosures through a hyperlink in the Relationship Summary will not meet the disclosure requirements.[35]

Firms can satisfy both Regulation BI and Form CRS disclosure requirements by electronic delivery.[36] To do so the firm must notify the client that "information is available electronically," the information must be equal to what would have been provided in paper, must not be "burdensome that the intended recipients cannot effectively access it," and must show that the information was actually delivered.[37] One difference between Form CRS and Reg BI Disclosure obligations is that a Relationship Summary can be delivered based on how the investor requested the information. Disclosures may be satisfied when translated into a different language as "long as the firm also delivers such disclosures in English at the same time."[38] The translated copy must: be an accurate translation; not make disclosures deceptive; and meet the rest of the Best Interest requirements.[39]

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[29] *Id.*

[30] *Id.*

[31] *Id.*

[32] *Id.*

[33] *Id.*

[34] *Id.*

[35] *Id.*

[36] *Id.*

[37] *Id.*

[38] *Id.*

[39] *Id.*

An associated person of a broker-dealer who is not a supervised person of a registered investment adviser presumptively violates the Disclosure Obligation when he/she use the terms "advisor" or "adviser" in his/her name or title.[40] The same presumption applies to a broker-dealer which is also not a registered investment advisor. A broker-dealer may also not use the terms "advisor" or "adviser" in a firm's "doing business name" or "marketing" name.[41] This does not prohibit a broker-dealer from using the term "advisor" or "adviser" when performing another role "defined by federal statute that does not entail providing investment advisory services to retail customers . . . ."[42]

A broker-dealer firm who is dually registered as an investment advisory firm can have its associated persons, but non-supervised persons distribute materials that describe employees generally as financial advisors. The associated person would have to disclose prior to the recommendation that he/she is an associated person and not a supervised person of an investment advisor to meet his/her Capacity Disclosure Obligation.[43] A broker-dealer firm who has associated persons that are also supervised persons with a separate investment advisor may not use materials that generally describe the broker-dealer's financial professionals as "advisors" or "advisers."[44]

iii. Care Obligation

Best Interest does not change how the term "series of transactions" has been determined. Whether or not a particular transaction is a part of a series of transactions would be determined based on the facts and circumstances of the customer.[45] Some factors that can be used to determine if a transaction is part of a series are "turnover rate[s], cost-to-equity ratio[s], and use of in-and-out trading . . . ."[46]

Another requirement under the Best Interests Care Obligation for dually registered financial professionals is to ensure that recommendations to transfer assets from a brokerage account to an advisory account or vice versa meet that obligation. The financial professional should consider the "risks, rewards, and costs associated with the transfer or rollover of the securities . . . ."[47] In situations where multiple accounts are necessary given the customer's need for different services, the transfer of assets from one account to another may be necessary to meet the customer's best interests.[48]

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[40] *Id.*

[41] *Id.*

[42] *Id.*

[43] *Id.*

[44] *Id.*

[45] *Id.*

[46] *Id.*

[47] *Id.*

[48] *Id.*

When making a recommendation to open an account with a potential customer, it is difficult to determine what capacity a dually registered financial professional is engaged in. Dually registered financial professionals are advised to "assume that both Regulation Best Interest and the Investment Advisers Act would apply, and the account recommendation generally should be evaluated under both Regulation Best Interest and the Investment Advisers Act."[49]

iv. Conflict of Interest Obligation

When eliminating conflicts of interest, the SEC has listed some specific conflicts that need to be removed. These include "sales contests, sales quotas, bonuses, and non-cash compensation, based on the sales of specific securities or types of security within a limited period of time."[50] Other possible conflicts, while not expressly prohibited, may violate Reg BI. These incentives may be allowed if the broker-dealer creates polices that are designed to disclose and mitigate the incentives.[51] These policies must reasonably identify possible conflicts and either disclose or eliminate the conflict that follows the recommendation.[52]

There are no specific policies that have been deemed presumptively compliant or mandatory. Each incentive will be different as will the types of mitigations and supervisory requirements necessary to properly deal with the conflict.[53] Some of the suggested policies that firms could implement include removing incentives for favoring specific securities; monitoring recommendations that involve products which have a higher compensation; preventing certain securities from being recommended to retail clients.[54] There are no specific policies that are mandated by Reg BI. Instead the polices should be designed in "proportionate to the scope, size and risks associated with the operations of the firm and types of business in which the firm engages."[55]

Forgivable loans are normally a conflict of interest. The SEC has stated that a forgivable loan based on performance goals would be a conflict of interest.

b. SEC FAQs on Form CRS

i. Scope of Form CRS Requirements

The SEC has stated that registered broker-dealers are not required to prepare or file a relationship summary if they do not have any retail investors to whom they must deliver a relationship summary to.

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[49] *Id.*

[50] *Id.*

[51] *Id.*

[52] *Id.*

[53] *Id.*

[54] *Id.*

[55] *Id.*

ii. Retail Investor

For the purposes of the definition of retail investor, only non-professional, non-regulated, legal representatives are covered under the term "legal representatives." [56] This includes non-professional trustees that represent the assets of natural persons and similar representatives such as "executors, conservators, and persons holding a power of attorney for a natural person."[57] This is true even if there is another person who is a trustee or managing agent of the trust. Except in limited circumstances, such as where the plan representative is a sole proprietor or other self-employed individual who will participate in the plan, workplace retirement plan representatives are not considered a non-professional legal representative.

Legal representatives who are regulated financial services industry professionals are not covered under the definition of retail investor. This includes "registered investment advisers and broker-dealers, corporate fiduciaries and insurance companies, and the employees or other regulated representatives of such advisers, broker-dealers, corporate fiduciaries and insurance companies."[58] However, for those legal representatives who are now former regulated financial services industry professionals they would be considered a non-professional legal representative under the definition of retail investor.

iii. Relationship Summary Format

Broker-dealers or investment advisors must only prepare one relationship summary summarizing all of the principal relationships and services it offers to retail investors. This would mean that brokers and investment advisors would have to describe all of the firm's different services on a single relationship summary. A firm that is dually registered can prepare a single relationship summary that addresses both the broker and investment advisory services.

When it comes to specific wording required in Form CRS there are limited circumstances where the firm can modify or omit a required disclosure or conversation starter. This includes situations where "(i) it is inapplicable to [the firm's] business; or (ii) the specific wording required by the Instructions is inaccurate."[59]

However, for the most part the firm needs to "respond to each item, . . provide responses in the same order as [it] appears [on] the Instructions, and [] may not include disclosures in the relationship summary other than [those] required or permitted under the Instructions. . . ." All of the information included must be true and firms mat not omit any material facts "necessary in order to make the required disclosures not misleading in light of the circumstances under which they were made."[60]

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[56] *Frequently Asked Questions on Form CRS*, U.S. SEC. EXCH. COMM'N, https://www.sec.gov/investment/form-crs-faq (last modified Jun. 29, 2020).

[57] *Id.*

[58] *Id.*

[59] *Id.*

[60] *Id.*

iv. Filing Requirements

Investment advisers must file Form ADV, Part 3 electronically through IARD in order to file their firm's relationship summary. That relationship summary will be publicly disseminated through the Investment Adviser Public Database ("IAPD"). Broker-dealers must file Form CRS electronically with FINRA. That relationship summary will be publicly disseminated through BrokerCheck.

However, dual registrants as defined under General Instruction 11 to Form CRS, must file their relationship summaries as Form ADV, Part 3 (Relationship Summary) through IARD. Both the broker-dealer and investment advisor relationship summary's must be included in one PDF file, although they can be included as separate relationship summaries or combined. If a dual registrant attempts to file with FINRA, the registrant will be automatically routed to IARD to file Form ADV, Part 3.

Further, a firm registered with the SEC as both a broker-dealer and an investment adviser can continue to file as a broker dealer with FINRA if their investment adviser has no clients that are retail investors. Dual registrants filing through IARD will satisfy their obligation to file with FINRA and IARD, and their relationship summaries will appear with both FINRA and in the IARD, which will be publicly disseminated through both BrokerCheck and IAPD.

Regarding a combined relationship summary prepared by a firm and its affiliate, the firm cannot file on behalf of both the firm and its affiliate. The firm will file its relationship summary and will check a box to indicate whether it includes "affiliate information."[61] The affiliated firms must separately file the combined relationship summary using its own login credentials in order to meet its filing obligations.

v. Delivery Requirements

According to the SEC, firms may deliver their relationship summary to new or existing retail investors in advance of the compliance date for Form CRS. If delivered in advance the firm should "(i) post the relationship summary on the firm's public website as described in General Instruction 10 to Form CRS; (ii) comply with the updating and related delivery requirements of General Instructions 8 and 9 to Form CRS; and (iii) file its relationship summary with the SEC."[62]

Further, all information included in the relationship summaries must be true and "may not omit any material facts necessary in order to make the disclosures, in light of the circumstances under which they were made, not misleading."[63] This is true for dually registered or affiliated firms who file a relationship summary that includes both advisory and brokerage businesses.

Additionally, firms can satisfy their relationship summary delivery requirement regarding retail investors when they include the relationship summary as a part of the delivery of any information the firm already provides, such as quarterly account statements.

If the relationship summary is delivered in a paper format as part of a package of documents, it must be the first among any documents that are delivered. If delivered electronically, the

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[61] *Id.*

[62] *Id.*

[63] *Id.*

relationship summary must be "presented prominently in the electronic medium" and easily accessible, such as a "direct link or in the body of an email."[64]

When it comes to pooled investment vehicles, such as hedge funds, venture capital funds, and private equity funds, the SEC has stated that these "types of pooled investment vehicles . . . would not meet the definition of a retail investor and a relationship summary would not be required to be delivered.[65]

If engaged in communications that "rise to the level of a recommendation" with a retail investor, the recommendation "triggers the delivery obligation under Form CRS."[66] Relationship summaries must be delivered to each retail investor "before or at the earliest of: (i) a recommendation of an account type, a securities transaction, or an investment strategy involving securities; (ii) placing an order for the retail investor; or (iii) the opening of a brokerage account for the retail investor."[67] The SEC has also stated that "recommendation" would be "interpreted consistently with how the Commission interprets that term in Regulation Best Interest."[68]

Additionally, in a scenario where one firm ("Firm A") provides investment advisory services to another firm's ("Firm B") retail investor clients, the SEC has stated that Firm A would not be required to deliver a relationship summary to Firm B's retail investor clients.

In a scenario where financial professionals work for two non-affiliated firms, one an investment advisor firm ("Firm A") and one a broker-dealer firm ("Firm B"), and are dually licensed as an investment advisor with Firm A and as a registered representative with Firm B, the SEC states that a firm should "evaluate the nature of its relationships with retail investors to determine its distinct delivery obligations."[69] Each firm should deliver a relationship summary to retail investors if a dually licensed financial professional offers services to retail investors through both firms.

vi. Additional Delivery Requirements to Existing Clients and Customers

The SEC determined that a firm that only amends an existing account agreement to add another account holder or beneficiary is not required to deliver another relationship summary.

In a situation where a retail customer of a dually registered firm elects to convert an investment advisory account to a brokerage account or vice versa, the firm must deliver a new relationship summary even if the account does not have a different name or account number.

The SEC has stated that under General Instruction 9.A.(iii) of Form CRS, the delivery requirement for an existing customer "applies to a new type of brokerage or investment advisory service that relates to a customer's or client's investment options or capabilities, without regard to whether the

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[64] *Id.*

[65] *Id.*

[66] *Id.*

[67] *Id.*

[68] *Id.*

[69] *Id.*

services are offered in an existing account."[70] This includes "the initial recommendation or provision of margin capability, options eligibility, account monitoring, or discretionary trading."[71] However, "the recommendation or provision of account features such as automatic bill pay, check writing privileges, or technological features, such as offering a chat feature or mobile application," are not considered "new brokerage or investment advisory service[s]" under General Instruction 9.A.(iii)" by the SEC as "they do not relate to the customer's or client's investment options or capabilities."[72]

The SEC also states that under General Instruction 9.A.(iii) of Form CRS, a first-time recommendation to invest in a private placement, structured product or other investment would trigger the delivery obligation if such investment is to be held outside an existing account.

Further, under General Instruction 9.A of Form CRS, if a firm has delivered a relationship summary to a retail investor, and within 30 days delivery is triggered again, the firm does not have to deliver another relationship summary to that retail investor. The firm must still adhere to General Instruction 8 of Form CRS and its relationship summary updating requirements and, upon request, must deliver a relationship summary within 30 days.

vii. State-Registered Investment Adviser Switching to SEC Registration

Firms that will be transitioning from a non-SEC registered investment adviser (such as a state-registered investment adviser) with retail investor clients to SEC registration after June 30, 2020 will not be required to deliver relationship summaries to existing retail investor clients while their application is pending. The SEC has stated that these firm's must deliver their relationship summary to existing retail investor clients within 30 days after the effective date of the order granting its SEC registration.

viii. Affiliate Services

The SEC has stated that under General Instruction 5 of Form CRS, "if you are an investment adviser or broker-dealer and your affiliate also provides investment advisory or brokerage services to retail investors, you may prepare a single relationship summary discussing the services you and your affiliate provide.[73] This instruction is not limited to investment advisers with a broker-dealer affiliate or broker-dealers with an investment adviser affiliate. Accordingly, an investment adviser may prepare a joint Form CRS with an investment adviser affiliate and a broker-dealer may prepare a joint Form CRS with a broker-dealer affiliate."

Additionally, firms may either "include multiple affiliates in a single combined relationship summary" or "prepare separate relationship summaries for their services and their affiliates' services."[74] This combined relationship summary must still comply with the four-page limit without

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[70] *Id.*

[71] *Id.*

[72] *Id.*

[73] *Id.*

[74] *Id.*

"compromising the relationship summary's accuracy, clarity, usability, and design."[75] Firms should also be aware that additional information from multiple affiliates could "obscure or impede understanding of the information that must be included in the relationship summary."[76] Firms must still follow the requirements to "present brokerage and investment advisory information with equal prominence and in a manner that clearly distinguishes and facilitates comparison of the two types of services."[77]

ix. Qualified Custodians

The SEC has stated that "a registered broker-dealer providing services solely as a 'qualified custodian' pursuant to Rule 206(4)-2 under the Advisers Act for a retail investor client of a registered investment adviser does not prepare, file or deliver its own relationship summary when acting solely in such capacity."[78]

x. Qualified Custodians, Clearing or Carrying Broker-Dealers - Introduced Accounts of Registered Investment Advisers' Clients

The SEC has stated that a registered broker-dealer who "provides services to retail investor clients of a registered investment adviser solely by: (i) opening brokerage accounts for such retail investors; (ii) introducing those retail investors to such qualified custodian, or clearing or carrying broker-dealer; and (iii) as instructed by the investment adviser, transmitting orders to buy and sell securities for those retail investor clients to such qualified custodian, or clearing or carrying broker-dealer," does not have to prepare, file, or deliver its own relationship summary, when acting solely in such capacity.[79] However, the obligations of Form CRS may apply if that broker-dealer interacts with retail investors in a different capacity, such as making "a recommendation of an account type, securities transaction or investment strategy involving securities, the retail investor places an order directly with the broker-dealer, or the retail investor opens a separate brokerage account with the broker-dealer."[80]

xi. Principal Underwriters — Orphaned, Abandoned Accounts

The SEC decided that it does not consider "a principal underwriter to whom a retail investor's 'orphaned' or 'abandoned' securities are transferred, and/or who becomes the default 'broker of record' on the books of the mutual fund issuer or insurance company with respect to such 'orphaned' or 'abandoned' securities to be offering services to such retail investor for purposes of Exchange Act Rule 17a-14 when acting solely in such capacity."[81] Form CRS obligations may

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[75] *Id.*

[76] *Id.*

[77] *Id.*

[78] *Id.*

[79] *Id.*

[80] *Id.*

[81] *Id.*

apply depending on the "extent such a broker-dealer interacts with such a retail investor in a different capacity."[82]

xii. Presentation and Delivery for Affiliates

In a situation where, an investment adviser ("Firm A") is affiliated with a broker-dealer ("Firm B"), where both firms offer services to retail investors but are not dual registrants, with dually licensed financial professionals associated with both firms[83], Firm A and Firm B can prepare a single relationship summary, not to exceed 4 pages, under General Instruction 5 of Form CRS that discusses the brokerage and investment advisory services the two affiliates provide. Both firms are still required to deliver the combined relationship summary they prepare, "whether or not all of their financial professionals are dually licensed with Firm A and Firm B."[84]

Additionally, affiliated firms can choose to prepare separate relationship summaries or prepare a single combined relationship summary. However, the firms cannot do both. "[E]ach broker-dealer or investment adviser can only prepare one relationship summary summarizing all of the principal relationships and services it offers to retail investors."[85]

xiii. Delivery — Cover Sheet, Wrap Fee Program Sponsors' Relationship Summaries

The SEC has stated that in situations where the "sponsor is delivering participating advisers' relationship summaries to clients of the wrap fee program that are clients of the participating adviser(s)," the sponsor can include a brief cover sheet that explains "why the retail investor is receiving multiple relationship summaries of the sponsor and the participating advisers in the wrap fee program."[86] If delivered in paper format, the "sponsor may provide the cover sheet on top of the relationship summaries, which must be the first among any other documents in a package that are delivered at that time consistent with Instruction 10.D. to Form CRS."[87] If delivered via electronic delivery, "the cover sheet may be delivered in the same electronic medium so long as the relationship summary is still presented in a prominent manner that is consistent with Instruction 10.C. to Form CRS."[88] The cover sheet may not obscure or impede the "understanding of the information that must be included in the relationship summary."[89] Additionally, while the cover sheet does not count towards the page limitation of the sponsor's or any participating

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[82] *Id.*

[83] *Id.* (Meaning that they are licensed both as investment adviser representatives with Firm A and as registered representatives with Firm B, other financial professionals are only licensed as investment adviser representatives with Firm A or only as registered representatives with Firm B).

[84] *Id.*

[85] *Id.*

[86] *Id.*

[87] *Id.*

[88] *Id.*

[89] *Id.*

adviser's relationship summary, it must not circumvent any page limitation or be used to satisfy any of the requirements of the relationship summary.

xiv. Amendments to the Relationship Summary

Under General Instruction 8.A. to Form CRS, firms are required to update their relationship summary within 30 days "whenever any information in the relationship summary becomes materially inaccurate."[90] In a situation where a firm offers advisory accounts managed by a subadvisor, if the subadvisor changes and there are no other changes to the advisory contract or to any of the firm's services this may result in the relationship summary becoming "materially inaccurate."[91] While certain subadvisor changes "may result in the relationship summary of the investment adviser becoming materially inaccurate," in situations where an advisor replaces the subadvisor and there are no other changes, such as "advisory agreement, services, investments, or conflicts of interest," that would make the information in the advisor's relationship summary materially inaccurate the firm does not have to amend its relationship summary.[92]

xv. Disciplinary History

In a situation where a firm reports disciplinary history related to its parent company in response to Item 11 on the firm's Form ADV and Items 11A-K on the firm's Form BD, that firm does need to reply "yes" to Item 4 ("The disciplinary history question") in Form CRS even though the reported event involved the parent company and not the firm.[93] Both Form ADV and Form BD require reporting for a parent company.

xvi. Fair Disclosure

When it comes to firms who communicate with retail investors in a different language other than English, they must send two versions of the relationship summary. While one version is in the language of choice that the firm and retail investor communicate in, the other version must be in English. The translated version of the relationship summary "(i) should be a complete, fair, and accurate translation of the English relationship summary; (ii) should not make any of the terms used in the relationship summary misleading; and (iii) would not count towards the applicable page limit.[94] Firms should also not translate the term "U.S. Securities and Exchange Commission."[95]

xvii. Recordkeeping and Recordmaking

Under Rule 17a-3(a)(24) broker-dealers are required to make a record of the date that each Form CRS was provided to each retail investor, including those provided prior to the retail investor

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[90] *Id.*

[91] *Id.*

[92] *Id.*

[93] *Id.*

[94] *Id.*

[95] *Id.*

opening an account.[96] This includes prospective customers who ultimately do not open an account.

Additionally, under Rule 17a-4(e)(10), "firms must maintain all records made pursuant to Rule 17a-3(a)(24)," including a copy of each Form CRS, for a period of six years after such record or Form CRS is created.[97] Similarly, these record keeping requirements for both rules include the retention of records for retail investors who do not end up opening accounts.

However, Investment Advisors have different obligations when it comes to prospective clients. Under Rule 204-2(a)(14)(i) under the Advisers Act, "advisers are required to make and keep a record of the dates that each Form CRS, and each amendment or revision thereto, was given to any client or any prospective client who then becomes a client."[98]

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[96] *Id.*

[97] *Id.*

[98] *Id.*

PROTECTING SENIORS AND VULNERABLE ADULTS FROM FINANCIAL EXPLOITATION: FEDERAL, STATE AND FINRA REGULATORY APPROACHES

Teresa J. Verges*

I. The Pervasive and Growing Problem of Senior Financial Exploitation

The SEC's Office of the Investor Advocate recently described the financial exploitation of seniors in the United States as "'a burgeoning public health crisis' and 'a virtual epidemic.'"[1] This crisis is projected to worsen as our population grows older.[2] Persons aged 65 and older represent the fastest growing segment of the U.S. population.[3] Between 2012 and 2050, the population of those aged 65 and over is expected to reach 83.7 million.[4] This exploding demographic is particularly vulnerable to fraud and abuse at a time in their lives when they cannot meaningfully add to their retirement savings.

A 2011 MetLife study reported a $2.9 billion annual loss by victims of elder financial abuse.[5] But actual losses may be significantly higher because financial fraud is often underreported. For example, according to a study conducted by the FINRA Investor Education Foundation, although 11% of survey respondents reported losing money in a likely fraudulent activity, only 4% actually

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[1] *See* Stephen Deane, U.S. SEC. & EXCH. COMM'N OFFICE OF THE INV'R ADVOCATE, ELDER FINANCIAL EXPLOITATION (June 2018), https://www.sec.gov/files/elder-financial-exploitation.pdf. [hereinafter "SEC Investor Advocate Report].

[2] *Id.*, at i. In addition to the demographic trend of an aging population, the SEC Investor Advocate Report identified financial and retirement trends, and the health related effects of aging, as additional interrelated factors responsible for the growing crisis. *Id.*

[3] Carrie A. Werner, *The Older Population: 2010*, U.S. Census Bureau, P1 U.S. Government Printing Office, Washington, DC (2010). Between 2000 and 2010, the population of persons aged 65 and over grew at over 15%, faster than the 9.7% growth of the overall U.S. population. *Id.* Approximately 10,000 people will turn age 65 every day for the next 15 years. SEC Press Release: *SEC Staff and FINRA Issue Report on National Senior Investor Initiative* (April 15, 2015). *See also* SEC OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS AND FINRA REPORT ON NATIONAL SENIOR INVESTOR INITIATIVE (April 15, 2015) (hereinafter, "SEC/FINRA National Senior Investor Report"), at 3 (citing ADMINISTRATION ON AGING ADMINISTRATION FOR COMMUNITY LIVING, U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES, A PROFILE OF OLDER AMERICANS: 2012, page 1 (2012), *available at:* http://www.aoa.gov/Aging_Statistics/Profile/2012/docs/2012profile.pdf).

[4] Jennifer M. Ortman et al., U.S. CENSUS BUREAU, AN AGING NATION 1 (2014) U.S. CENSUS BUREAU https://www.census.gov/prod/2014pubs/p25-1140.pdf [hereinafter "U.S. CENSUS BUREAU"]. This considerable growth is due to the aging of the baby boomer generation (those born between 1946 and 1964), who began turning 65 in 2011. *Id.*

[5] METLIFE, THE METLIFE STUDY OF ELDER FINANCIAL ABUSE 2, (2011), https://www.evawintl.org/Library/DocumentLibraryHandler.ashx?id=1172.

admitted to being a victim of fraud.[6] A TIAA Institute study found that as many as 8% of the survey respondents had been a victim of at least one fraudulent activity.[7] In another study, 5% of survey respondents reported they had been the victim of a fraudulent investment in the past five years.[8] These figures illustrate a problem affecting a significant portion of the population that is expected to worsen absent remedial measures.

Older Americans are particularly vulnerable to financial exploitation because they are typically at the peak of their wealth accumulation phase. Indeed, persons over 65 hold 70% of the nation's wealth.[9] Yet as retirees begin to tap into their retirement savings, many will lack the ability to manage their investments, or even their financial affairs generally for a number of reasons. First, many individuals (regardless of age) do not have the training or specialized knowledge to make sound decisions about investments and appropriate withdrawal rates, among other issues.[10] As

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[6] APPLIED RESEARCH & CONSULTING LLC, FINANCIAL FRAUD AND FRAUD SUSCEPTIBILITY IN THE UNITED STATES 3,(2013), https://www.finrafoundation.org/sites/finrafoundation/files/Financial-Fraud-And-Fraud-Susceptibility-In-The-United-States_0_0_0.pdf [hereinafter FINRA FINANCIAL FRAUD STUDY]. Approximately a quarter of the survey respondents reported that they may have been asked to invest in a fraudulent investment and at least 16% reported investing money in a likely fraudulent offering. *Id.* at 18, 20.

[7] MARGUERITE DELIEMA ET AL., TIAA INST., CAUSES AND CONSEQUENCES OF FINANCIAL MISMANAGEMENT AT OLDER AGES 3 (2018), https://gflec.org/wp-content/uploads/2018/04/TIAA_Instituteauses_and_Consequences_TI_Mitchell_April-2018.pdf?x22667.

[8] Marguerite DeLiema et al., *Financial Fraud among Older Adults: Evidence and Implications*, J. GERONTOLOGY: SERIES B, Dec. 2018, at 8.

[9] Note, *The Not-So-Golden Years: Power of Attorney, Elder Abuse, and Why Our Laws Are Failing a Vulnerable Population*, 82 St. John's L. Rev. 289, 290 (2008)(citing Jane Gross, *New Techniques Used to Fight Elder Abuse*, Pittsburgh Post-Gazette, Oct. 1, 2006, at A7).

The Baby Boomer generation has made dramatic economic gains in the last quarter century. SEC OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS & FINRA, NATIONAL SENIOR INVESTOR INITIATIVE 3 (2015) https://www.sec.gov/ocie/reportspubs/sec-finra-national-senior-investor-initiative-report.pdf. [hereinafter, SEC/FINRA NATIONAL SENIOR INVESTOR REPORT]. Although housing has been a significant driver of the increased wealth over the past quarter century the market's performance has also contributed to these economic gains: "The Dow Jones Industrial Average increased from 2,031 points on May 31, 1988 to 16,717 points on May 30, 2014, a gain of nearly 723%." *Id.*

[10] Lawrence A. Frolik, *Protecting Our Aging Retirees: Converting 401(k) Accounts into Federally Guaranteed Lifetime Annuities*, 47 San Diego L. Rev. 277, 278 (Spring 2010). One study determined that many of the survey respondents lacked an understanding of basic investment terms, including what would be a reasonable return on an investment. FINRA FINANCIAL FRAUD STUDY, *supra* note 6, at 3. The study asked survey respondents how much risk they were willing to take to meet their retirement needs; more than half of the survey respondents indicated that they were not willing to invest in riskier investments regardless of their financial situation. *Id.* at 10. Other studies have also found that investors have low financial literacy when it comes to topics such as comprehending risk or compound interest. For example, in a recent study conducted by the TIAA Institute, over 60% of survey respondents answered questions about risk-related concepts incorrectly. PAUL J. YAKOBOSKI ET AL., TIAA INST. & GFLEC, FINANCIAL LITERACY IN THE UNITED STATES AND ITS LINK TO FINANCIAL WELLNESS 3–5 (2019), https://gflec.org/wp-content/uploads/2019/03/TIAA-Institute-GFLEC_P-Fin-Index-Report_April-2019_FINAL-1.pdf?x70028. Another study found that half of survey respondents aged 55 or older could not correctly answer two simple questions about inflation and compound interest. Annamaria Lusardi et al., *Financial Sophistication in the Older Population*, 13 J. PENSION, ECON. & FIN. 347, 348 (2014).

a result, many individuals will seek out professional advice, which presents its own set of challenges. In a 2015 joint report, the SEC and FINRA explained that seniors with such limited knowledge, when combined with historically low yields on savings accounts and more conservative investments, may be particularly vulnerable to bad investment advice, observing that "some broker-dealers may be recommending riskier and possibly unsuitable securities to senior investors looking for higher returns and may be failing to adequately disclose the terms and risks of the securities they recommend."[11] In its 2019 Annual Risk Monitoring and Examination Priorities Letter,[12] FINRA identified the topic of senior and retired investors as a top priority, and expressed concern about "registered representatives using their role as a fiduciary to take control of trusts or other assets and direct funds to themselves."[13]

Even seniors who do have sufficient knowledge to handle their investments into retirement, however, will likely face other challenges. Specifically, increasing mental and physical ailments associated with aging that can impede their ability to handle their financial affairs.[14] The Alzheimer's Association reports that "[a]n estimated 5.8 million people in the United States have Alzheimer's disease" and 45% of persons over 85, suffer from dementia;[15] it further estimates that by 2050, the number of individuals with the disease is expected to nearly triple.[16] Other seniors will face significant declines in their physical well-being, such as their mobility or vision. These mental and physical challenges will affect millions, creating enormous challenges and subject significant portion to financial exploitation and abuse. [17]

The ongoing novel coronavirus pandemic has further increased older Americans' vulnerability to exploitation. Along with the increasing health risks posed by COVID-19, older persons are facing a different epidemic regarding abuse. In May of 2020, the United Nations warned that stay-at-home orders that restrict movement may cause an increase in elder abuse, including financial

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[11] SEC/FINRA NATIONAL SENIOR INVESTOR REPORT, at 3.

[12] *2019 Risk Monitoring and Examination Priorities Letter*, FINRA.ORG, https://www.finra.org/rules-guidance/communications-firms/2019-annual-risk-monitoring-and-examination-priorities-letter (last visited Jan. 20, 2019).

[13] *Id.*

[14] Lawrence A. Frolik, supra note 10, at 292-94 (observing that the shift from "defined benefit plans" to "defined contributions plans" places retirees at risk of outliving their savings because, among other things, significant mental and physical decline exposes seniors to financial exploitation and abuse).

[15] THE ALZHEIMER'S ASSOC., 2012 REPORT, ALZHEIMER'S DISEASE FACTS AND FIGURES, at 14, *available at*: https://www.alz.org/downloads/facts_figures_2012.pdf.

[16] *See* THE ALZHEIMER'S ASSOC., http://www.alz.org/facts/

[17] K. L. Triebel & D. C. Marson, *The Warning Signs of Diminished Financial Capacity in Older Adults*, GENERATIONS, Summer 2012, at 39–45, *available at* https://www.questia.com/library/journal/1P3-2717110131/the-warning-signs-of-diminished-financial-capacity; Robert Abrams, *The Dementia Crisis*, 89 N.Y. ST. B. ASS'N J., Jan. 2017, at 9 ("Approximately 47 million people have dementia worldwide, over 20 percent of whom reside in the United States. By 2050, 135 million people worldwide are projected to have dementia and similar growth of this disease is expected to increase proportionately in the United States.").

elder abuse.[18] In addition, the stock market fluctuations create further opportunities for elderly financial exploitation.[19] Uncertain times and separation from loved ones have contributed to the current spike in reports of elder abuse.[20] Since January of this year, the Federal Trade Commission has received over 130,000 reports of fraud, reporting losses to date of over $90 million.[21] Although the exact amount of elder financial exploitation related to the COVID-19 pandemic is yet unknown, both FINRA and the SEC have issued releases showing concern for the potential consequences of the current environment.[22]

II. New FINRA Rules for Protection of Seniors and Vulnerable Adults

In October 2017, the SEC approved two new FINRA rules designed to curb the financial exploitation of seniors.[23] First, FINRA amended existing FINRA Rule 4512, *Customer Account Information*, to require members to make reasonable efforts to obtain the name and contact information for a "Trusted Contact Person" on a customer's account. FINRA also adoption new Rule 2165, *Financial Exploitation of Vulnerable Adults*, which permits member firms to place a temporary hold on disbursements when there is a reasonable belief of financial exploitation of the senior or vulnerable adult.[24] Both the amendment and the new rule, which became effective on February 5, 2018, provide significant new tools for member firms to assist in curbing financial exploitation of seniors. And additional rules and guidance are on the way.

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[18] U.N. Secretary-General, *Policy Brief: The Impact of COVID-19 on Older Persons*, 7 (May 2020), https://www.un.org/development/desa/ageing/wp-content/uploads/sites/24/2020/05/COVID-Older-persons.pdf (explaining that "[t]he pandemic leaves many older victims without access to assistance and services").

[19] Lena K. Makaroun, et al., *Elder Abuse in the Time of COVID-19—Increased Risks for Older Adults and Their Caregivers*, 28 AM. J. GERIATRIC PSYCHIATRY 876, 877 (2020).

[20] *See* Don Dwyer, *Senior Abuse Reports on the Rise as State Works on New Campaign*, WGEM (July 16, 2020, 5:51 AM), https://wgem.com/2020/07/16/senior-abuse-reports-on-the-rise-as-state-works-on-new-campaign/ (stating that the Adult Protective Services of West Central Illinois has seen an increase in financial exploitation cases since the pandemic began); Robert Hur, et al., *Scammers Using Pandemic to Target Elderly During the Pandemic*, BALTIMORE SUN (June 15, 2020, 5:59 AM), https://www.baltimoresun.com/opinion/op-ed/bs-ed-op-0615-elder-abuse-20200615-xhnenofi5ze6xptile3keumtpy-story.html (noting that fraud cases in Maryland and across the United States have risen overall since the pandemic began).

[21] *See* FTC COVID-19 AND STIMULUS REPORTS (last visited July 25, 2020), https://public.tableau.com/profile/federal.trade.commission#!/vizhome/COVID-19andStimulusReports/Map.

[22] SEC. & EXCH. COMM'N, SEC CORONAVIRUS (COVID-19) RESPONSE (2020), https://www.sec.gov/sec-coronavirus-covid-19-response; FIN. INDUS. REG. AUTHORITY, FRAUD AND CORONAVIRUS (COVID-19) (2020), https://www.finra.org/investors/insights/fraud-and-coronavirus-covid-19.

[23] Regulatory Notice 17-11, *Financial Exploitation of Seniors; SEC Approves Rules Relating to the Financial Exploitation of Seniors* (March 2017). FINRA proposed the new rules – its first conduct rules specifically addressing senior exploitation – in October 2015, only six months after it had launched its Securities Helpline for Seniors in April 2015. Regulatory Notice 15-37, *Financial Exploitation of Seniors and Other Vulnerable Adults* (October 2015).

[24] Regulatory Notice 17-11, at 2.

A. Establishing a Trusted Contact Person

The amendment to Rule 4512 requires firms opening a new customer account to make "reasonable efforts to obtain the name of and contact information for a trusted contact person upon the opening of a non-institutional customer's account or when updating account information."[25] In addition, the amendment requires firms to disclose to customers in writing that the firm "is authorized to contact the trusted contact person and disclose information about the customer's account to address possible financial exploitation, to confirm the specifics of the customer's current contact information, health status, or the identity of any legal guardian, executor, trustee or holder of a power of attorney, and as otherwise permitted by [new rule] 2165."[26]

The purpose of the trusted contact person is to provide a resource for member firms "in administering the customer's account protecting assets and responding to possible financial exploitation." Other scenarios include situations where the firm or broker has been unable to contact the customer after multiple attempts, or if there is concern about the customer's mental capacity. In such situations, the member may, but is not required to, reach out to the trusted contact person to inquire about the customer's health.[27]

The notice makes clear that member firms are not prevented from opening and maintaining an account if a customer fails to identify a trusted contact person, as long as the member makes "reasonable efforts to obtain the information."[28] However, the expectation is that firms will encourage customers to provide this information, which firms can then use as a resource to handle problems, including potential financial exploitation.[29]

B. Temporary Hold on Disbursements

New Rule 2165 (*Financial Exploitation of Specified Adults*) permits – but does not require – firms to implement a process to temporarily place a hold on any disbursements.[30] Also known as the "pause rule," Rule 2165 provides members with authority to place temporary holds on disbursements of funds or securities from the accounts of "Specified Adults"[31] where there is a reasonable belief that financial exploitation of the Specified Adult "has occurred, is occurring, has

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[25] *Id.*; Rule 4512(a)(1)(F). The "trusted contact person" would have to be age 18 years or older and not authorized to transact business on the account. *Id.*

[26] Rule 4512.06(a) (Supplementary Material).

[27] *Id.*

[28] *Id*.

[29] *Id.* at 2-3.

[30] *Id.* at 3.

[31] Regulatory Notice 71-11, at 3. The rule provides a safe harbor from FINRA Rules 2010 (*Standards of Commercial Honor and Principles of Trade)*, 2150 (*Improper Use of Customers' Securities or Funds; Prohibition Against Guarantees and Sharing in Accounts)* and 11870 (*Customer Account Transfer Contracts)* when members exercise discretion in placing temporary holds on funds or securities from a customer's account in accordance with the rule's requirements. *Id.*

been attempted or will be attempted."[32] A "Specified Adult" is defined as "(A) a natural person age 65 and older; or (B) a natural person age 18 and older who the member reasonably believes has a mental or physical impairment that renders the individual unable to protect his or her own interests."[33]

The rule only allows for a hold on the "suspicious disbursements," not all funds in the account, and does not apply to securities transactions.[34] If a member firm does exercise its authority to place a "hold" on disbursements, within two days the firm must notify the person(s) authorized to transact business on the account and the "Trusted Contact Person" (unless the firm reasonably believes the authorized person or Trusted Contact Person is involved in the financial exploitation); and the firm must also initiate an internal review.[35] The temporary hold expires after 15 days, unless extended under certain defined circumstances, such as an order by a state regulator, state or local agency, or court of competent jurisdiction.[36] The firm may also extend the 15-day period by 10 days if its internal review of the facts and circumstances support the extension.[37]

The rule has a broad definition of "financial exploitation," specifically including: "(A) the wrongful or unauthorized taking, withholding, appropriation, or use of a Specified Adult's funds or securities; or (B) any act or omission by a person, including through the use of a power of attorney, guardianship, or any other authority regarding a Specified Adult, to: (i) obtain control, through deception, intimidation or undue influence, over the Specified Adult's money assets or property; or (ii) convert the Specified Adult's money, assets or property."[38]

There is no obligation to implement a system to pause on disbursements. However, if a firm chooses to use this safe harbor, it must also establish and implement procedures and processes within its supervisory system. Specifically, firms must: (1) establish and maintain specific written supervisory procedures reasonably designed to achieve compliance with the rule, including, but not limited to, procedures related to the identification, escalation and reporting of such matters;[39] (2) identify the title of each person authorized to place, terminate or extend the hold on behalf of the member, which person must be a supervisor, compliance or legal representative;[40] (3) develop and document specific training policies or programs reasonably designed to ensure that

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[32] Rule 2165(b)(1)(A).

[33] 2165(a)(1).

[34] Regulatory Notice 17-11, at 4.

[35] 2165(b)(1)(B).

[36] 2165(b)(2).

[37] 2165(b)(3).

[38] 2165(a)(4).

[39] 2165(c)(1).

[40] 2165(c)(2).

registered persons comply with the requirements of this Rule;[41] and (4) establish and maintain records related to the compliance with the rule.[42]

Although there is no obligation for firms to implement this process, given the steps that many firms have already taken in the last decade to deal with senior issues, it is reasonable to expect that many firms will do so. Firms are already required to have written supervisory procedures designed to safeguard customer funds and securities,[43] and monitor the transmittal of customer funds or securities to third party accounts, outside entities, locations "other than a customer's primary residence" or to the customer's registered representative.[44]

C. Additional Customer Protection Rules on the Horizon

About 18 months after the two new senior rules went into effect, FINRA issued Regulatory Notice 19-27 announcing it was conducting a "retrospective review to assess the effectiveness and efficiency of its rules and administrative processes that help protect senior investors from financial exploitation."[45] The Notice observed that "[r]ecent evidence suggests that financial exploitation of seniors has been increasing, in terms of both magnitude and impact,"[46] emphasized the important role broker-dealers can play in protecting senior investors, and sought comment on the existing rules and whether changes or additional tools were appropriate.[47] FINRA raised questions concerning the two new rules, including, among other things:

- Whether Rule 2165's safe harbor should be extended to include securities transactions, in addition to disbursements of funds and securities. Of particular

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[41] Rule 2165.02 (Supplementary Materials).

[42] Rule 2165(d).

[43] Rule 3110(c)(2)(A)(i).

[44] Rule 3110(c)(2)(A)(iv). FINRA recently censured and fined *Park Avenue Securities* $195,000 for supervisory failures that led to the firm's failure to detect the transfer of over $215,000 in funds misappropriated by the firm's unregistered administrative assistant from the accounts of several elderly investors, which she wired to the same third party account. *See, e.g.,* FINRA Letter of Acceptance, Waiver and Consent re *Park Avenue Securities, LLC,* Case No. 2014041510202 (Nov. 18, 2016).

[45] FINRA Regulatory Notice 19-27, *Retrospective Rule Review: FINRA Requests Comment on Rules and Issues Relating to Senior Investors* (Aug. 9, 2019). FINRA explained that it was seeking comments from internal and external stakeholders, FINRA's own advisory committee and subject matter experts outside the organization, investors and investor advocates. *Id.* at 3.

[46] *Id.*; *see also id*. at n.2 ("[S]uspicious activity report (SAR) filings on elder financial exploitation quadrupled from 2013 to 2017 with financial institutions filing 63,500 SARs reporting elder financial abuse in 2017. The Report also states that these SAR filings likely represent only a tiny fraction of the actual 3.5 million incidents of elder financial exploitation estimated to have happened that year.") (citing Naomi Karp & Hector Ortiz, Financial institutions report widespread elder financial abuse, Consumer Financial Protection Bureau (Feb. 27, 2019) https://www.consumerfinance.gov/about-us/blog/financial-institutions-report-widespread-elder-financial-abuse/).

[47] *Id.* at 2.

concern in including securities transactions is any changes in the price of securities if a hold is terminated and there is a determination of no financial exploitation.[48]

- Whether Rule 2165's safe harbor should be extended to apply where there is a reasonable belief that the customer has a cognitive impairment or diminished capacity that renders the individual unable to protect his or her interest, irrespective of whether the individual may be a victim of a third party.[49]

- Regarding Rule 4125, what methods firms have used to obtain the name of a trusted contact person, response rates from new and existing customers, and what firms have done when firms suspected financial exploitation but did not have a trusted contact person on the account.[50]

FINRA also expressed its concern about lending arrangements between registered persons and customers as an area of interest, because of its potential for misconduct. FINRA requested comments from stakeholders as to whether Rule 3240, *Borrowing From or Lending to Customers*, has been effective in addressing potential misconduct, and what, if any changes or modifications would better protect senior customers from potential abuse.[51]

FINRA also requested comments on whether it should amend its sanction guidelines to add, "as a principal consideration the fact that a victimized customer is a 'specified adult'" as defined by Rule 2165.[52] FINRA had previously amended its sanction guidelines in 2017 to include senior exploitation as a new factor for consideration. FINRA Regulatory Notice 17-13 announced that FINRA would consider whether a member or associated person exercised "undue influence" over vulnerable individuals, which include seniors and other persons suffering from diminished capacity.[53] FINRA stressed that "[t]his new consideration reaffirms that financial exploitation of senior and other vulnerable customers should result in strong sanctions."[54]

Finally, FINRA indicated concern with registered representatives holding certain positions of trust with their customers, resulting in the broker being named as the customer's beneficiary, executor, trustee or holding a power of attorney.[55] FINRA explained that these positions of trust "may

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[48] *Id.* at 8.

[49] *Id.*

[50] *Id.* at 8-9.

[51] *Id.* at 7, 9.

[52] *Id.* at 9.

[53] FINRA Regulatory Notice 17-13, *FINRA's NAC Revises its Sanction Guidelines* (April 2017).

[54] *Id.*

[55] FINRA Regulatory Notice 19-27, at 7. In its 2019 Annual Risk Monitoring and Examination Priorities Letter, FINRA identified the topic of senior and retired investors as a top priority, and expressed concern about "registered representatives using their role as a fiduciary to take control of trusts or other assets and direct funds to themselves." 2019 RISK MONITORING AND EXAMINATION PRIORITIES LETTER, FINRA.ORG, https://www.finra.org/rules-guidance/communications-firms/2019-annual-risk-monitoring-and-examination-priorities-letter (last visited July 14, 2019).

present significant conflicts of interest," and indicated that it was considering rulemaking to limit brokers being named in such positions of trust.

Shortly after the comment period closed in connection with its retrospective review, FINRA issued proposed Rule 3241, *Registered Person Being Named a Customer's Beneficiary or Holding a Position of Trust for a Customer*, which would limit the circumstances under which a broker could be named as a beneficiary of a customer's estate or hold a position of trust.[56] Under the proposed Rule, brokers would be barred from either being named a beneficiary of (or receiving a bequest from) a customer's estate, unless: (1) the customer is a member of the broker's immediate family; *or* (2) the broker provides written notice to the firm and, upon learning of the status, the firm provides written approval of this status or bequest.

A broker is similarly prohibited from being named as an executor or trustee or holding a power of attorney or similar position of trust for or on behalf of a customer unless: (1) the customer is a member of the broker's immediate family; *or* (2) the broker provides written notice to the firm and, upon learning of the status, the firm provides written approval of this status *prior* to the broker acting in that capacity or receiving any fees, assets or other benefits from such capacity; *and* the broker does not derive financial gain from acting in such capacity other than from fees or other charges that are reasonable and customary for acting in such capacity. On June 23, 2020, FINRA sent proposed Rule 3241 to the SEC for approval.

III. The NASAA Model Act and the States

State securities regulators have also been on the front lines to address the growing problem of senior exploitation, through enforcement actions and rulemaking. The North American Securities Administrators Association ("NASAA"),[57] announced that in 2018 alone, state regulators brought enforcement actions that involved over 750 senior victims.[58] The enforcement actions concerned unregistered securities, traditional securities, variable annuities, affinity fraud, equity-indexed annuities, and viatical or life settlements.[59] Looking back at NASAA's enforcement statistics over the past five years, these products have consistently been connected with senior investor protection issues.[60]

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[56] Regulatory Notice 19-36, *Registered Persons Being Named a Customer's Beneficiary or Holding a Position of Trust for a Customer* (Nov. 11, 2019).

[57] NASAA's membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, and the U.S. Virgin Islands, http://www.nasaa.org/.

[58] NASAA, NASAA 2019 ENFORCEMENT REPORT 8 (2019) https://www.nasaa.org/wp-content/uploads/2019/11/2019-Enforcement-Report-Based-on-2018-Data-FINAL.pdf.

[59] *Id.*

[60] *See*, *e.g.*, NASAA, NASAA 2017 ENFORCEMENT REPORT (2017), https://www.nasaa.org/wp-content/uploads/2017/09/2017-Enforcement-Report-Based-on-2016-Data.pdf; NASAA, NASAA 2015 ENFORCEMENT REPORT (2015), https://www.nasaa.org/wp-content/uploads/2011/08/2015-Enforcement-Report-on-2014-Data_FINAL.pdf.

According to the 2013 Nationwide Survey of Mandatory Reporting Requirements for Elderly and/or Vulnerable Persons, updated in December, 2015 ("Updated 2013 Survey"),[61] all 50 states have passed statutes requiring or permitting certain categories of professionals, including, but not limited to, attorneys, accountants, doctors, nurses and other health care workers, nursing homes and care providers to report suspected abuse to the state's Adult Protective Services or law enforcement officials. However, only 25 states and the District of Columbia require financial institutions to adhere to reporting requirements.[62] Moreover, among the states that include employees of financial institutions within the category of persons either required or permitted to report suspected abuse to authorities, the definition of a "financial institution" does not necessarily include a broker-dealer or investment adviser.

In an attempt to provide consistency, NASAA adopted model legislation[63] on January 22, 2016, that provides a framework for broker-dealers and investment advisers confronted with suspected financial exploitation of seniors and other vulnerable adults. The NASAA Model Act was an initiative of NASAA's Committee on Senior Issues and Diminished Capacity, to provide "industry participants and state regulators with new tools to help detect and prevent financial exploitation of vulnerable adults."[64]

NASAA's Model Act protects "eligible adults", defined as individuals age 65 or older or those adults who would be subject to the provisions of an adopting state's adult protective services statute.[65]

The Model Act *mandates* reporting to the state securities regulator and adult protective services when a "qualified individual" (a broker, investment advisor, or those that serve in a supervisory,

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[61] The Updated 2013 Survey was published by New York District Attorney's Office and NAPSA Elder Financial Exploitation Advisory Board, available at: http://www.napsa-now.org/wp-content/uploads/2016/05/Mandatory-Reporting-Chart-Updated-December-2015-FINAL.pdf.

[62] Thirteen states require "any person" or "any individual" to report suspected financial exploitation to the relevant authorities, including: Florida, Indiana, Kentucky, Louisiana, Mississippi, New Hampshire, Oklahoma, Rhode Island, South Carolina, Tennessee, Texas, Utah and Wyoming. The remaining twelve states, Arizona, Arkansas, California, Colorado, Delaware, Georgia, Hawaii, Kansas, Maryland, Nevada, New Mexico, and North Carolina, and the District of Columbia, have specific references to "financial institutions" or persons having custody or control of the vulnerable adult's property. *See* Updated 2013 Survey.

While anyone "may" report financial abuse, only three states, Iowa, Virginia and Washington, have statutes that specifically include "financial institutions" among the group of professionals who may report instances of financial abuse (but, of course, reporting is voluntary and not mandatory). *Id.* Effective since June, 2010, Washington State has a mandatory reporting requirement, but only in special circumstances. Specifically, *if* the institution places a hold on a disbursement of funds due to suspected financial exploitation, only then it *must* report the suspected abuse to authorities. WASH. REV. CODE ANN. § 74.34.215.

[63] NASAA, AN ACT TO PROTECT VULNERABLE ADULTS FROM FINANCIAL EXPLOITATION (2016), http://serveourseniors.org/wp-content/uploads/2015/11/NASAA-Model-Seniors-Act-adopted-Jan-22-2016.pdf ("NASAA Model Act").

[64] *Id.* at 1.

[65] *Id.*

compliance or legal capacity for broker-dealers or investment advisers) "reasonably believes" that financial exploitation of an eligible adult has occurred or is being attempted.[66] It also authorizes notification to third-parties of potential financial exploitation with advance consent of the investor (i.e., a preexisting designation of a "trusted contact person"), unless the third party is the suspected abuser.[67]

Like FINRA Rule 2165, NASAA's Model Act also authorizes (but does not require) broker-dealers and investment advisers to delay disbursing funds from an eligible adult's account for up to 15 days (with an option to extend an additional 10 days) in cases of suspected financial exploitation.[68] The Model Act provides immunity from any administrative or civil liability that may arise out of the delay in disbursement if the broker-dealer or investment adviser acts in good faith and exercises reasonable care.[69]

Finally, the Model Act requires broker-dealers and investment advisers to share records relevant to the suspected or attempted financial exploitation with law enforcement and state adult protective services agencies, either as part of a referral or upon request of law enforcement or the agency pursuant to an investigation.[70]

IV. Reporting and the Federal Senior Safe Act

Federal and state regulators have long recognized the important role financial professionals can play in curbing elder financial exploitation by identifying and, importantly, reporting suspected abuse to law enforcement or state protective services. The SEC's Office of the Investor Advocate observed that "[m]any broker-dealers and investment advisers have known their clients for years and may be among the first to recognize signs of diminished capacity or financial exploitation."[71]

In 2013, the SEC and seven other government agencies issued joint guidance to financial institutions regarding their ability to report suspected elder financial exploitation in light of the privacy provisions of the Gramm-Leach-Bliley Act (GLBA), which prohibits financial institutions

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[66] *Id.* at 1-2 (explaining that the act utilizes the nomenclature "commissioner of securities" and "Adult Protective Services" but that jurisdictions will need to use nomenclature appropriate to their government agencies).

[67] *Id.* at 2. NASAA considered FINRA's proposed senior rules announced in Regulatory Notice 15-37 when drafting the Model Act, the Model Act tracks many of the same requirements NASAA Release, *NASAA Model Act to Protect Vulnerable Adults from Financial Exploitation*, https://www.nasaa.org/industry-resources/senior-issues/model-act-to-protect-vulnerable-adults-from-financial-exploitation/.

[68] NASAA Model Act, *supra* note 63, at 2-3.

[69] *Id.*, at 3.

[70] *Id*.

[71] SEC Office of the Investor Advocate, *Report on Activities for Fiscal Year 2015*, at 10. Regulatory Notice 15-37, at 5. Financial advisers frequently become aware of suspicious activity even before the investor's family or friends Naomi Karp & Ryan Wilson, *Protecting Older Investors: The Challenge of Diminished Capacity*, AARP PUBLIC POLICY INSTITUTE 17 (Nov. 2011), available at: http://www.aarp.org/content/dam/aarp/research/public_policy_institute/cons_prot/2011/rr2011-04.pdf.

from disclosing nonpublic customer information to unaffiliated third parties without providing customers with notice that describes the disclosure and a reasonable opportunity to opt out.[72] The joint guidance recognized the "key role" financial institutions could play in preventing elder financial exploitation.[73] Although it did not impose an obligation (or modify an existing obligation) to report suspected elder abuse, the guidance confirmed that disclosure of nonpublic personal information for the purpose of reporting suspected financial abuse could fall within one or more of exceptions under the GLBA (and its implementing provisions).[74] Yet, without a uniform federal standard providing, at minimum, a safe harbor to financial firms for voluntary reporting of suspected abuse, firms have been limited by the inconsistent patchwork of state laws.

Although the NASAA Model Act requires reporting of suspected financial exploitation, its protections are only applicable in states that have adopted it in whole or in part. To date, twenty-seven states have enacted legislation or regulations based on the NASAA Model Act.[75] Of those

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[72] *Interagency Guidance on Privacy Laws and Reporting Financial Abuse of Older Adults* (Sept. 24, 2013) ("Interagency Guidance"), available at: https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539837338. The federal agencies included the Board of Governors of the Federal Reserve, the Commodity Futures Trading Commission, the Consumer Financial Protection Bureau, the Federal Deposit Insurance Corporation, the Federal Trade Commission, the National Credit Union Administration, the Office of the Comptroller of the Currency and the SEC. The respective federal agencies issued implementing regulations under the GLBA, 15 U.S.C. 6802 et seq. (1999), governing the disclosure of customer nonpublic information, which is prohibited absent notice to the customer and an opportunity to opt out. SEC Regulation S-P, Part 248, Subpart A, governs the treatment of nonpublic information, and describes the conditions under which a "financial institution" may disclose nonpublic information to nonaffiliated third parties; it also provides "a method for consumers to prevent a financial institution from disclosing" that information by "opting out" of that procedure. "Financial institutions" covered by Regulation S-P include brokers, dealers, investment companies and investment advisers registered with the Commission. 17 CFR 248.1 (Purpose and Scope). Regulation S-P became effective November 13, 2000, and compliance became mandatory for all brokers, dealers, investment advisers and investment companies on July 1, 2001. SEC Release of Final Rule, 65 Fed. Reg. 40334-01 (June 29, 2000).

[73] Interagency Guidance, at 2. Financial institutions are permitted to report suspected elder financial abuse in Suspicious Activity Reports ("SARs") filed with the Department of the Treasury Financial Crimes Enforcement Network ("FinCEN"). Indeed, FinCen issued an advisory in 2011 alerting financial institutions of an upward trend at the federal level SARs, describing instances of elder financial exploitation; the advisory set forth a narrative of "red flags" that could indicate possible illegal activity impacting an elderly customer and possibly warranting further investigation or review by the firm.[73] FinCEN advised that SARs were a valuable avenue through which financial institutions could report suspected elder financial abuse, and requested that the firm expressly include the term "elder financial exploitation" in the narrative portion of the SAR. Department of the Treasury Financial Crimes Enforcement Network, *Advisory to Financial Institutions on Filing Suspicious Activity Reports Regarding Elder Financial Exploitation*, FIN-2011-A003 (Feb. 22, 2011), available at: https://www.fincen.gov/statutes_regs/guidance/pdf/fin-2011-a003.pdf

[74] *Id.* at 3-4. For example, a financial institution may disclose nonpublic information "to comply with federal, state, or local laws requiring disclosure, in response to a properly authorized civil, criminal, or regulatory subpoena or summons, or "to protect against or prevent actual or potential fraud, unauthorized transactions, claims or other liability," or to regulators for an investigation on a matter related to public safety. *Id.* (*citations omitted).*

[75] NASAA Model Act, *supra* note 63.

states Alabama,[76] Alaska,[77] California,[78] Colorado,[79] Delaware,[80] Florida,[81] Indiana,[82] Maine,[83] Maryland,[84] Mississippi,[85] New Jersey,[86] New Mexico,[87] North Dakota,[88] Oregon,[89] Tennessee,[90] Utah,[91] Vermont,[92] and West Virginia[93] require broker-dealers and investment advisers to report suspected financial exploitation of vulnerable adults to state authorities. The remaining nine states authorize broker-dealers and investment advisers to report suspected abuse on a voluntary basis.[94]

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[76] ALA. CODE § 8-6-172 (2016).

[77] ALASKA STAT. § 45.56.480 (2018).

[78] CAL. WELF. & INST. CODE § 15630.2 (2019).

[79] COLO. REV. STAT. § 11-51-1003 (2017).

[80] DEL. CODE ANN. tit. 6, § 73-307 (2018).

[81] FLA. STAT. § 415.1034 (2020).

[82] IND. CODE § 23-19-4.1-6 (2017).

[83] ME. STAT. tit. 32, § 16802 (2019).

[84] MD. CODE ANN., CORPS. & ASS'NS § 11-307 (West 2017).

[85] MISS. CODE ANN. § 75-71-413 (2017); *see also* MISS. CODE ANN. § 43-47-7 (2019).

[86] N.J. STAT. ANN. § 49:3-86 (West 2020).

[87] N.M. STAT. ANN. § 58-13D-3 (2017).

[88] N.D. CENT. CODE § 10-04-08.5 (2017).

[89] OR. REV. STAT. § 59.485 (2018).

[90] TENN. CODE ANN. § 48-1-102 (2017).

[91] UTAH CODE ANN. § 61-1-202 (West 2018).

[92] VT. SEC. REG. § 8-4 (2019).

[93] W. VA. CODE § 32-6-603 (2020).

[94] The following states provide for reporting only on a voluntary basis: Arizona (ARIZ. REV. STAT. ANN. § 46-472 (2019)), Arkansas (ARK. CODE ANN. § 23-42-309 (2017)), Kentucky (KY. REV. STAT. ANN. § 365.245 (West 2018)), Louisiana (LA. STAT. ANN. § 51:733 (2017)), Minnesota (MINN. STAT. § 45A.02 (2018)), Montana (MONT. CODE ANN. § 30-10-340 (2017)), New Hampshire (N.H. REV. STAT. ANN. § 421-B:5-507-A (2019)), and Virginia (VA. CODE ANN. § 63.2-1606 (2020). In Texas, employees of financial institutions must notify the institution, which in turn notifies state authorities. TEX. FIN. CODE ANN. § 281.002 (West 2019).

Fortunately, the Senior Safe Act became federal law on May 24, 2018,[95] providing protection to covered financial institutions– broker-dealers, investment advisers, insurance agents and transfer agents – and their eligible employees, from liability in any civil or administrative proceeding due to their reporting of potential financial exploitation of a senior citizen (individual aged 65 or older) to a covered agency.[96] Specifically, the act provides that individuals will not be liable for reporting suspected financial exploitation of a senior citizen to a covered agency if, at the time of the disclosure: (i) the disclosing individual was employed by the covered financial institution in a supervisory, compliance or legal function, (ii) before the time of the disclosure, that individual received training (as described in the act); and (iii) the disclosure was made in good faith and with reasonable care.[97]

Although the act does not require reporting or elder abuse training at firms, it encourages financial firms to develop such programs by providing broad immunity from lawsuits, and making training a central requirement to that immunity. The training should instruct individuals on "how to identify and report suspected exploitation of a senior citizen internally, and as appropriate, to government officials or law enforcement authorities, including common signs that indicate the financial exploitation of a senior citizen.[98] Firms are required to maintain records of the training provided to individuals that have authority to report suspected financial abuse, and provide such records upon request from a covered agency.[99]

The Senior Safe Act provides a valuable tool for financial firms to report suspected financial abuse of their senior clients. Moreover, due to the expansive definition of "covered financial institution" and their eligible employees, the act applies to many financial professionals who interact with senior clients every day. Although time will tell, the act should encourage reporting and, in turn, help regulators, law enforcement and adult protective services agencies better protect seniors.

V. Conclusion

The new and proposed FINRA rules and the Senior Safe Act provide powerful tools that financial firms can use to report and abate incidents of senior financial exploitation. Although not required to act, firms are incentivized to report suspected abuse and pause disbursements through a grant of limited immunity. Yet much more is needed to stem the rising tide of elder abuse, which is

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[95] 12 U.S.C. § 3423, IMMUNITY FROM SUIT FOR DISCLOSURE OF FINANCIAL EXPLOITATION OF SENIOR CITIZENS. The Senior Safe Act was included as Section 303 of the ECONOMIC GROWTH, REGULATORY RELIEF, AND CONSUMER PROTECTION ACT, 132 Stat. 1296, Pub. L. No. 115-174 (May 24, 2018).

[96] 12 U.S.C. § 3423 (a)(2)(A), (B). "Exploitation" is defined the fraudulent or otherwise illegal, unauthorized or improper act or process of an individual, caregiver or fiduciary that uses the resources of a senior citizen for monetary or personal gain, or results in depriving a senior citizen of rightful access to or use of benefits, resources, belongings or assets. *Id.* at §3423(a)(1)(G). A "covered agency" includes state or federal securities regulators, FINRA, state or federal law enforcement, and state or local agency responsible for administering adult protective services. *Id.* at §3423(a)(1)(C).

[97] *Id.* at §3423(a)(2)(A). Covered financial institutions are similarly immune from suit for said disclosure if the individual was employed by or affiliated with the firm at the time of the disclosure and the individual received the required training. *Id.* at §3423(a)(2)(B).

[98] Section 303(b)(2)(A), 132 Stat. at 1338.

[99] Section 303(b)(2)(C), 132 Stat. at 1338.

growing as our population ages. Given the vast amount of retirement wealth at financial firms, FINRA should consider additional incentives, or rules requiring additional training on senior-specific issues and, at minimum, mandatory reporting when there is an objectively reasonable basis to suspect financial abuse. FINRA's focus on increasing penalties for violations involving senior exploitation is another step in the right direction. This is particularly important as federal and state regulators face additional challenges and strain on resources necessary for a robust and aggressive enforcement program.

REPRESENTING CLIENTS WITH DIMINISHED CAPACITY

Nicole G. Iannarone and Mary Kate McDevitt*

INTRODUCTION

Lawyers representing clients in securities arbitration proceedings often face concerns related to the potential diminished capacity of their clients. This is particularly so because a high proportion of investors with FINRA arbitration claims are advanced in age. America is rapidly becoming much older, making it more important than ever that attorneys representing investors in securities arbitration proceedings be attuned to the ethical considerations that come into play should their clients present signs of impairment.

In this article, we begin by discussing the risk of diminished capacity, including how it may manifest in a lawyer's clients. In section II, we describe the ethical rules that govern an attorney's representation of a client who exhibits signs of diminished capacity. Finally, in section III, we conclude with a list of resources and additional information to assist attorneys as they navigate representing a client who exhibits diminished capacity.

This article is an intentionally short, high-level overview of ethical considerations and resources for lawyers who are concerned that their clients are exhibiting signs of diminished capacity and need guidance for the steps to take upon coming to that realization.

I. DIMINISHED CAPACITY: RISK AND TYPES

In recent years, the United State Census Bureau has made a remarkable projection that "older people" will outnumber children for the first time in U.S. history.[1] Today, nearly 45 million Americans are 65 or older, a number that is expected to increase by 30 million before the year 2030.[2] By 2035, "the United States will – for the first time ever – be a country comprised of more older adults than of children."[3]

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[1] United States Census Bureau, *Older People Projected to Outnumber Children for First Time in U.S. History*, available at https://www.census.gov/newsroom/press-releases/2018/cb18-41-population-projections.html (Mar. 13, 2018, last revised Oct. 8, 2019).

[2] Danielle Argoni, *Preparing for an Aging Population*, available at https://www.aarp.org/livable-communities/about/info-2018/aarp-livable-communities-preparing-for-an-aging-nation.html#:~:text=Among%20the%20reasons%20AARP%20has,United%20States%20than%20under%2018.&text=We%20are%20all%2C%20of%20course,will%20reach%2073%20million%20Americans, (last visited July 5, 2020).

[3] *Id.*

Aging is inevitable and no one is immune from it or the challenges it brings. Those challenges include an increased risk of diminished capacity. The concept of capacity to make a decision is important because it is the baseline from which we can determine whether a person can legally engage in an act.[4]

Should an individual exhibit any diminishment of capacity, the client is more at risk of elder abuse, called by some to be "the crime of the 21st century."[5] Even if a client or the client's children do not come to an attorney with an elder abuse claim, lawyers should be aware that their clients – young and old – may have conditions that will render the representation more challenging.

Diminished capacity includes several conditions that can limit a client's decision-making and participation abilities, conditions that may be permanent or temporal. The type and scope of diminished capacity should be evaluated so the lawyer can determine how best to proceed in the representation in accordance with the ethical rules described in section II of this article

Diminished capacity includes a number of conditions, and it may present in different ways. One of those conditions - dementia - impacts between one-third and one-half of people over the age of 85.[6] Dementia is a general decline in mental ability and can affect a person's decision-making capabilities.[7] Dementia may manifest in several ways, including in cognitive, emotional, or behavioral forms.[8] For example, as described in a American Bar Association and American Psychological Association joint handbook for lawyers, cognitive signs of dementia can include forgetfulness, difficulty communicating, or confusion.[9]

Emotional indicators that a client has dementia might include responses or reactions that are inappropriate for the situation or cannot be explained.[10] Dementia may also be deduced from a client's changed behaviors, including engaging in delusional actions or exhibiting poor hygiene.[11]

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[4] Lawrence A. Frolik and Mary R. Radford, *"Sufficient" Capacity: The Contrasting Capacity Requirements for Different Documents*, 2 NAELA Journal 303, 304 (2006) ("The legal concept of mental capacity, therefore, is the basis for 'when a state legitimately may take action to limit an individual's rights to make decisions about his or her own person or property.'"), available at https://readingroom.law.gsu.edu/cgi/viewcontent.cgi?article=1009&context=faculty_pub.

[5] Kristin Lewis, *The Crime of the 21st Century: Elder Financial Abuse*, PROB. & PROP. Vol. 28 No. 4 (Jul./Aug. 2014).

[6] Mary F. Radford, *The Multifaceted Challenges of Recognizing & Representing Clients Whose Capacity is Diminishing* at 8 (2017), available at https://www.saepc.org/assets/Councils/SouthernArizona-AZ/library/10-18-17%20%20Radford%20-%20Diminished%20Capacity.pdf (hereinafter "Radford, *Multifaceted Challenges*").

[7] *Id*.

[8] American Bar Association/American Psychological Association, *Assessment of Older Adults with Diminished Capacity: A Handbook for Lawyers* at 14-18, available at https://www.apa.org/pi/aging/resources/guides/diminished-capacity.pdf. *Id*. at 22-26 ("Capacity Worksheet for Lawyers").

[9] *Id*.

[10] *Id*.

[11] *Id*.

Though dementia is most often associated with advanced age, younger individuals may exhibit forms of the terminal disease.

Dementia is a form of a continued incapacity – while it can be slowed, it continues inexorably and is largely permanent. Other forms of cognitive decline may not be permanent or total. For example, cognitive decline can also present temporally.[12] Such temporal cognitive decline appears in what is known as Sundowner's Syndrome, a condition in which an individual has sound mental capacity during certain parts of the day but loses those capabilities later in the day.[13]

Partial temporal incapacity can also be exhibited in forms that are not necessarily tied to age. Drug and alcohol abuse, which affects nearly 20 million Americans, also causes individuals to temporarily have a diminished capacity as it pertains to making important legal decisions.[14] Whether permanent incapacity resulting from dementia or temporal incapacity from Sundowner's Syndrome or substance abuse, lawyers should be aware of the ethical rules that govern how the client-lawyer relationship should proceed under those circumstances.

II. Ethical Considerations for Clients with Diminished Capacity

Lawyers should approach each representation with a client assuming that it will be a normal relationship. Each state has its own ethical requirements governing the client-lawyer relationship, although the *American Bar Association's Model Rules of Professional Conduct* serve as a guide for discussing the key components of the client-lawyer relationship that apply in some fashion in most jurisdictions.

A. Maintaining a Normal Client-Lawyer Relationship When a Client has Diminished Capacity

Model Rule 1.14 should be a starting point when lawyers are concerned that their representation of a client who they believe may be impacted by a form of diminished capacity. The rule simply requires that "[w]hen a client's capacity to make adequately considered decisions in connection with a representation is diminished…the lawyer shall, as far as reasonably possible, maintain a normal client-lawyer relationship with the client."[15]

As the comments to Rule 1.14 explain, while client-lawyer relationships are normally founded on the client's ability to make decisions, "a severely incapacitated person may have no power to make legally binding decisions."[16] Notwithstanding the fact that a client may not be able to make certain decisions, the client may "often [have] the ability to understand, deliberate upon, and

[12] Radford, *Multifaceted Challenges*, *supra* n. 6 at 25.

[13] *Id*.

[14] American Addiction Centers, *Alcohol and Drug Abuse Statistics*, available at https://americanaddictioncenters.org/rehab-guide/addiction-statistics (last accessed July 5, 2020).

[15] American Bar Association, Model Rule of Professional Conduct, Rule 1.14(a).

[16] American Bar Association, Model Rule of Professional Conduct, Rule 1.14, Comment [1].

reach conclusions about matters affecting the client's own well-being."[17] Thus, Model Rule 1.14 seeks to strike a balance between involving the client as much as possible, and as normally as possible, given the circumstances.[18]

Before Model Rule 1.14(a)'s admonition to maintain normalcy applies, an attorney must first determine whether and to what extent the client exhibits diminished capacity. Lawyers are not required to become doctors, though lawyers may consult with medical professionals as they undertake this analysis in appropriate circumstances.[19] Consulting with a professional is not required, however.

The ABA counsels lawyers to consider a number of factors in making their determination that a client has diminished capacity, including by evaluating "the client's ability to articulate reasoning leading to a decision; variability of state of mind and ability to appreciate consequences of a decision; the substantive fairness of a decision; and the consistency of a decision with the known long-term commitments and values of the client."[20]

Lawyers must be careful in making this determination. Clients, -whether or not they have diminished capacity - have the right to make poor decisions and lawyers must not substitute their own judgment for that of their clients.[21]

Maintaining normalcy in the representation might differ depending on the form of incapacity exhibited by the client. For example, if a lawyer believes a client suffers from Sundowner's Syndrome after seeing the client engage in cogent, consistent, and independent decision making during certain times that dissipate at later times, the lawyer should work with the client and ensure that meetings and case-related events are scheduled when the client is most able to meaningfully participate and engage.[22]

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[17] *Id*.

[18] *Id*.

[19] *Id*. at Comment [6] ("In appropriate circumstances, the lawyer may seek guidance from an appropriate diagnostician.").

[20] *Id*.

[21] *See* American Bar Association Formal Opinion No. 96-404 ("A client who is making decisions that the lawyer considers to be ill-considered is not necessarily unable to act in his own interest, and the lawyer should not seek protective action merely to protect the client from what the lawyer believes are errors in judgment.").

[22] Radford, *Multifaceted Challenges, supra* n. 6 at 25. *See also* NAELA, *Aspirational Standards for the Practice of Elder Law and Special Needs Law with Commentaries,* available at https://www.naela.org/AspirationalStandards (2d ed. 2017) (last accessed July 5, 2020) (encouraging attorneys to maintain as normal a relationship as possible, adapting the "interview environment, timing of meetings, communications, and decision making process to maximize the client's ability to understand and participate in light of the client's capacity and circumstances".).

What does not differ, however, are the ethical requirements that a lawyer must follow to maintain the normal client-lawyer relationship envisioned under Model Rule 1.14(a). For example, Model Rule 1.2, which addresses authority and control in the client-attorney relationship, mandates that "a lawyer shall abide by a client's decisions concerning the objectives of representation."[23]

To do so, a lawyer must abide by the duty to communicate, which requires that the lawyer "reasonably consult with the client about the means by which the client's objectives are to be accomplished."[24] Communication also includes a duty to "explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation," a responsibility that can be met even when a client has diminished capacity.[25] Finally, lawyers must ensure that they maintain client confidentiality.

Under Model Rule 1.6, a lawyer "shall not reveal information relating to the representation of a client."[26] Confidentiality is a much broader duty than realized by most lawyers – protecting "all information relating to the representation, whatever its source."[27] Confidential information would include that the client is suffering from some form of diminished capacity.[28] Accordingly, Rule 1.14 makes clear that "unless authorized to do so, the lawyer may not disclose" the client's diminished capacity.[29]

B. Protective Action When the Normal Client-Attorney Relationship is Impossible

While normalcy can be maintained in many client-lawyer relationships even when the client exhibits signs of diminished capacity, a normal client-lawyer relationship is not always possible. Thus, Model Rule 1.14 provides the lawyer with the ability to "take reasonably necessary protective action" in the event that a client has diminished capacity and a fully normal representation is not possible.[30]

Those protective actions can include:

- seeking the appointment of a representative to take action on behalf of the client as an extreme step; or
- consulting with persons or entities who are in a position to protect the client.[31]

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[23] American Bar Association, Model Rules of Professional Conduct, Rule 1.2(a).

[24] American Bar Association, Model Rules of Professional Conduct, Rule 1.4(a)(2).

[25] American Bar Association, Model Rules of Professional Conduct, Rule 1.4(b).

[26] American Bar Association, Model Rules of Professional Conduct, Rule 1.6(a).

[27] *Id*. at Comment [3].

[28] American Bar Association, Model Rules of Professional Conduct, Rule 1.14(c) ("Information relating to the representation of a client with diminished capacity is protected by Rule 1.6.").

[29] American Bar Association, Model Rules of Professional Conduct, Rule 1.14, Comment [8].

[30] American Bar Association, Model Rules of Professional Conduct, Rule 1.14(b).

[31] *Id*. at Comment [5] ("Such measures could include: consulting with family members, using a reconsideration period to permit clarification or improvement of circumstances, using voluntary surrogate decisionmaking tools such

Before taking such drastic measures, the lawyer should have attempted to continue the client-attorney relationship as normal and to take the least restrictive means to protect the client while respecting the client's autonomy and seeking to involve them and their wishes in the representation.[32]

III. Resources for Lawyers Representing Clients with Diminished Capacity

This short article has provided a high-level overview of the ethical concerns a lawyer should consider if the client may have some form of diminished capacity. Accordingly, lawyers may wish to consult additional sources before they take any actions that could impact the normal client-lawyer relationship. Here is a non-exhaustive list of further materials that should be of assistance

1. American Bar Association Center for Professional Responsibility: The ABA maintains substantial resources online via its Center for Professional Responsibility. From model ethics rules to opinion letters providing advice to lawyers with questions on ethics matters, this site provides information for attorneys seeking to study and understand their ethical responsibilities to clients.[33]

2. NAELA Aspirational Standards for the Practice of Elder Law: Drafted by the National Academy of Elder Law Attorneys, the Aspirational Standards for the Practice of Elder Law and Special Needs Law with Commentaries provides attorneys with information "to navigate the many difficult ethical issues that often arise when representing elderly individuals and individuals with special needs."[34] NAELA's work fills in gaps and questions left open under the ABA's Model Rules and provides advice for holistic representation.

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as durable powers of attorney or consulting with support groups, professional services, adult-protective agencies or other individuals or entities that have the ability to protect the client.").

[32] American Bar Association, Model Rules of Professional Conduct, Rule 1.14 at Comment [2] ("Even if the person has a legal representative, the lawyer should as far as possible accord the represented person the status of client, particularly in maintaining communication."); *id*. at Comment [5] ("In taking any protective action, the lawyer should be guided by such factors as the wishes and values of the client to the extent known, the client's best interests and the goals of intruding into the client's decisionmaking autonomy to the least extent feasible, maximizing client capacities and respecting the client's family and social connections.").

[33] *See*, American Bar Association, *Center for Professional Responsibility*, available at https://www.americanbar.org/groups/professional_responsibility/ (last accessed July 5, 2020) ("The Center for Professional Responsibility provides national leadership in developing and interpreting standards and scholarly resources in legal and judicial ethics, professional regulation, professionalism and client protection.").

[34] NAELA, *Aspirational Standards for the Practice of Elder Law and Special Needs Law with Commentaries*, available at https://www.naela.org/AspirationalStandards
(2d ed. 2017) (last accessed July 5, 2020).

3. American Bar Association/American Psychological Association, Assessment of Older Adults with Diminished Capacity: The ABA has a robust set of resources, including seminars and written materials, for lawyers, judges, psychologists, and physicians to assist each professional when they believe that a lawyer's client may be suffering from diminished capacity.[35]

4. American College of Trust and Estate Counsel (ACTEC), Commentaries on the Model Rules of Professional Conduct: ACTEC undertook its own review of the ABA's Model Rules of Professional Conduct to provide guidance relevant to trust and estate counsel, many of whom work with clients who may be exhibiting signs of diminished capacity.[36]

5. AARP, Protecting Older Investors: The Challenge of Diminished Capacity: Focused on the entirety of the financial industry, lawyers representing clients in FINRA arbitration proceedings may find AARP's white paper on concerns facing older investors helpful as they both develop their case theory and navigate representing a client who may have diminished capacity.[37]

6. State and City Bar Association Ethics Hotlines: A lawyer concerned about ethical considerations in representing a client with diminished capacity may ethically seek out advice from an expert, including by hiring their own attorney or by contacting their licensing jurisdiction's ethics hotline. Many bar associations maintain a phone number that lawyers licensed in that jurisdiction may call to see the bar authority's free advice on matters of ethical concern.[38]

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[35] American Bar Association, *Capacity Assessment*, available at https://www.americanbar.org/groups/law_aging/resources/capacity_assessment/ (May 20, 2020) (last accessed July 5, 2020).

[36] The American College of Trust and Estate Counsel, *Commentaries on the Model Rules of Professional Conduct*, available at https://www.actec.org/assets/1/6/ACTEC_Commentaries_5th_rev_06_29.pdf (5th Ed. 2016) (last accessed July 5, 2020).

[37] Naomi Karp, *et al.*, *Protecting Older Investors: The Challenge of Diminished Capacity*, AARP Public Policy Institute (Nov. 2011), available at https://www.aarp.org/content/dam/aarp/research/public_policy_institute/cons_prot/2011/rr2011-04.pdf (last accessed July 5, 2020).

[38] *See, e.g.*, The State Bar of California, *Ethics Hotline*, available at http://ethics.calbar.ca.gov/Ethics/Hotline.aspx ("The Ethics Hotline, a confidential research service for attorneys only, helps lawyers identify and analyze their professional responsibilities.") (800-238-4427); State Bar of Georgia, *Ethics & Professionalism*, available at https://www.gabar.org/barrules/ethicsandprofessionalism/ ("Lawyers who would like to discuss an ethics dilemma with a member of the Office of General Counsel staff should contact the Ethics Helpline at 404-527-8741, 800-682-9806 or log in and submit your question by email."); New York City Bar, *Ethics Hotline*, available at http://www.nycbar.org/member-and-career-services/ethics/hotline ("New York lawyers faced with ethical questions regarding their own prospective conduct can reach the Ethics hotline through Customer Service at 212.382.6663."); Virginia State Bar, *Ethics Questions and Opinions*, available at https://www.vsb.org/site/regulation/ethics ("Any member of the bar may seek informal ethics or unauthorized practice of law advice by calling the Ethics Hotline at (804) 775-0564."); State Bar of Arizona, *Ethics Hotline*, available at http://www.azbar.org/ethics/ethicshotline/ ("Ethics Hotline Number: 602.340.7284"); Pennsylvania Bar Association; *Ethics Hotline*, available at http://www.pabar.org/public/Membership/ethics.asp ("The Ethics Hotline provides free advisory opinions to PBA members based upon a review of a member's prospective conduct by members of the PBA Committee on Legal Ethics and Professional Responsibility .... The Ethics hotline can be reached at (800) 932-0311, ext. 2214."); State

CONCLUSION

Representing clients exhibiting forms of diminished capacity – either total, partial, or temporal – is difficult. If a lawyer suspects that a client has diminished capacity, the lawyer should start by looking to the ethical rules in the jurisdiction where the lawyer is licensed.

Core principles of client-centered representation, including communication, confidentiality, and allowing the client to direct the representation, should guide the lawyer's next steps. As much as possible, lawyers should strive to maintain normalcy in the client-lawyer relationship and allow the client to meaningfully participate in the representation.

In accommodating the most normal relationship that can be achieved, lawyers should not, however, be afraid to seek the help of others so long as core client-lawyer ethical responsibilities are not violated.

Bar of Texas, *Toll-Free Ethics Helpline for Lawyers*, available at https://www.texasbar.com/Content/NavigationMenu/ForLawyers/GrievanceandEthics/Toll_Free_Ethics_Helpline_for_Lawyers/default.htm (800.532.3947); State Bar of Michigan, *Ethics Article: Ethics Hotline - Frequently Asked Questions*, available at https://www.michbar.org/opinions/ethics/articles/july98 ("The Ethics Hotline at the State Bar of Michigan (877) 558-4760 receives approximately 20 calls per day from Michigan lawyers seeking guidance on a full array of ethics issues from lawyers."); The Florida Bar, *Ethics Hotline*, available at https://www.floridabar.org/ethics/ethotline/ ((800) 235-8619).

WHISTLEBLOWER UPDATE

Benjamin P. Edwards

I. Introduction

State and federal whistleblower programs now exist. Most notably, the Securities and Exchange Commission and the Commodities Futures Trading Commission programs created as a part of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 serve as a paradigmatic example of a new model. These whistleblower programs offer protections for whistleblowers and the possibility of substantial bounties for whistleblowers bringing valuable information to public enforcers. Although the programs have had notable successes, whistleblowers seeking to recover under the programs may also face real challenges.

II. NASAA Model Legislation

In 2020, the North American Securities Administrators Association released draft model legislation for a state whistleblower bounty program. A copy of the NASAA model legislation has been included as Exhibit A to these materials.

III. SEC Whistleblower Program

The SEC describes its whistleblower program as follows:

> Assistance and information from a whistleblower who knows of possible securities law violations can be among the most powerful weapons in the law enforcement arsenal of the Securities and Exchange Commission. Through their knowledge of the circumstances and individuals involved, whistleblowers can help the Commission identify possible fraud and other violations much earlier than might otherwise have been possible. That allows the Commission to minimize the harm to investors, better preserve the integrity of the United States' capital markets, and more swiftly hold accountable those responsible for unlawful conduct.
>
> The Commission is authorized by Congress to provide monetary awards to eligible individuals who come forward with high-quality original information that leads to a Commission enforcement action in which over $1,000,000 in sanctions is ordered. The range for awards is between 10% and 30% of the money collected.[1]

Since the inception of its bounty program, the SEC has awarded over $350 million to whistleblowers. More comprehensive information about the program is available from the SEC's 2019 Report on its Whistleblower program. A copy of the report is attached to these materials as Exhibit B.

[1] SEC, Office of the Whistleblower, https://www.sec.gov/whistleblower (last visited Aug. 3, 2020).

The ruling may create pressure for institutional investors to formalize their litigation monitoring and to develop relationships with outside counsel.

IV. CFTC Whistleblower Program

The Commodities Futures Trading Commission also has a whistleblower bounty program. Like the SEC program, it originated with the Dodd-Frank legislation. The CFTC's program has granted approximately $100 million in awards to whistleblowers to date. More information about the CFTC program can be found in the annual report the CFTC makes to Congress. A copy of the report has been attached as Exhibit C.

Anti-Retaliation Claims

V. Possible CFPB Whistleblower Program

Recognizing the need for a whistleblower bounty program, the CFPB recently proposed a whistleblower bounty program to enhance its enforcement efforts. The CFPB's proposed text offers a promising start which could be made substantially more effective with some modifications. A copy of the CFPB's proposal is attached as Exhibit D.

There are some flaws with the CFPB proposal. At the outset, the CFPB's proposed whistleblower statute needlessly caps awards to whistleblowers at $10 million. Although a $10 million award would be significant, the cap on possible awards may deter some whistleblowers from coming forward. Whistleblowers considering whether to seek a bounty face significant risks. Because merely reporting valuable information to the CFPB will not guarantee a reward, potential bounty hunters must discount a possible award by the likelihood that the CFPB will actually secure a significant penalty. The CFPB might pursue the case ineptly or settle far too cheaply if politically connected regulators sympathize with an industry member caught in the wrong.

A cap on whistleblower awards may deter potential whistleblowers from developing or reporting significant information. Consider the incentives faced by a high-level executive. Becoming a whistleblower may offer a possible award, but it would also likely result in her exclusion from the industry were her reporting ever to become known. A potential whistleblower must balance the benefits of staying silent and remaining in the industry against the uncertain prospects of an award. If the potential whistleblower holds a significant amount of stock in an entity that might face real liability, she may hesitate to make a report which would destroy her family's wealth.

Award caps may also inhibit other potential whistleblowers from getting involved. Importantly, not every whistleblower will be an industry insider. Opportunistic, bounty-hunters may spend time and treasure to develop information which the CFPB could use in enforcement actions. These types of private investigations may never occur if the CFPB program includes a cap that would deter a bounty-hunter from spending time and money to investigate.

Fortunately, draft legislation introduced by Senator Cortez Masto aims to authorize a whistleblower bounty program for the CFPB without any cap on a whistleblower's potential recovery. This approach may make the bounty an attractive enough carrot to induce whistleblowers to provide information to the CFPB. A copy of the draft legislation has been included as Exhibit E.

The legislation could go further and look at the other side of the whistleblower's ledger. A potential whistleblower must balance rewards against risk. Without ready access to protection from retaliation, an employer's stick may produce more fear than a bounty's carrot can overcome. A whistleblower might report information in good faith and find her office suddenly a hostile place and herself without a job.

The CFPB's proposed whistleblower program could be further improved by enhancing existing protections designed to reduce the risk for whistleblowers who do come forward. The CFPB's current whistleblower protections require whistleblowers seeking redress for retaliation to seek relief through the Department of Labor even though Labor's whistleblower office has faced challenges. It would be better to let them go directly to court with an improved private cause of action. Importantly, any cause of action should include an anti-arbitration provision so that a whistleblower could seek protection in a public court.

NOTICE OF REQUEST FOR PUBLIC COMMENTS ON
PROPOSED MODEL WHISTLEBLOWER AWARD AND PROTECTION ACT

May 26, 2020

NASAA is seeking public comments on the attached proposed Model Whistleblower Award and Protection Act (the "Act"). The proposed Act draws upon the whistleblower award provisions contained in Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the SEC's related rules in Regulation 21F, Indiana Code § 23-19-7, and Utah Code § 61-1-101 et. seq. In summary, the proposed Act:

- Provides a state's securities regulator with the authority to make monetary awards to whistleblowers based on the amount of monetary sanctions collected in the related administrative or judicial action.
- Provides that the aggregate amount of awards made in connection with an administrative or judicial action shall be 10-30% of the monetary sanctions collected.
- Sets forth certain non-exclusive factors to be considered in determining the amount of an award.
- Disqualifies certain individuals from being eligible to receive a whistleblower award.
- Prohibits retaliation by an employer against a whistleblower.
- Creates a cause of action and establishes relief for whistleblowers that are retaliated against by their employer.
- Exempts information that would identify the whistleblower from public disclosure.
- Invalidates waivers of the rights and remedies available under the Act.
- Contains an optional bracketed provision granting rulemaking authority under the Act to the securities regulator.

Comments on the proposed Act are due by June 30, 2020. To facilitate consideration of comments, please email comments to Lynne Egan, Chair of the State Legislation Committee, at legan@mt.gov, and Faith Anderson, Chair of the Whistleblower Protections/Awards working group, at faith.anderson@dfi.wa.gov. In addition, please copy the NASAA Corporate Office at nasaacomments@nasaa.org. In light of remote working environments during the COVID-19 outbreak, commenters are discouraged from sending comments through physical mail.

Introduction

NASAA is seeking public comments on a proposed Model Whistleblower Award and Protection Act (the "Act"). The intent of this legislation is to incentivize individuals who have knowledge of potential securities law violations to make reports to state regulators in the interest of investor protection. The Act provides not only for monetary awards to whistleblowers, but also protections for those who make whistleblower complaints, including an express cause of action against employers that retaliate against whistleblowers. The Act draws upon the whistleblower award provisions contained in Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), the SEC's related rules in Regulation 21F, Indiana Code § 23-19-7, and Utah Code § 61-1-101 et. seq. The Act is intended to be fully operational upon adoption with no need for the promulgation of administrative rules, although it does contain an optional bracketed provision to provide the Securities Administrator with rule-making authority.

The two states that have already enacted whistleblower award legislation have reported that they have received a small number of complaints by purported whistleblowers and have made a total of two whistleblower awards. Since Indiana's law was enacted in 2012, the Securities Division has made one whistleblower award in the amount of $95,000[1] in connection with a $950,000 settlement with JPMorgan Chase Bank, N.A. and J.P. Morgan Securities LLC.[2] In the Securities Division's press release announcing the whistleblower award, the Indiana Secretary of State indicated that this case was "a perfect example of why the whistleblower statute is in place" because in the absence of the whistleblower complaint "the office would not have uncovered this issue and Hoosiers would still be at risk. Thanks to [Indiana's whistleblower law], we are able to provide a safe environment for individuals to come forth and protect Hoosiers from wrongful securities practices."[3] Utah has also reported making one whistleblower award since its whistleblower legislation was enacted in 2011. In its first whistleblower award, the Utah Securities Division awarded $15,000 to a Utah financial adviser that reported a suspicious investment sold to one of his clients.[4]

Section-by-Section Analysis of the Proposal

Section 1 establishes a short title for the Act: the "Whistleblower Award and Protection Act."

Section 2 defines necessary terms, specifically "original information," "monetary sanction," and "whistleblower." While additional terms are defined under the laws of Illinois and Utah, as well as under the federal whistleblower rules, the members of the working group opted to include only those definitions deemed essential to the operation of the law in the interest of efficiency.

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[1] JP Morgan Whistleblower Awarded $95,000 First whistleblower award in the state, Indiana Secretary of State (Aug. 19, 2016), *available at* https://calendar.in.gov/site/sos/event/sos-jp-morgan-whistleblower-awarded-95000-first-whistleblower-award-in-the-state/

[2] In the Matter of JPMorgan Chase Bank, N.A. and J.P. Morgan Securities, LLC, Cause No. 16-0003 CA (July 27, 2016).

[3] JP Morgan Whistleblower Awarded $95,000 First whistleblower award in the state, *supra* note 1.

[4] Securities Commission approves first whistleblower award for $15K since S.B.100 *Securities Fraud Reporting Program Act* passed in 2011, State of Utah Department of Commerce Securities Division (May 22, 2014), *available at* https://commerce.utah.gov/releases/14-05-22_sec-whistleblower-award.pdf.

Section 3 establishes the authority of the Securities Administrator to make whistleblower awards to one or more individuals that provide original information that leads to the successful enforcement of an administrative or judicial action under the securities laws of the state.

Section 4 specifies that if the Securities Administrator determines to make one or more whistleblower awards under Section 3, the aggregate amount of the awards made shall be no less than 10% of the monetary sanctions collected nor more than 30% of the monetary sanctions collected. This provision is based on the range of whistleblower awards provided for in Sec. 922 of the Dodd-Frank Act. The members of the working group opted to follow the language of the Dodd-Frank Act with respect to the amount of whistleblower awards, including the 10% floor, to ensure that potential whistleblowers are appropriately incentivized to file whistleblower reports.

Section 5 provides that the amount of a whistleblower award shall be determined in the discretion of the Securities Administrator consistent with Sections 4 and 7 of the Act.

Section 6 provides that any whistleblower awards paid under the Act shall be paid from a fund established elsewhere under state law. Under the Dodd-Frank Act, whistleblower awards are paid from the Investor Protection Fund. Under Indiana law, whistleblower awards are paid from its securities restitution fund. Under Utah law, whistleblower awards are paid from its Securities Investor Education, Training, and Enforcement Fund. Each state that enacts the Act will need to determine the source of payment of whistleblower awards, which can be expected to vary.

Section 7 sets forth a brief, non-exclusive list of factors that the Securities Administrator shall consider in determining the amount of an award under the Act. This list includes the core provisions included in the Dodd-Frank Act, as well as the state whistleblower laws enacted by Utah and Indiana. In the interest of brevity, the list is more abbreviated than the more exhaustive list of factors included in the SEC's whistleblower rules, which span several pages.

Section 8 establishes an exhaustive list of disqualifications for receiving a whistleblower award based on the Dodd-Frank Act, the SEC's whistleblower rules, and the laws enacted by Indiana and Utah.

Section 9 provides protections for individuals who file whistleblower complaints. The protections include: a prohibition on retaliation by an employer, the creation of a cause of action for retaliation by an employer, remedies that may be awarded to a whistleblower who prevails against an employer for retaliation, an exemption from public disclosure of information that could reasonably be expected to reveal the identity of a whistleblower, and a provision providing that the rights and remedies provided for in the Act may not be waived.

Section 10 is an optional bracketed provision that would provide a securities administrator with authority to adopt rules and regulation as necessary or appropriate to implement the Act. The members of the working group included all relevant provisions deemed necessary to implement and operate a whistleblower program in the proposed Act itself. Some states may, however, want authority to issue rules under the Act and so we have included this bracketed provision.

Conclusion

The State Legislation Committee seeks internal member comments on the proposed Model Whistleblower Award and Protection Act by June 30, 2020. We look forward to hearing from you.

Model Whistleblower Award and Protection Act
Proposed for Public Comment
May 15, 2020

Section 1: Short title. Sections 2 to 9 may be cited as the "Whistleblower Award and Protection Act."

Section 2: Definitions. In this act, unless the context otherwise requires:

(1) **"Original information"** means information that is:

a. derived from the independent knowledge or analysis of a whistleblower;

b. not already known to the [Securities Administrator] or [Securities Division] from any other source, unless the whistleblower is the original source of the information;

c. not exclusively derived from an allegation made in an administrative or judicial hearing, in a governmental report, hearing, audit, or investigation, or from the news media, unless the whistleblower is the source of the information; and

d. provided to the [Securities Division] for the first time after the date of the enactment of this act.

(2) **"Monetary sanction"** means any monies, including penalties, disgorgement, and interest ordered to be paid as a result of an administrative or judicial action. However, the term does not include any amounts ordered or identified as restitution.

(3) **"Whistleblower"** means an individual who, alone or jointly with others, provides the [Securities Division] with information pursuant to the procedures set forth in this act, and the information relates to a possible violation of state or federal securities laws, including any rules or regulations thereunder, that has occurred, is ongoing, or is about to occur.

Section 3: Authority to make a whistleblower award. Subject to the provisions of this act, the [Securities Administrator] may award an amount to one or more individuals who voluntarily provide original information in writing, and in the form and manner required by the [Securities Administrator], to the [Securities Division] that leads to the successful enforcement of an administrative or judicial action under [the Securities Act of this State].

Section 4: Amount of a whistleblower award. If the [Securities Administrator] determines to make one or more awards under Section 3, the aggregate amount of awards that may be awarded in connection with an administrative or judicial action may not be less than ten percent (10%) nor more than thirty percent (30%) of the monetary sanctions imposed and collected in the related administrative or judicial action.

Section 5: Discretion to determine the amount of a whistleblower award. The determination of the amount of an award made under this act shall be in the discretion of the [Securities Administrator] consistent with Section 4 and Section 7.

Section 6: Source of payment of whistleblower award. Any whistleblower awards paid under this act shall be paid from the fund established in [state code citation].

Section 7: Factors used to determine the amount of a whistleblower award. In determining the amount of an award under this act, the [Securities Administrator] shall consider:

(1) the significance of the original information provided by the whistleblower to the success of the administrative or judicial action;

(2) the degree of assistance provided by the whistleblower in connection with the administrative or judicial action;

(3) the programmatic interest of the [Securities Administrator] in deterring violations of the securities laws by making awards to whistleblowers who provide original information that leads to the successful enforcement of such laws; and

(4) any other factors the [Securities Administrator] considers relevant.

Section 8: Disqualification from award. The [Securities Administrator] shall not provide an award to a whistleblower under this section if the whistleblower:

(1) is convicted of a felony in connection with the administrative or judicial action for which the whistleblower otherwise could receive an award;

(2) acquires the original information through the performance of an audit of financial statements required under the securities laws and for whom providing the original information violates 15 U.S.C. 78j-1;

(3) fails to submit information to the [Securities Division] in such form as the [Securities Administrator] may prescribe;

(4) knowingly or recklessly makes a false, fictitious, or fraudulent statement or misrepresentation as part of, or in connection with, the original information provided or the administrative or judicial proceeding for which the original information was provided;

(5) in the whistleblower's submission, its other dealings with the [Securities Administrator], or in its dealings with another authority in connection with a related action, knowingly and willfully makes any false, fictitious, or fraudulent statement or representation, or uses any false writing or document knowing that it contains any false, fictitious, or fraudulent

statement or entry with intent to mislead or otherwise hinder the [Securities Administrator] or another authority;

(6) knows that, or has a reckless disregard as to whether, the original information provided is false, fictitious, or fraudulent;

(7) has a legal duty to report the original information to the [Securities Administrator] or [Securities Division];

(8) is, or was at the time the whistleblower acquired the original information submitted to the [Securities Division], a member, officer, or employee of the [Securities Division], the Securities and Exchange Commission, any other state securities regulatory authority, a self-regulatory organization, the Public Company Accounting Oversight Board, or any law enforcement organization;

(9) is, or was at the time the whistleblower acquired the original information submitted to the [Securities Division], a member, officer, or employee of a foreign government, any political subdivision, department, agency, or instrumentality of a foreign government, or any other foreign financial regulatory authority as that term is defined in 15 U.S.C. 78c(a)(52); or

(10) is the spouse, parent, child, or sibling of the [Securities Administrator] or an employee of the [Securities Division], or resides in the same household as the [Securities Administrator] or an employee of the [Securities Division]; or

(11) directly or indirectly acquires the original information provided to the [Securities Division] from a person:

a. who is subject to subsection (2) of this section, unless the information is not excluded from that person's use, or provides the [Securities Division] with information about possible violations involving that person;

b. who is a person described in subsections (8), (9), or (10) of this section; or

c. with the intent to evade any provision of this chapter.

Section 9: Protection of whistleblower

(1) **Prohibition against retaliation.** No employer may terminate, discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner retaliate against, a whistleblower because of any lawful act done by the whistleblower:

a. in providing information to the [Securities Division] in accordance with this Act;

b. in initiating, testifying in, or assisting in any investigation or administrative or judicial action of the [Securities Administrator] or [Securities Division] based upon or related to such information; or

c. in making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201 et seq.); the Securities Act of 1933 (15 U.S.C. 77a et seq.); the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.); 18 U.S.C. 1513(e); any other law, rule, or regulation subject to the jurisdiction of the Securities and Exchange Commission; or [the Securities Act of this State] or a rule adopted thereunder.

(2) **Exceptions from protection against retaliation.** Notwithstanding subsection (1) of this section, a whistleblower is not protected under this section if:

a. the whistleblower knowingly [or recklessly] makes a false, fictitious, or fraudulent statement or misrepresentation;

b. the whistleblower uses a false writing or document knowing that[, or with reckless disregard as to whether,] the writing or document contains false, fictitious, or fraudulent information; or

c. the whistleblower knows that[, or has a reckless disregard as to whether,] the disclosure is of original information that is false or frivolous.

(3) **Cause of Action.** A whistleblower, who alleges any act of retaliation in violation of subsection (1) of this section may bring an action for the relief provided in subsection (6) of this section in the court of original jurisdiction for the county or state where the alleged violation occurs, the whistleblower resides, or the person against whom the action is filed resides or has a principal place of business.

(4) **Subpoenas.** A subpoena requiring the attendance of a witness at a trial or hearing conducted under subsection (3) of this section may be served at any place in the United States.

(5) **Statute of limitations.** An action under subsection (3) of this section may not be brought:

a. more than 6 years after the date on which the violation of subsection (1) of this section occurred; or

b. more than 3 years after the date when facts material to the right of action are known or reasonably should have been known by the employee alleging a violation of subsection (1) of this section.

Notwithstanding the above limitations, an action under subsection (3) of this section may not in any circumstance be brought more than 10 years after the date on which the violation occurs.

(6) **Relief.** A court may award as relief for a whistleblower prevailing in an action brought under this section:

a. reinstatement with the same compensation, fringe benefits, and seniority status that the individual would have had, but for the retaliation;

b. two (2) times the amount of back pay otherwise owed to the individual, with interest;

c. compensation for litigation costs, expert witness fees, and reasonable attorneys' fees;

d. actual damages; or

e. any combination of these remedies.

(7) **Confidentiality.** Information that could reasonably be expected to reveal the identity of a whistleblower is exempt from public disclosure under [citation to state public records act]. This subsection does not limit the ability of the any person to present evidence to a grand jury or to share evidence with potential witnesses or defendants in the course of an ongoing criminal investigation.

(8) **Non-enforceability of confidentiality agreements with respect to communications with the [Securities Division].** No person may take any action to impede an individual from communicating directly with the [Securities Division] staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement with respect to such communications, except with respect to:

a. agreements concerning communications covered by the attorney-client privilege, unless disclosure of that information would otherwise be permitted by an attorney under applicable state attorney conduct rules or otherwise; and

b. information obtained in connection with legal representation of a client on whose behalf an individual or the individual's employer or firm are providing services, and the individual is seeking to use the information to make a whistleblower submission for the individual's own benefit, unless disclosure would otherwise be permitted by an attorney pursuant to applicable state attorney conduct rules or otherwise.

(9) **Waiver of rights and remedies.** The rights and remedies provided for in this Act may not be waived by any agreement, policy form, or condition of employment, including by a predispute arbitration agreement.

[**Section 10: Rulemaking authority.** The [Securities Administrator] may adopt such rules and regulations as may be necessary or appropriate to implement the provisions of this act consistent with its purpose.]

2019 ANNUAL REPORT TO CONGRESS

Whistleblower Program

U.S. SECURITIES AND EXCHANGE COMMISSION

DISCLAIMER

This is a report of the Staff of the U.S. Securities and Exchange Commission. The Commission has expressed no view regarding the analysis, findings, or conclusions contained herein.

CONTENTS

Report available on the Web at: www.sec.gov/whistleblower

MESSAGE FROM THE CHIEF OF THE OFFICE OF THE WHISTLEBLOWER

The U.S. Securities and Exchange Commission's (SEC or Commission) whistleblower program continued to have a significant impact on the Commission's enforcement and investor protection efforts in Fiscal Year (FY) 2019. In addition to multiple awards being granted for information impacting retail investors, the program has also reached a momentous milestone. Since the program's inception, the SEC has ordered wrongdoers in enforcement matters brought with information from meritorious whistleblowers to pay over $2 billion in total monetary sanctions, including more than $1 billion in disgorgement of ill-gotten gains and interest, of which almost $500 million has been, or is scheduled to be, returned to harmed investors. We continue to take pride in the whistleblower program's contributions to the protection of markets and investors including, importantly, Main Street investors.

> "The SEC has ordered wrongdoers in enforcement matters brought with information from meritorious whistleblowers to pay over $2 billion in total monetary sanctions."

In FY 2019, the Commission received its second largest number of whistleblower tips in a fiscal year and made its third largest award to date—a $37 million award to a whistleblower who provided significant evidence and assistance that enabled the agency to bring the matter to an efficient and successful resolution. This award followed a $50 million award to joint claimants in March 2018 and a $39 million award to a whistleblower in September 2018. While all awards are important to the Commission and to whistleblowers, these larger awards reflect the significance of the information that whistleblowers are providing to the Commission and are testaments to the whistleblower program's success.

Whistleblower Awards Made in Fiscal Year 2019

Since the beginning of the whistleblower program, the Commission has awarded approximately $387 million to 67 individuals. Despite an unusual year challenged by a lapse in appropriations, in FY 2019, the SEC awarded approximately $60 million in whistleblower awards to eight individuals whose information and cooperation assisted the Commission in bringing successful enforcement actions.

Information from whistleblowers in FY 2019 helped the Commission bring a variety of enforcement actions, including actions involving wrongdoing against retail investors and difficult-to-detect misconduct occurring abroad. Recipients of whistleblower awards in FY 2019 were diverse, including overseas whistleblowers and insiders who reported internally and took meaningful and timely steps in an effort to have their employer remediate the harm caused by the misconduct. Three award recipients in FY 2019 were located abroad, or reported conduct that was occurring abroad, demonstrating the international reach of the program. Three award recipients reported misconduct that was impacting retail investors, furthering a Commission priority to protect the Main

"The Commission received over 5,200 whistleblower tips in FY 2019, the second highest number of tips received in a fiscal year and a 74 percent increase since the beginning of the program"

Street investor. Seven of the eight award recipients reported their concerns to the company. We hope that the awards made in FY 2019 will continue to incentivize individuals, both in the U.S. and abroad, to report high-quality information regarding potential securities laws violations promptly to the Commission, which in turn, helps the Commission better protect investors and the marketplace.

Whistleblower Tips Received and Communications in Fiscal Year 2019

The Commission received over 5,200 whistleblower tips in FY 2019, the second highest number of tips received in a fiscal year and a 74 percent increase since the beginning of the program. As in prior fiscal years, tips received this fiscal year hailed from a variety of geographic origins, both domestic and foreign. The Commission received tips from individuals in 70 countries outside of the United States, as well as from every state in the United States. The tips covered a broad range of allegation types, including nearly 300 tips relating to cryptocurrencies, an emerging area of interest in FY 2019.

The Office of the Whistleblower (the Office or OWB) also staffs a public hotline to answer questions from whistleblowers and the general public concerning the whistleblower program or how to submit information to the Commission. In FY 2019, OWB staff returned over 2,600 calls to the public. Since the hotline was established, the Office has returned nearly 24,000 calls responding to questions about the program.

Retaliation and Agreements to Impede

The Office continues to work with the SEC's Division of Enforcement (Enforcement) staff to review fact patterns of potential retaliation and attempts to impede communications with the Commission. Whistleblower protections continue to be a high priority for the Office to ensure that whistleblowers feel comfortable and safe reporting to the SEC without fear of reprisal.

Whistleblower Rule Amendments

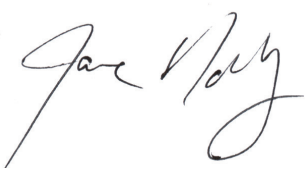
In FY 2019, the Commission continued to consider the public comments received on the Whistleblower Rule amendments proposed in June 2018. In addition to clarifying the requirements for anti-retaliation protections under the whistleblower statute following the Supreme Court's ruling in *Digital Realty Trust, Inc. v. Somers*[1] (*Digital Realty*), the proposed amendments would, among other things, provide tools to increase efficiencies in the claims review process and address other topics that have developed during the program's eight year history. We anticipate new rules being adopted in FY 2020.

1 138 S. Ct. 767 (2018).

Conclusion

The whistleblower program continues to have a significant positive impact on the Commission's enforcement efforts and protection of investors and markets, including assisting the Commission with actions that resulted in the return of hundreds of millions of dollars to harmed investors, many being Main Street investors, as a result of whistleblower tips. We look forward to the continuing growth and success of the program and the anticipated increased efficiencies in claims processing that the rule amendments will provide in the upcoming fiscal years.

We encourage those who believe they have credible information concerning a potential federal securities law violation to expeditiously submit a tip via the Commission's online portal (www.sec.gov/whistleblower). If individuals or their counsel have any questions about the program, including questions about how to submit a tip to the Commission, we encourage them to call OWB's whistleblower hotline at (202) 551-4790.



JANE NORBERG
Chief, Office of the Whistleblower
November 15, 2019

"The whistleblower program continues to have a significant positive impact on the Commission's enforcement efforts and protection of investors and markets, including assisting the Commission . . . in the return of hundreds of millions of dollars to harmed investors, many being Main Street investors, as a result of whistleblower tips."

HISTORY AND PURPOSE

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank)[2] amended the Securities Exchange Act of 1934 (Exchange Act)[3] by, among other things, adopting Section 21F,[4] entitled "Securities Whistleblower Incentives and Protection." Section 21F directs the Commission to make monetary awards to eligible individuals who voluntarily provide original information that leads to successful Commission enforcement actions resulting in monetary sanctions over $1 million and successful related actions.[5]

Awards must be made in an amount that is 10 percent or more and 30 percent or less of the monetary sanctions collected.[6] To ensure that whistleblower payments would not diminish the amount of recovery for victims of securities law violations, Congress established a separate fund, called the Investor Protection Fund (Fund), from which eligible whistleblowers are paid.

"Employers are prohibited from retaliating against whistleblowers for providing information to the Commission."

The Commission established OWB, an office within Enforcement, to administer and effectuate the whistleblower program. It is OWB's mission to administer a vigorous whistleblower program that will help the Commission identify and halt securities frauds early and quickly to minimize investor losses.

In addition to establishing an awards program to encourage the submission of high-quality information, Dodd-Frank and the Commission's Whistleblower Rules[7] also establish confidentiality protections for whistleblower submissions,[8] including the ability to file a whistleblower tip anonymously with the assistance of an attorney. Employers are prohibited from retaliating against whistleblowers for providing information to the Commission.[9]

Section 924(d) of Dodd-Frank requires OWB to report annually to Congress on OWB's activities, whistleblower complaints received, and the response of the Commission to such complaints.[10] In addition, Section 21F(g)(5) of the Exchange Act requires the Commission to submit an annual report to Congress that addresses the following subjects:

- The whistleblower award program, including a description of the number of awards granted and the types of cases in which awards were granted during the preceding fiscal year;
- The balance of the Fund at the beginning of the preceding fiscal year;

2 Pub. L. No. 111-203, § 922(a), 124 Stat. 1841 (2010).
3 15 U.S.C. § 78a, *et seq*.
4 *Id.* § 78u-6.
5 "Related actions" is defined at 15 U.S.C. § 78u-6(a)(5) and 17 C.F.R. § 240.21F-3.
6 15 U.S.C. § 78u-6(b)(1).
7 17 C.F.R. §§ 240.21F-1 through 21F-17.
8 *Id.* § 240.21F-7.
9 15 U.S.C. § 78u-6(h)(1). The Commission proposed rule amendments to modify the Whistleblower Rules to comport with the ruling in *Digital Realty* that an employee must report possible securities law violations to the Commission to qualify for protection against retaliation.
10 15 U.S.C. § 78u-7(d).

- The amounts deposited into or credited to the Fund during the preceding fiscal year;
- The amount of earnings on investments made under Section 21F(g)(4) during the preceding fiscal year;
- The amount paid from the Fund during the preceding fiscal year to whistleblowers pursuant to Section 21F(b);
- The balance of the Fund at the end of the preceding fiscal year; and
- A complete set of audited financial statements, including a balance sheet, income statement, and cash flow analysis.[11]

OWB, in consultation with other offices within the Commission, has prepared this report, which covers the period October 1, 2018 through September 30, 2019, to satisfy the reporting requirements of Section 924(d) of Dodd-Frank and Section 21F(g)(5) of the Exchange Act. The sections in this report addressing the activities of OWB, the whistleblower tips received during FY 2019, and the processing of whistleblower tips primarily address the requirements of Dodd-Frank's Section 924(d). The sections addressing the Fund and whistleblower incentive awards made during FY 2019 primarily address the requirements of Section 21F(g)(5) of the Exchange Act.

11 15 U.S.C. § 78u-6 (g)(5).

ACTIVITIES OF THE OFFICE OF THE WHISTLEBLOWER

Section 924(d) of Dodd-Frank directed the Commission to establish a separate office within the Commission to administer and enforce the provisions of Section 21F of the Exchange Act. Jane Norberg heads the Office as Chief of OWB. There are currently two Assistant Directors and nine attorneys who are dedicated to the work of the Office, which includes, among other things, processing award claims, as well as two attorneys devoted to communications with the public. OWB's work is also furthered by a number of support staff, including an accountant, paralegals, analysts, law clerks, and an administrative assistant. Following is an overview of OWB's primary responsibilities and activities over the past fiscal year.

"The whistleblower program was designed, in part, to provide monetary incentives to individuals with relevant information concerning potential securities violations to report their information to the Commission."

Assessment of Award Applications

The whistleblower program was designed, in part, to provide monetary incentives to individuals with relevant information concerning potential securities violations to report their information to the Commission. As such, much of OWB's work relates to the assessment of claims for whistleblower awards.

OWB posts a Notice of Covered Action (NoCA) on its webpage[12] for every Commission enforcement action that results in monetary sanctions of over $1 million. Those individuals who have submitted whistleblower tips pursuant to the program's requirements and whose information significantly advanced the particular investigation that led to the Covered Action may submit an application in response to a posted NoCA.

Although it is ultimately a whistleblower's responsibility to make a timely application for an award, OWB may contact whistleblowers who have been actively working with investigative staff—or who have previously contacted OWB about the posting of a particular Covered Action—to confirm they are aware of the posting and applicable deadline for submitting claims for award.

Based on an initial review, as well as communications with the relevant investigative staff, OWB prioritizes those claims that appear to be award-eligible. At the same time, OWB may process non-meritorious or frivolous claims that are easy to process in an effort to gain efficiencies and conserve resources. For every claim, OWB attorneys assess the application and the eligibility of the claimant and confer with relevant investigative or other Commission staff to understand the contribution of the claimant, if any, to the success of the Covered Action. OWB then makes recommendations to the Claims Review Staff, currently comprised of five senior officers in Enforcement, as to award eligibility. Pages 9-16 of this report provide a fuller explanation of how applications for awards are processed at the Commission, as well as what awards were made during this past fiscal year.

12 www.sec.gov/whistleblower/claim-award

Advancing Anti-Retaliation Protections and Combating Efforts to Impede Reporting

OWB identifies and monitors whistleblower complaints alleging retaliation by employers or former employers in response to an employee's reporting of possible securities law violations. The Commission may bring an enforcement action against companies or individuals who violate the anti-retaliation provisions of Dodd-Frank. With the Supreme Court's ruling in *Digital Realty*, such enforcement actions can be brought only when a whistleblower reports to the Commission. OWB continues to view anti-retaliation protections as a high priority to ensure that whistleblowers can report to the Commission without fear of reprisal. OWB continues to work with investigative staff to identify cases where companies take reprisals for whistleblowing efforts that may be appropriate for enforcement action.

In addition, OWB monitors reports of the usage of confidentiality, severance, and other kinds of agreements, or engagement in other practices, to interfere with individuals' abilities to report potential wrongdoing to the SEC. Exchange Act Rule 21F-17(a) provides that "[n]o person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement . . . with respect to such communications."[13] OWB continues to work with investigative staff to identify and investigate practices in the use of confidentiality and other kinds of agreements, or other actions, that may violate Rule 21F-17(a).

Intake of Whistleblower Tips

The Whistleblower Rules specify that individuals who would like to be part of the whistleblower program must submit their tips via the Commission's online portal or by mailing or faxing their tips on Form TCR to OWB.[14] The Commission's Tips, Complaints, and Referrals Intake and Resolution System (TCR System) serves as a central repository for all tips and complaints received by the Commission, as well as referrals from self-regulatory organizations and other government agencies. In FY 2019, OWB benefited from the updated version of the TCR System that the Commission implemented in FY 2018. OWB encourages all individuals to submit their whistleblower tips and any additional information electronically through the Commission's online portal. There are several advantages to using the online portal, including the fact that individuals receive an immediate acknowledgement of their submission along with a confirmation number. The tip is also automatically populated in a queue for staff who triage tips and complaints. For greater efficiency and quicker review, OWB recommends electronic submission over hard-copy submission.

For more information on the number and types of tips received, please refer to pages 22-25 of this report.

"OWB encourages all individuals to submit their whistleblower tips and any additional information electronically through the Commission's online portal."

13 17 C.F.R. § 240.21F-17(a).
14 17 C.F.R. § 240.21F-9(a).

"Since the hotline was established, OWB has returned nearly 24,000 calls from the public."

Communications with Whistleblowers

OWB serves as the primary liaison between the Commission and individuals who have submitted information or are considering whether to submit information to the agency concerning a possible securities violation. OWB created a whistleblower hotline, in operation since May 2011, to respond to questions from the public about the whistleblower program. Individuals may leave messages on the hotline by calling (202) 551-4790. Calls to the hotline are returned by OWB attorneys generally within 24 business hours.

During FY 2019, the Office returned over 2,600 phone calls from members of the public. Since the hotline was established, OWB has returned nearly 24,000 calls from the public.

Many of the calls OWB receives relate to how the caller should submit a tip to be eligible for an award, how the Commission will maintain the confidentiality of a whistleblower's identity, requests for information on the investigative process or tracking an individual's complaint status, and whether the SEC is the appropriate agency to handle the caller's tip. OWB provides a menu of options with answers to frequently asked questions on the voicemail hotline.

In addition to communicating with the public through the hotline, the Office communicates with whistleblowers who have submitted tips, claims for awards, and other correspondence to OWB.

Public Outreach and Education

One of OWB's primary goals is to promote public awareness of the Commission's whistleblower program. As part of that outreach effort, the Office aims to promote the program and educate the public about the program through OWB's webpage.[15] The webpage contains information about the program, links to the forms required to submit a tip or claim an award, a listing of enforcement actions for which a claim for award may be made, links to helpful resources, including a section dedicated to retaliation-related issues, and answers to frequently asked questions. In FY 2019, OWB published information on its approach to processing whistleblower award claims on its webpage.[16]

OWB also actively participates in numerous webinars, media interviews, presentations, press releases, and other public communications. In FY 2019, OWB participated in many public engagements aimed at promoting and educating the public about the Commission's whistleblower program. The Office's target audience generally includes potential whistleblowers, whistleblower counsel, and corporate compliance counsel and professionals. OWB's Chief also participates in legal panels and forums with other federal agencies with similar whistleblower programs.

15 www.sec.gov/whistleblower
16 www.sec.gov/files/OWB%20Approach%20to%20Processing%20Award%20Claims.pdf

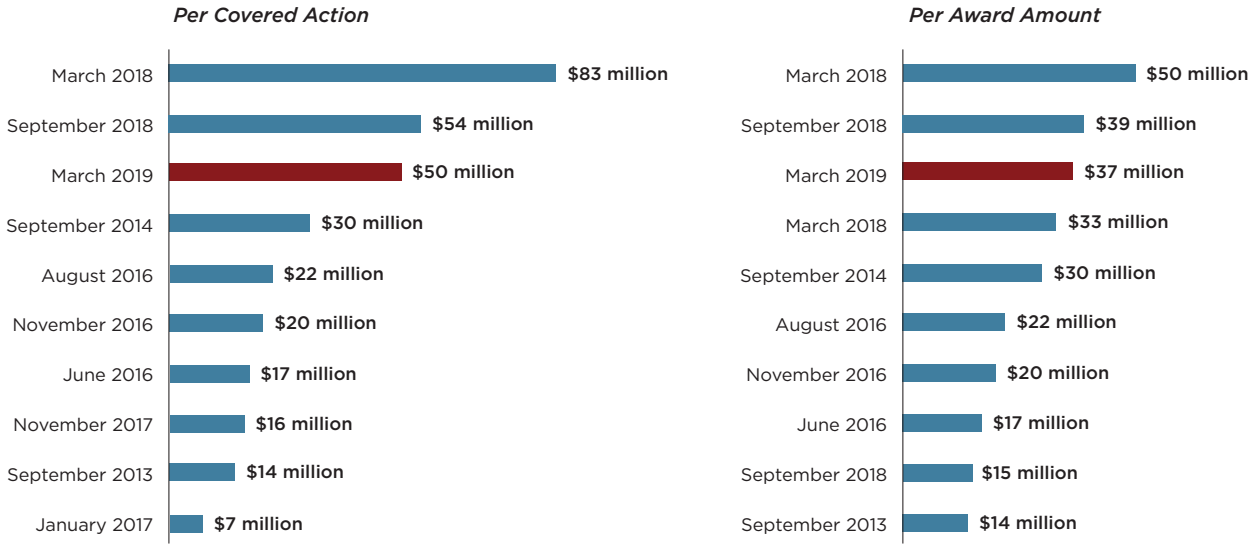
CLAIMS FOR AWARDS

Whistleblower Awards Made in Fiscal Year 2019

In FY 2019, the Commission ordered whistleblower awards of approximately $60 million to eight individuals, each of whom voluntarily provided original information that either led to the opening of an investigation or significantly contributed to a successful enforcement action.

Below are the top ten highest awards made under the SEC's whistleblower program both by Covered Action (*i.e.*, considering all awards made within a single Covered Action) and by award amount from inception of the program through FY 2019. The awards highlighted in red were ordered this past fiscal year.

TOP 10 SEC WHISTLEBLOWER AWARDS



From program inception to end of Fiscal Year 2019, the SEC awarded approximately $387 million to 67 individuals.

Below is an overview of the whistleblower awards made by the Commission during the past fiscal year.

$50 Million Awarded to Two Whistleblowers

On March 26, 2019, the Commission announced awards totaling $50 million to two whistleblowers whose high-quality information assisted the agency in bringing a successful enforcement action. One individual received an award of $37 million, and the other received an award of $13 million. The $37 million award is the Commission's third largest award to date, after the $50 million award made in March 2018 to joint whistleblowers and the more than $39 million award in September 2018. Both whistleblowers provided information that prompted Commission staff to open the investigations and thereafter met with Commission staff. The whistleblower who received the $37 million award met with investigative staff multiple times and provided information and documentation that was of significantly high quality and critically important to the staff's ability to bring the investigations to an efficient and successful resolution.[17]

$4.5 Million Awarded to Whistleblower Whose Internal Reporting Led to Successful SEC Case and Related Action

On May 24, 2019, the Commission announced an award of more than $4.5 million to a whistleblower whose tip triggered the company to review the allegations as part of an internal investigation and subsequently report the whistleblower's allegations to the SEC and another agency. As a result of the self-report by the company, the SEC opened its own investigation into the alleged misconduct. This was the first time a whistleblower was awarded under the provision of the Whistleblower Rules that was designed to incentivize internal reporting by whistleblowers who also report the same information to the Commission within 120 days. Although Commission staff never communicated with the whistleblower or the whistleblower's counsel, the whistleblower was credited for the company's internal investigation because the allegations were reported to the Commission within 120 days of the report to the company. The Commission found that the Claimant also contributed to the success of the related action and awarded the claimant the same percentage for both actions.[18]

$3 Million Awarded to Joint Whistleblowers

On June 3, 2019, the Commission announced an award of $3 million to joint whistleblowers whose tip launched the SEC's investigation and subsequent successful enforcement action involving an alleged securities law violation that impacted retail customers. In reaching the award determination, the Commission positively assessed the significant and timely steps the claimants undertook in an effort to have the firm remediate the harm caused by the alleged violations, including advocating for full disclosure of the violation and for compensation of harmed investors. In addition to

17 *See* Order Determining Whistleblower Award Claims, Exchange Act Rel. No. 85412, File No. 2019-4 (March 26, 2019); SEC Press Rel. No. 2019-42, "SEC Awards $50 Million to Two Whistleblowers."

18 *See* Order Determining Whistleblower Award Claims, Exchange Act Rel. No. 85936, File No. 2019-6 (May 24, 2019); SEC Press Rel. No. 2019-76, "SEC Awards $4.5 Million to Whistleblower Whose Internal Reporting Led to Successful SEC Case and Related Action."

participating in the firm's internal compliance system promptly after learning of the misconduct, claimants assisted the staff by meeting with them in person and identifying potential witnesses and also experienced hardships by raising concerns about the violation.[19]

More Than $1.8 Million Awarded to Whistleblower

On August 29, 2019, the Commission announced an award of more than $1.8 million to a whistleblower who provided critical information and assistance to Commission staff. After alerting the Commission to the misconduct, which occurred overseas, the whistleblower provided extensive and ongoing cooperation during the course of the investigation, including identifying witnesses, assisting with testimony preparation, and encouraging witnesses to cooperate with Enforcement staff. The whistleblower in this matter also internally reported the conduct on multiple occasions. The whistleblower's information and assistance resulted in a programmatically significant enforcement action.[20]

SEC Awards Half-Million Dollars to Overseas Whistleblower

On July 23, 2019, the Commission announced a $500,000 award to an overseas whistleblower whose expeditious reporting helped the Commission bring a successful enforcement action involving misconduct occurring abroad. The whistleblower's tip was the first information that the Commission received on the charged misconduct.[21]

More Than $38,000 Awarded to Whistleblower

On September 20, 2019, the Commission issued a Final Order for an award of more than $38,000 to a whistleblower whose quick reporting prompted Enforcement staff to open an investigation that resulted in the filing of two successful enforcement actions involving harm to retail investors. The whistleblower provided investigative testimony and encouraged others to cooperate with Commission staff.[22]

19 *See* Order Determining Whistleblower Award Claims, Exchange Act Rel. No. 86010, File No. 2019-7 (June 3, 2019); SEC Press Rel. No. 2019-81, "SEC Awards $3 Million to Joint Whistleblowers."

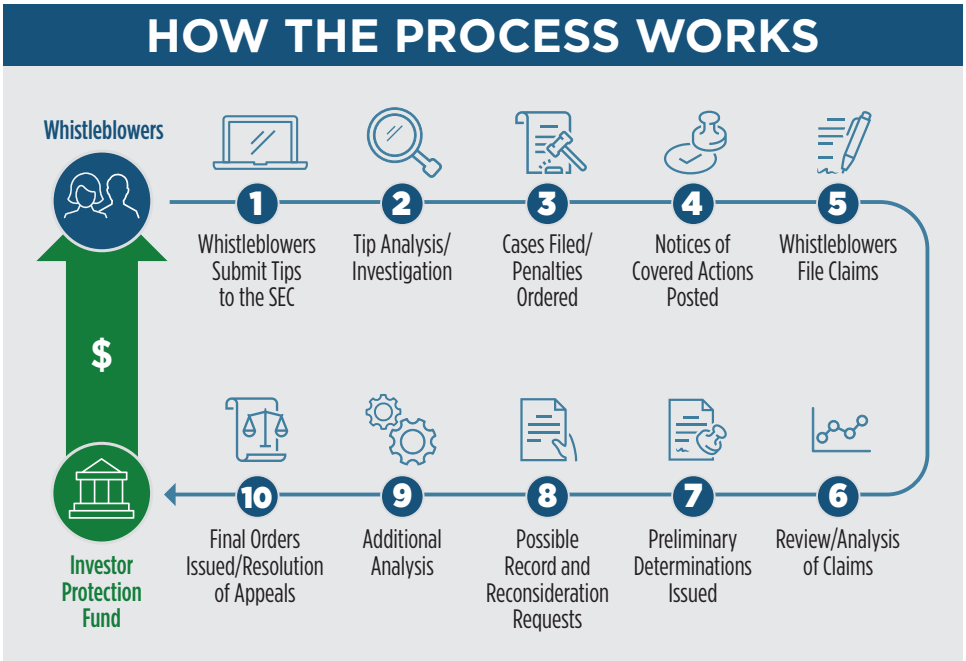
20 *See* Order Determining Whistleblower Award Claim, Exchange Act. Rel. No. 86803, File No. 2019-9 (Aug. 29, 2019); SEC Press Rel. No. 2019-165, "SEC Awards More Than $1.8 Million to Whistleblower."

21 *See* Order Determining Whistleblower Award Claims, Exchange Act Rel. No. 86431, File No. 2019-8 (July 23, 2019); SEC Press Rel. No. 2019-138, "SEC Awards Half-Million Dollars to Overseas Whistleblower."

22 *See* Order Determining Whistleblower Award Claim, Exchange Act. Rel. No. 87039, File No. 2019-11 (Sept. 20, 2019).

Overview of Award Process

For a whistleblower to receive an award, there are a number of preconditions that must be met. The diagram below provides a snapshot of the overall process, from the filing of the whistleblower tip to payment of the whistleblower award. As reflected, the time between the submission of a whistleblower tip and when an individual may receive payment of an award can be several years, particularly where the underlying investigation is especially complex, litigation is lengthy, there are multiple, competing award claims, or there are claims for related actions. OWB undertakes appropriate due diligence to ensure a careful and thorough evaluation of all award claims.



The discussion below focuses on the award claims process, from the posting of the NoCA (Step #4 above) to the issuance of a Final Order by the Commission (Step #10 above).

NoCA Posted

OWB posts on its webpage a NoCA for each Commission enforcement action where a final judgment or order, by itself or together with other judgments or orders in the same action results in monetary sanctions exceeding $1 million.[23] During FY 2019, OWB posted 151 NoCAs.

OWB sends email alerts to GovDelivery[24] when the NoCA listing is updated. Whistleblowers and other members of the public may sign up to receive an update via email every time the list of NoCAs on OWB's webpage is updated. OWB posts new NoCAs on its webpage on the last business day of each month.

23 By posting a NoCA for a particular case, the Commission is not making a determination either that a whistleblower tip, complaint, or referral led to the Commission opening an investigation or filing an action with respect to the case or that an award to a whistleblower will be paid in connection with the case.

24 GovDelivery is a vendor that provides communications for public-sector clients.

Whistleblowers File Claims

Once a NoCA is posted, claimants have 90 calendar days to apply for an award by submitting a completed award application on Form WB-APP to OWB.[25] Only claimants who have a clear nexus between the information they provided to the Commission and the charges in the underlying action should apply for an award in any given matter. In making that determination, claimants are encouraged to (i) consider whether they had any communications with the relevant Enforcement staff who brought the action and (ii) review the relevant charging documents and consider the proximity between the Commission's specific charges and the claimant's tip. The proposed amendments to the Whistleblower Rules include tools intended to deter frivolous claims, which drain resources and slow down the review process for meritorious claims. Frivolous claims can substantially complicate and delay the award process.

While OWB may contact whistleblowers who have worked with investigative staff to inform them of the application deadline, it is the responsibility of the claimant to make a timely application for award. The Commission has denied late-filed award claims. The Court of Appeals for the Second Circuit upheld the Commission's denial of two claimants whose award applications were submitted approximately two years after the required deadline.[26] As such, OWB encourages whistleblowers and their counsel to regularly review the monthly NoCA postings or to sign up to receive emails to alert them as to when new NoCAs are posted.

Review and Analysis of Award Claims

Based on an initial review of the award application and in consultation with investigative staff, OWB makes a preliminary assessment of the whistleblower claim. In keeping with OWB's goal of processing meritorious claims, claims that appear to be eligible for an award are prioritized for processing. At the same time, OWB may process non-meritorious or frivolous claims that are easy to process in an effort to gain efficiencies and conserve resources.

OWB attorneys evaluate each application for a whistleblower award. In addition to analyzing the information provided by the claimant on the Form WB-APP, OWB attorneys may look at prior correspondence between the claimant and the Commission and may consult intra-agency databases to understand the origin of the case and what tips or other correspondence the claimant may have submitted to the Commission. In addition, OWB attorneys may work closely with investigative staff responsible for the relevant action, and/or other Commission staff who may have interacted with the claimant or have other relevant knowledge, to understand the contribution or involvement the claimant may have had in the matter.

Utilizing the information and materials provided by the claimant in support of the application, as well as other relevant materials reviewed, OWB attorneys prepare a recommendation to the Claims Review Staff as to whether the claimant meets the criteria for receiving an award, and if so, the recommended amount of the award.

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25 17 C.F.R. §§ 240. 21F-10(a), (b).

26 *See* Order Determining Whistleblower Award Claim, Exchange Act Release No. 77368 (Mar. 14, 2016), *pet. for rev. denied sub nom. Cerny v. SEC*, 707 F. App'x 29 (2d Cir. 2017), *cert. denied*, 138 S. Ct. 2005 (2018); *see also LaViola v. SEC*, No. 19-1079, 2019 WL 3229356 (D.C. Cir. July 16, 2019) (unpublished).

Depending on the complexity of the award claim, the number of claimants who applied, and whether OWB is awaiting input from others, including from other agencies in connection with related action claims, this due diligence process may take a significant amount of time.

Generally, most non-frivolous award claim recommendations also go through a multi-tiered, robust review process, including review and comment by Enforcement's Office of Chief Counsel and the Commission's Office of the General Counsel.

Preliminary Determinations Issued

The Claims Review Staff, designated by the Co-Directors of Enforcement, considers OWB's recommendation on the award application in accordance with the criteria set forth in Dodd-Frank and the Whistleblower Rules. The Claims Review Staff currently is composed of five senior officers in Enforcement, including the Co-Directors of Enforcement. The Claims Review Staff then issues a Preliminary Determination setting forth its assessment of whether the claim should be approved or denied and, if approved, setting forth the proposed award amount.[27]

"Award amounts are based on the particular facts and circumstances of each case."

The Whistleblower Rules outline a number of positive and negative factors that the Commission and Claims Review Staff may consider in assessing an individual's award amount.[28] Award amounts are based on the particular facts and circumstances of each case.

Factors that may increase an award amount include the significance of the information provided by the whistleblower, the level of assistance provided by the whistleblower, the law enforcement interests at stake, and whether the whistleblower reported the violation internally through an entity's internal reporting channels or mechanisms.[29]

Factors that may decrease an award amount include whether the whistleblower was culpable or involved in the underlying misconduct, including whether the whistleblower financially benefited from the misconduct, interfered with internal compliance systems, or unreasonably delayed in reporting the violation to the Commission.

Possible Record and Reconsideration Requests

A claimant may submit a written request within 30 calendar days of the date of the Preliminary Determination asking for a copy of the record that formed the basis of the Claims Review Staff's decision as to the claim for award. As a precondition to receiving a copy of the record, OWB requires claimants and their counsel, if the claimant is represented, to execute a confidentiality agreement limiting the use of such materials to the claims review process.[30] In keeping with our statutory obligation of confidentiality, OWB carefully redacts each record to remove any information that could identify another whistleblower in the matter. A claimant also has 30 calendar days to request a meeting with OWB, which OWB may grant at its discretion.

27 17 C.F.R. § 240.21F-10(d).
28 *Id.* § 240.21F-6.
29 *But see* the discussion of the *Digital Realty* decision on page 21 of this report.
30 *Id.* § 240.21F-12(b). Rule 21F-12(b) states, "The Office of the Whistleblower may also require you to sign a confidentiality agreement, as set forth in § 240.21F-(8)(b)(4) of this chapter, before providing [Preliminary Determination] materials."

Claimants may seek reconsideration of the Preliminary Determination by submitting a written response to OWB within 60 calendar days of the later of (i) the date of the Preliminary Determination, or (ii) if the record was requested, the date when OWB made the record available for a claimant's review.[31] If a claim is denied and the claimant does not object within the time period prescribed under the Whistleblower Rules, then the Preliminary Determination of the Claims Review Staff becomes the Final Order of the Commission.

Requests for reconsideration should include new information or argument and not simply restate what was included in the original award claim application. OWB attorneys may spend a considerable amount of time evaluating requests for reconsideration. OWB attorneys analyze claimants' legal arguments and take other steps before recommending a Proposed Final Determination for the Claims Review Staff to submit to the Commission. Because of the amount of time it takes to process reconsideration requests, OWB encourages claimants and their counsel to consider the merits of their reconsideration request in a particular matter and not to ask for reconsideration as a matter of course. OWB welcomes meritorious reconsideration requests.

Final Order Issued and Resolution of Appeals

After considering any requests for reconsideration, the Claims Review Staff makes a Proposed Final Determination, and the matter is submitted to the Commission for its decision.[32]

All Preliminary Determinations of the Claims Review Staff that involve granting an award are submitted to the Commission for consideration as Proposed Final Determinations irrespective of whether the claimant objected to the Preliminary Determination.[33]

Within 30 days of receiving the Proposed Final Determination, any Commissioner may request that the Proposed Final Determination be further reviewed by the Commission. If no Commissioner requests such a review within the 30-day period, then the Proposed Final Determination becomes the Final Order of the Commission. Claimants who are issued a denial have a right to appeal the Commission's Final Order within 30 days of issuance to the United States Court of Appeals for the District of Columbia Circuit, or to the circuit where the claimant resides or has his or her principal place of business.[34]

Final Orders of the Commission are publicly available on the Commission's website and OWB's webpage. The public Final Orders are redacted to protect award claimants' confidentiality.

31 17 C.F.R. § 240.21F-10(e).
32 *Id.* §§ 240.21F-10(g)-(h).
33 *Id.* §§ 240.21F-10(f), (h).
34 *Id.* § 240.21F-10(h). A whistleblower's rights of appeal from a Commission Final Order are set forth in Section 21F(f) of the Exchange Act, 15 U.S.C. § 78u-6(f), and Exchange Act Rule 21F-13(a), 17 C.F.R. § 240.21F-13(a).

There are several factors that may affect the length of time it takes for OWB to review an award claim and for the Commission to issue a Final Order. For example, the number of claimants, both meritorious and non-meritorious, applying for an award in connection with a Covered Action affects the time it takes to process a claim. Similarly, the presence of novel or complex issues, or the need to supplement the record with additional information from the claimant, may also lengthen the time it takes to process a claim. There may be a delay when there is a claim for an award in connection with a related action, requiring OWB to coordinate with or receive assistance from another regulator to understand what contribution the whistleblower may have made in the related action. Additionally, requests for the record and for reconsideration can substantially delay the issuance of a Final Order.

PROFILES OF AWARD RECIPIENTS

Protecting whistleblower confidentiality is an integral component of the whistleblower program. Dodd-Frank prohibits the Commission and its staff from disclosing any information that reasonably could be expected to reveal the identity of a whistleblower, subject to certain exceptions. Consequently, information that may tend to reveal a whistleblower's identity is redacted from Commission orders granting or denying awards before they are issued publicly. This may include redacting the name of the enforcement action upon which the award is based.

Consistent with our statutory obligation to maintain whistleblower confidentiality but in an effort to provide more transparency, this section provides information about the profiles of past award recipients—from the whistleblower program's inception to the end of FY 2019—while still protecting the identity of any particular individual.

Since program inception, the Commission has issued awards of approximately $387 million to 67 individuals in connection with 55 Covered Actions, as well as in connection with several related actions. Many of the tips or complaints that were submitted by these successful whistleblowers share similar characteristics. The information provided by each award recipient was specific. For example, the whistleblowers identified particular individuals involved in the misconduct, or provided specific documents that substantiated their allegations or explained where such documents could be located. In some instances, the whistleblowers identified specific financial transactions that evidenced fraud, or provided detailed assessment of the wrongdoing. The misconduct reported by award recipients is often relatively current or ongoing at the time it was reported to the Commission. Additionally, nearly all of the award recipients provided Commission staff with additional assistance and/or information (*e.g.*, answered staff questions or provided testimony) after they submitted their initial tips.

An individual may be eligible to receive an award where his or her information leads to a successful enforcement action—meaning generally that the original information either caused the staff to open an examination or investigation, or the original information significantly contributed to a successful enforcement action where the matter was already under examination or investigation. Of the whistleblowers who have received awards under the program, approximately 68 percent provided original information that caused staff to open an investigation or examination, and approximately 32 percent received awards because their original information significantly contributed to an already-existing investigation or examination. In assessing whether information assisted with an ongoing matter, the Commission considers factors such as whether the information allowed the

"Since program inception, the Commission has issued awards of approximately $387 million to 67 individuals in connection with 55 Covered Actions, as well as in connection with several related actions."

Commission to bring an action in significantly less time or with fewer resources, and whether it supported additional successful charges, or successful claims against additional individuals or entities.[35] When the Commission has found claimants to be ineligible for awards on non-procedural grounds, it is often because the claimants' information did not result in the opening of an investigation or examination, opening of a new line of inquiry in an existing investigation or examination, nor significantly contributed to an ongoing investigation or examination.

"Past whistleblower award recipients hail from several different parts of the United States, and fifteen recipients were foreign nationals or residents of foreign countries at the time they submitted their tips to the Commission."

There is no requirement under the Whistleblower Rules that an individual be an employee or company insider to be eligible for an award. However, approximately 69 percent of the award recipients to date were current or former insiders of the entity about which they reported information of wrongdoing to the SEC. Of those recipients, approximately 85 percent raised their concerns internally to their supervisors, compliance personnel, or through internal reporting mechanisms, or understood that their supervisor or relevant compliance personnel knew of the violations, before reporting their information of wrongdoing to the Commission.

Award recipients have also included investors who had been victims of the fraud, professionals working in the same or related industry, or other types of outsiders, such as individuals who had a personal relationship with the wrongdoer or individuals who have a special expertise in the market.

Whistleblowers have helped the Commission bring cases against a variety of individuals and entities, many of which are involved in the financial services industry. Individuals comprised approximately 40 percent of the defendants and respondents in cases resulting in whistleblower awards. Approximately 33 percent of the defendants and respondents in cases in which a whistleblower received an award concerned entities registered with the Commission, including broker-dealers, investment advisers, or other registered market participants. Unregistered entities comprised approximately 26 percent of the defendants and respondents.

In addition, whistleblowers have assisted the Commission in bringing enforcement cases involving an array of securities violations, including offering frauds, such as Ponzi or Ponzi-like schemes, false or misleading statements in a company's offering memoranda or marketing materials, false pricing information, accounting violations, internal controls violations, and Foreign Corrupt Practices Act (FCPA) violations, among other types of misconduct.

Under the Whistleblower Rules, individuals are permitted to jointly submit a tip to the Commission. Eight of the matters for which whistleblower awards were ordered involved two or more whistleblowers jointly submitting information to the Commission.

35 Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,325 (June 13, 2011).

Individuals who provide information that leads to successful SEC actions resulting in monetary sanctions over $1 million also may be eligible to receive an award if the same information led to a related action, such as a parallel criminal prosecution. Seven of the award recipients to date have received payments based, in part, on collections made in related criminal or other qualifying related actions.

Past whistleblower award recipients hail from several different parts of the United States, and fifteen recipients were foreign nationals or residents of foreign countries at the time they submitted their tips to the Commission.

PRESERVING INDIVIDUALS' RIGHTS TO REPORT TO THE COMMISSION AND SHIELDING EMPLOYEES FROM RETALIATION

Section 21F(h)(1) of Dodd-Frank expanded protections for whistleblowers and broadened prohibitions against retaliation.[36] Following the passage of Dodd-Frank, the Commission implemented rules that enabled the SEC to take legal action against employers who have retaliated against whistleblowers. To date, the Commission has brought three anti-retaliation enforcement actions.

Exchange Act Rule 21F-17(a) prohibits any person from taking any action to prevent an individual from contacting the SEC directly to report a possible securities law violation. The Rule states that "[n]o person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement . . . with respect to such communications."[37] To date, the Commission

36 15 U.S.C. § 78u-6(h)(1).
37 17 C.F.R. § 240.21F-17(a).

has brought eleven enforcement actions or administrative proceedings involving violations of Rule 21F-17. One of the most recent actions, *Securities and Exchange Commission v. Kenneth W. Crumbley, Jr. and Sedona Oil & Gas Corp.*, Civil Action No. 3:16-CV-00172 (N.D. Tex.), settled at the end of FY 2018. The action involved the fraudulent offer and sale of oil and gas investments. The Commission alleged that the defendants engaged in the deliberate destruction of evidence in the months leading up to the action and that defendant Crumbley threatened to terminate Sedona employees for speaking with Commission staff or other government authorities. As part of the settlement, the Court ordered that Crumbley be enjoined from future violations of Rule 21F-17.

In February 2018, the Court in *Digital Realty* held that the whistleblower provisions of the Exchange Act require that an employee report a possible securities law violation to the Commission to qualify for protection against employment retaliation under Section 21F. The Court thus invalidated the Commission's rule interpreting Section 21F's anti-retaliation protections to apply in cases where an employee had reported only internally. The proposed rule amendments will modify Rule 21F-2 to comport with the Court's holding by, among other things, establishing a uniform definition of "whistleblower" that would apply to all aspects of Exchange Act Section 21F.

Retaliation protection remains a key tenet of the whistleblower program. OWB continues to support enforcement investigations where retaliation occurred after the whistleblower reported securities violations to the Commission and continues to support the enforcement of the whistleblower protections of Exchange Act Rule 21F-17(a). OWB also continues to work with investigative staff to identify and investigate practices in the use of confidentiality and other kinds of agreements, or engagement in other practices, to interfere with individuals' abilities to report potential wrongdoing to the Commission.

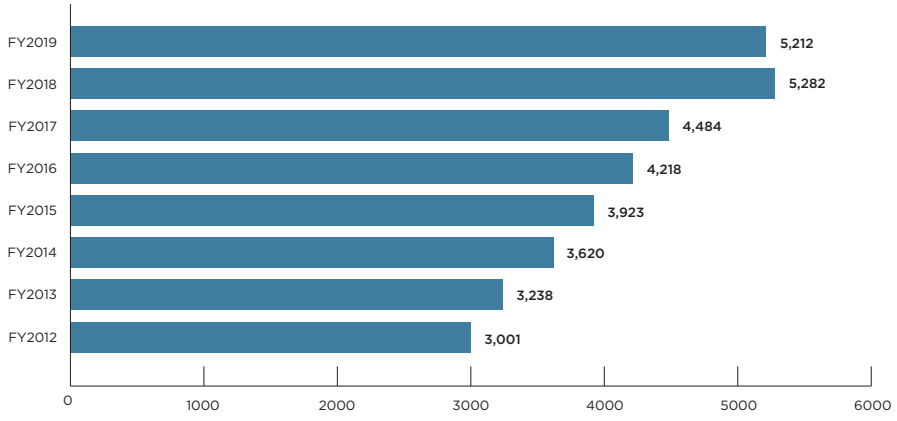
"Retaliation protection remains a key tenet of the whistleblower program."

WHISTLEBLOWER TIPS RECEIVED

The Whistleblower Rules specify that individuals who would like to be part of the whistleblower program must submit their tips via the Commission's online portal or by mailing or faxing their tips on Form TCR to OWB.[38] Whistleblowers who use the online portal to submit a tip receive a computer-generated confirmation of receipt with a TCR submission number. All whistleblower tips referring to potential securities law violations are entered into the TCR System and are evaluated by the Commission's Office of Market Intelligence (OMI) within Enforcement. The Commission's TCR System was updated in FY 2018 to include more user-friendly features, including the ability to upload larger attachments. OWB encourages individuals and their counsel to submit tips using the Commission's online portal, rather than through a hard-copy Form TCR. Due to the increasing volume of mailed and faxed submissions, and the ready availability of electronic submissions, OWB no longer provides acknowledgement letters in response to paper filings. Claimants and their counsel are encouraged to submit their tip via only one method. For example, the same tip should not be entered through the online portal and then mailed in hard-copy to the office. This can create duplication of work for intake staff.

Number of Whistleblower Tips

In FY 2019, the Commission received more than 5,200 tips—the second largest number of tips received in a fiscal year, just slightly below the number of tips received in FY 2018. Since August 2011, the Commission has received over 33,300 whistleblower tips. The table below shows the number of whistleblower tips received by the Commission on a yearly basis.[39]



From FY 2012, the first year for which we have full-year data,[40] to FY 2019, the number of whistleblower tips received by the Commission has grown by approximately 74 percent.

38 17 C.F.R. § 240.21F-9(a).

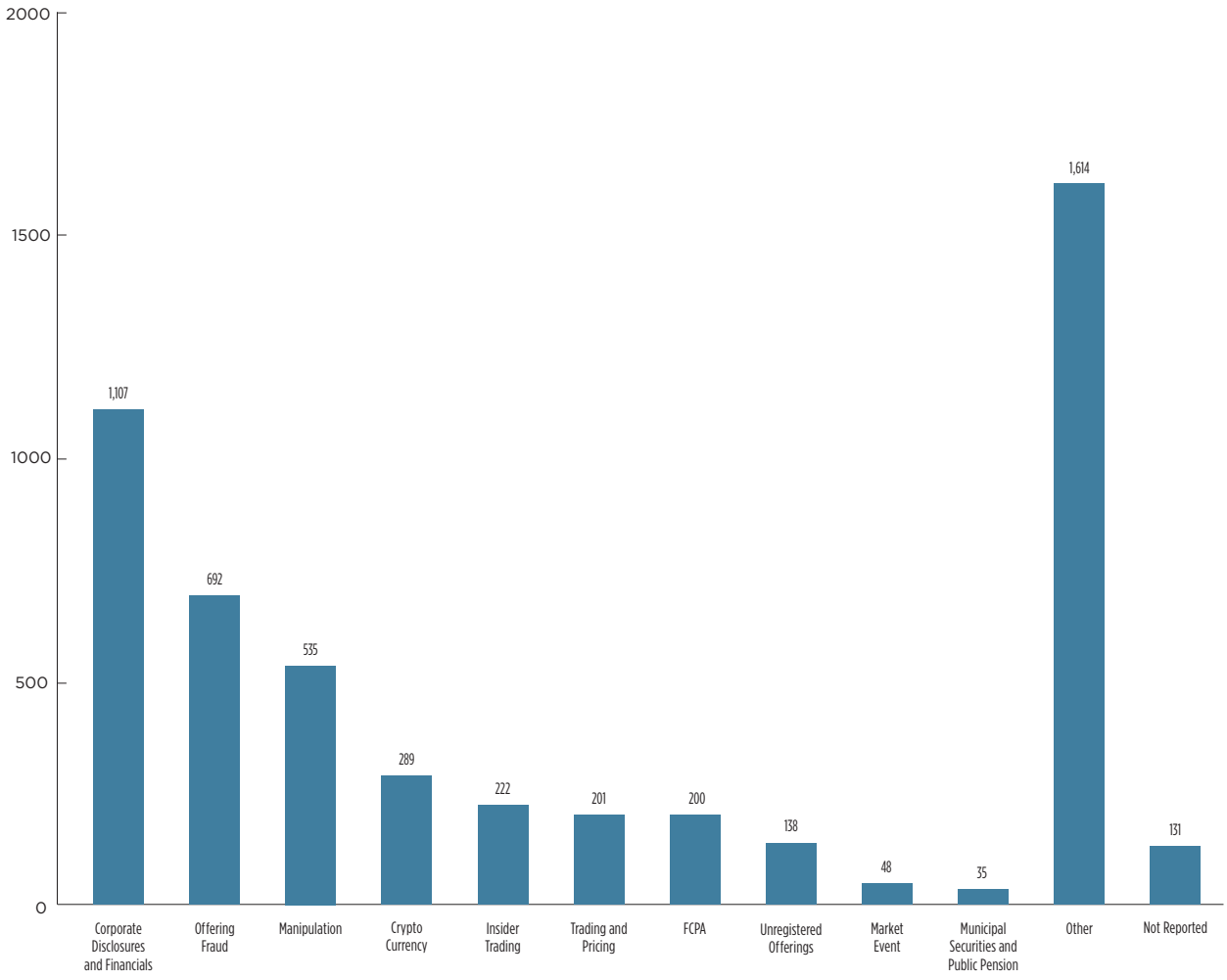
39 The Commission also receives tips from individuals who do not wish to be part of the whistleblower program. The data in this report is limited to whistleblower tips and does not reflect all tips or complaints received by the Commission during the fiscal year.

40 Because the Whistleblower Rules became effective on August 12, 2011, only seven weeks of whistleblower data is available for FY 2011.

Whistleblower Allegation Type

Whether submitting tips on Form TCR or through the online portal, whistleblowers should identify the nature of their complaint allegations. In FY 2019, the most common complaint categories reported by whistleblowers were Corporate Disclosures and Financials (21 percent), Offering Fraud (13 percent), and Manipulation (10 percent).[41]

The following graph reflects the number of whistleblower tips received in FY 2019 by allegation type.[42]



41 This breakdown reflects the categories selected by whistleblowers and, thus, the data represents the whistleblower's own characterization of the violation type.

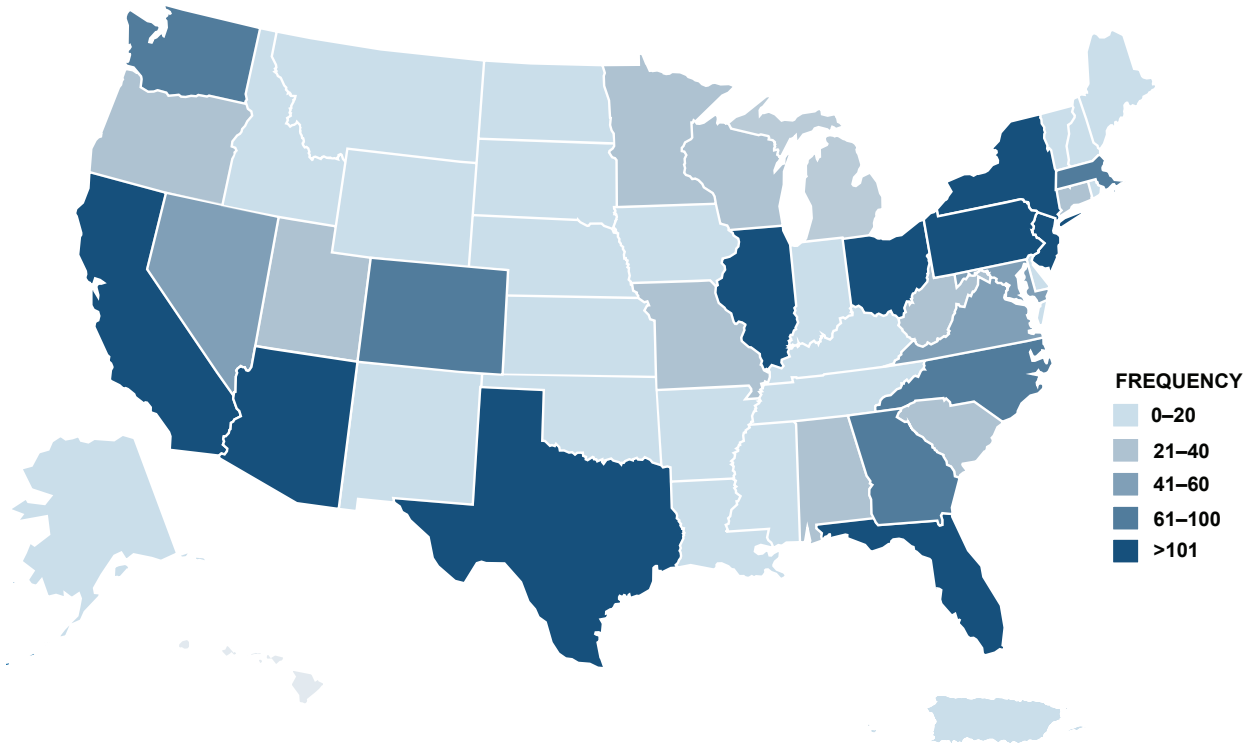
42 The category of "Other" indicates that the submitter identified the whistleblower TCR as not fitting into any allegation category that is listed on the questionnaire.

The types of securities violations reported by whistleblowers have remained generally consistent over the last eight years. Since the beginning of the program, Corporate Disclosures and Financials, Offering Fraud, and Manipulation have consistently ranked as the three highest allegation types reported by whistleblowers. Crypto Currency was added to the TCR System as an allegation type in the fourth quarter of FY 2018. The Commission received nearly 300 tips (6 percent), the fourth highest allegation type, relating to cryptocurrencies in FY 2019. Appendix A to this report provides a comparison among the number of whistleblower tips by allegation type that the Commission received during FY 2016 through FY 2019.

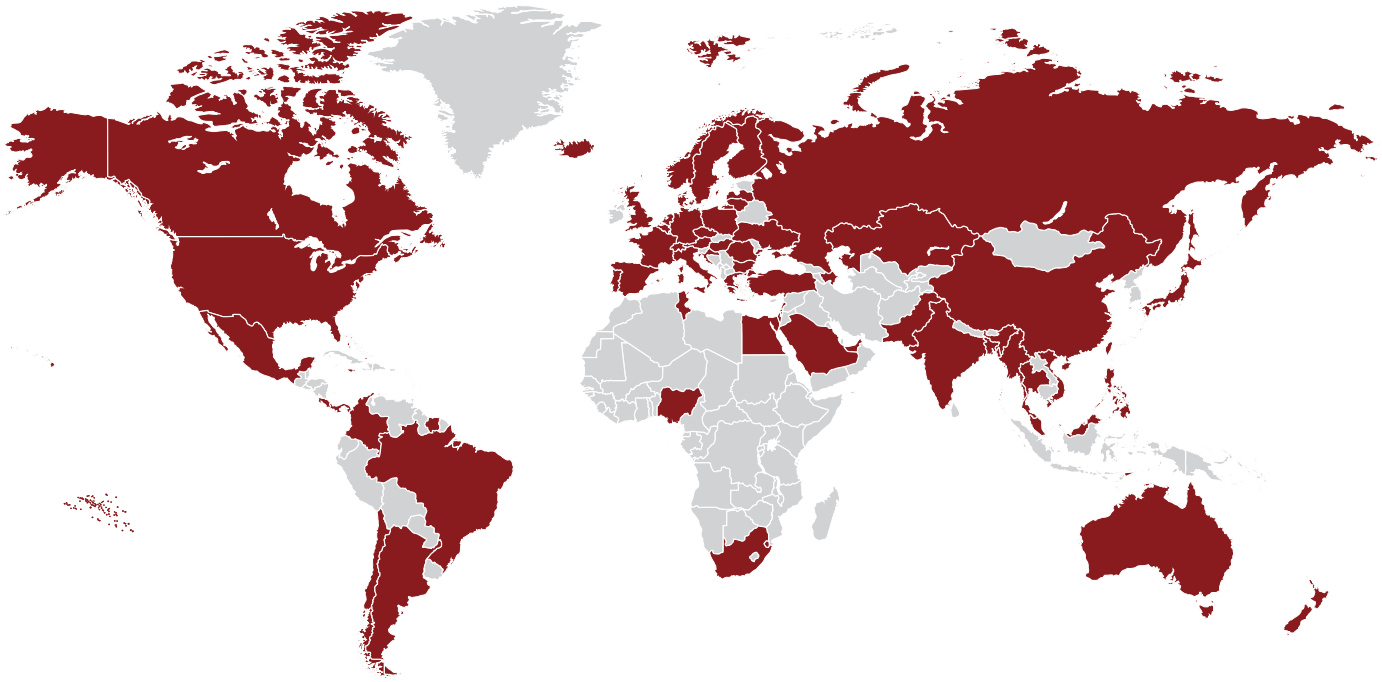
Geographic Origin of Whistleblower Tips

Through OWB's extensive outreach efforts to publicize and promote the Commission's whistleblower program, the Commission continues to receive whistleblower submissions from individuals throughout the United States, as well as internationally.

During FY 2019, California, Pennsylvania, New York, Texas, and Florida yielded the highest number of whistleblower tips domestically.



Since the beginning of the whistleblower program, the Commission has received whistleblower tips from individuals in 123 countries outside the United States. In FY 2019 alone, the Commission received whistleblower submissions from individuals in 70 foreign countries. After the United States, OWB received the highest number of whistleblower tips this past fiscal year from individuals in Canada, Germany, and the United Kingdom. The map below reflects the countries in which whistleblower tips originated during FY 2019.



Appendices B and C to this report provide detailed information concerning the sources of domestic and foreign whistleblower tips that the Commission received during FY 2019.

PROCESSING OF WHISTLEBLOWER TIPS

OMI evaluates incoming whistleblower TCRs and assigns specific, credible, and timely TCRs to members of the Commission staff for further analysis or investigation.

TCR Evaluation

OMI reviews every TCR submitted by a whistleblower to the Commission that references a possible securities law violation. OMI examines each tip to identify those with high-quality information that warrant the additional allocation of Commission resources. Generally, when the evaluation of a tip could benefit from the specific expertise of another Division or Office within the SEC, the tip is forwarded to staff in that Division or Office for further analysis. When OMI determines that a tip should be considered for investigation, OMI assigns the tip to one of the Commission's eleven regional offices, a specialty unit, or to an Enforcement group in the Home Office. Tips that relate to an existing investigation are forwarded to the staff working on the matter.

The Commission may use information from whistleblower tips in several different ways. For example, the Commission may initiate an enforcement investigation based on the whistleblower's tip. Even if the tip does not cause an investigation to be opened, it may still help lead to a successful enforcement action if the whistleblower provides additional information that significantly contributes to an ongoing or already-existing investigation. Tips may also prompt the Commission to commence an examination of a regulated entity, which may lead to an enforcement action.

OWB tracks whistleblower tips that are referred to Enforcement staff for investigation. OWB currently is tracking over 1,000 matters in which a whistleblower's tip has caused a Matter Under Inquiry or investigation to open, or has been forwarded to Enforcement staff for review and consideration in connection with an ongoing investigation. Not all of these matters, however, will result in an enforcement action, or an enforcement action where the required threshold of over $1 million in monetary sanctions will be ordered. Whistleblower tips may also be used to open an examination or referred to examination staff in connection with a planned or ongoing exam.

In general, whistleblower tips that are specific, credible, and timely, and that are accompanied by corroborating documentary evidence, are more likely to be forwarded to investigative staff for further analysis or investigation. For instance, if the tip identifies individuals involved in the scheme, provides examples of particular fraudulent transactions, or points to non-public materials evidencing the fraud, the tip is more likely to be assigned to Enforcement staff for investigation. Tips that make blanket assertions or general inferences based on market events are less likely to be forwarded to or investigated by Enforcement staff.

In certain instances, OMI or other Enforcement staff may determine it is more appropriate that a whistleblower's tip be investigated by another regulatory or law enforcement agency. When this occurs, the tip is referred to the other agency in accordance with the Exchange Act's whistleblower confidentiality requirements.

Tips that relate to the financial affairs of an individual investor or a discrete investor group usually are forwarded to the Commission's Office of Investor Education and Advocacy (OIEA) for resolution. Comments or questions about agency practice or the federal securities laws also are forwarded to OIEA.

Assistance by OWB

OWB supports the tip allocation and investigative processes in several ways. When whistleblowers submit tips on a Form TCR in hard-copy by mail or fax, the information is entered into the TCR System so it can be evaluated by OMI. Tips submitted by whistleblowers through the Commission's online portal are automatically forwarded to OMI for evaluation.

After submitting an initial tip, a whistleblower is free to, and often does, submit additional information or materials to buttress his or her earlier allegations. Additional information may be submitted through the online portal, with reference to the original TCR submission number (if known), or may be submitted directly to investigative staff if the whistleblower is working with staff on the matter. To the extent additional information is sent to OWB in hard-copy by mail or fax, the additional information is uploaded to the TCR System. Due to the increasing volume of additional information submitted in paper form to OWB, and the ready availability of electronic submissions, OWB no longer provides acknowledgement letters in response to mailed or faxed submissions.

"Whistleblower tips that are specific, credible, and timely, and that are accompanied by corroborating documentary evidence, are more likely to be forwarded to investigative staff for further analysis or investigation."

SECURITIES AND EXCHANGE COMMISSION INVESTOR PROTECTION FUND

Section 922 of Dodd-Frank established the Investor Protection Fund to provide funding for the Commission's whistleblower award program, including the payment of awards in related actions.[43] As required by statute, all payments are made out of this Fund, which is financed entirely through monetary sanctions paid to the SEC by securities law violators. No money has been taken or withheld from harmed investors to pay whistleblower awards. The Fund also is used to finance the operations of the suggestion program of the SEC's Office of Inspector General.[44] The suggestion program is intended for the receipt of suggestions from SEC employees for improvements in work efficiency, effectiveness, productivity, and the use of resources at the Commission, as well as allegations by SEC employees of waste, abuse, misconduct, or mismanagement within the Commission, and is operated outside of OWB.[45]

Section 21F(g)(5) of the Exchange Act requires certain Fund information to be reported to Congress on an annual basis. Below is a chart containing Fund-related information for FY 2019.

	FY 2019
Balance of Fund at beginning of fiscal year	$ 299,333,981.82
Reversal of prior year sequestered amount[46]	$ 12,234,592.57
Amounts deposited into or credited to Fund during fiscal year	$ 156,519,496.36
Amounts of interest receipts from investments during fiscal year	$ 6,583,501.46
Current year sequestered amount[46]	$ (10,112,385.86)
Amounts paid from Fund during fiscal year to whistleblowers	$ (141,976,223.37)
Reversal of obligations accrued in prior years	$ 81,426,463.14
Amount disbursed to Office of the Inspector General during fiscal year	$ (33,497.17)
Balance of Fund at end of fiscal year	$ 403,975,928.95

43 Section 21F(g)(2)(A) of the Exchange Act, 15 U.S.C. § 78u-6(g)(2)(A).

44 Section 21F(g)(2)(B) of the Exchange Act, 15 U.S.C. § 78u-6(g)(2)(B), provides that the Fund shall be available to the Commission for "funding the activities of the Inspector General of the Commission under section 4(i)." The Commission's Office of General Counsel has interpreted this section to refer to Exchange Act Section 4D, which established the Inspector General's suggestion program. That section provides that the "activities of the Inspector General under this subsection shall be funded by the Securities and Exchange Commission Investor Protection Fund established under Section 21F." *Id.* § 78d-4(e).

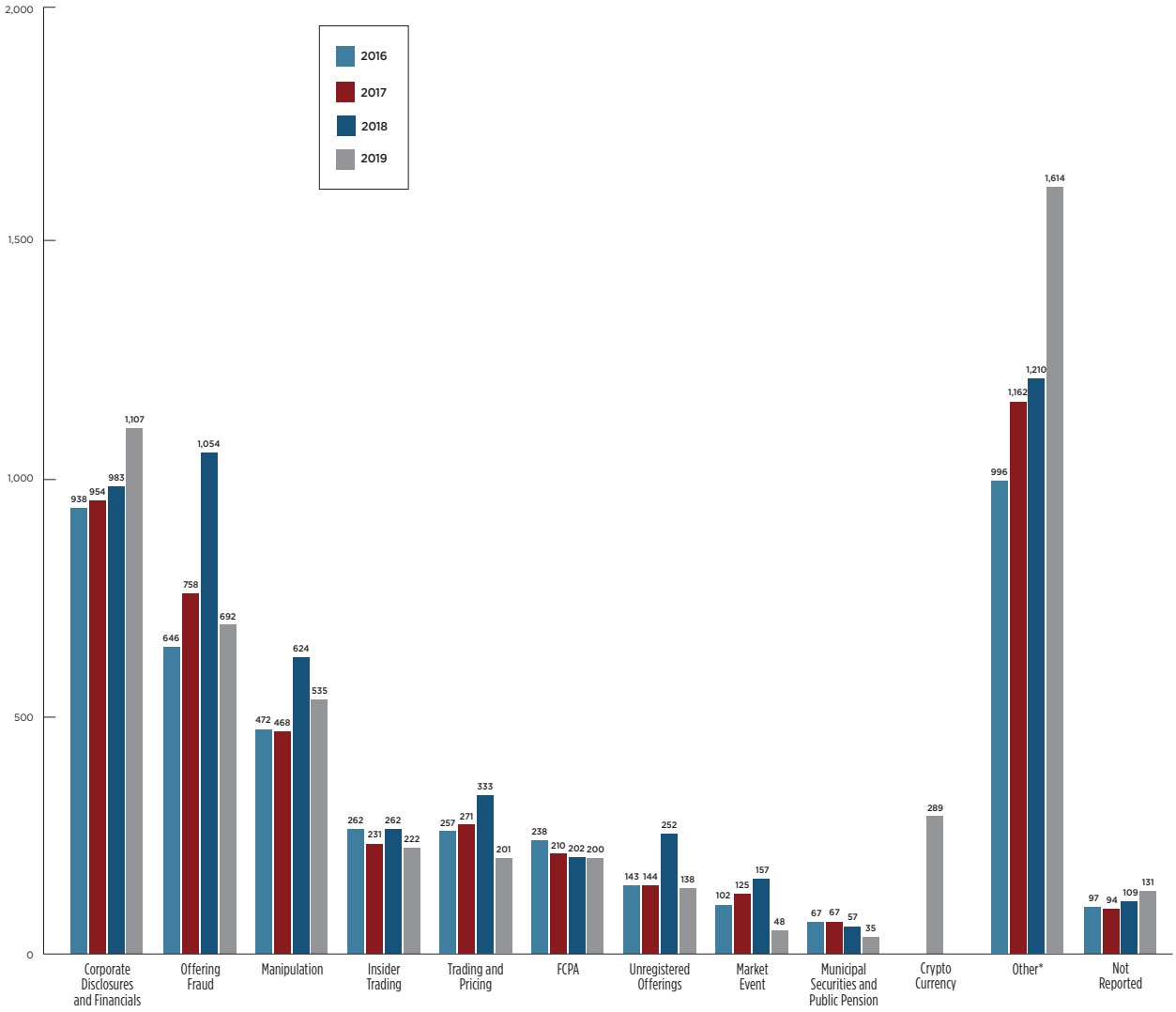
45 Section 4D(a) of the Exchange Act, *id.* § 78d-4(a).

46 Amounts relate to available resources temporarily reduced during the fiscal year as a result of the Budget Control Act of 2011 through the process known as "sequestration." These amounts become available at the beginning of the following fiscal year.

Whenever the balance of the Fund falls below $300 million, a statutory replenishment mechanism is triggered. On March 31, 2019, the fund fell below $300 million. On April 30, 2019, the Fund was replenished in the amount of $156.5 million from monetary sanctions collected by the Commission between March 31, 2019 and April 11, 2019, which were not to be added to a disgorgement fund or otherwise distributed to victims of a violation of the securities laws. For a complete description of the mechanisms that Congress established to replenish the Fund, *see* Section 21F(g)(3) of the Exchange Act, 15 U.S.C. 78-6(g)(3).

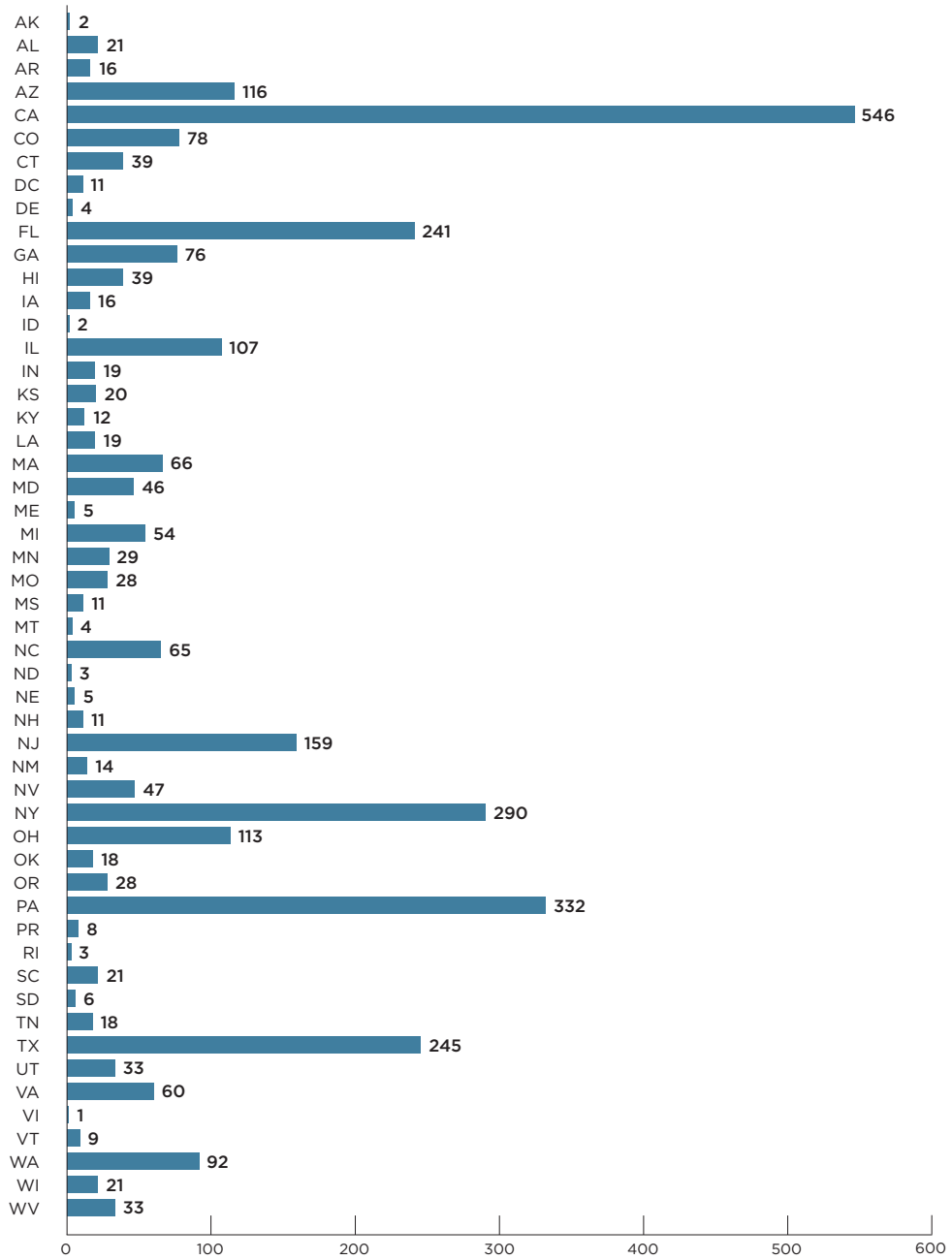
Section 21F(g)(5) of the Exchange Act also requires the Commission to provide a complete set of audited financial statements for the Fund, including a balance sheet, income sheet, income statement, and cash-flow analysis. That information will be included in the Commission's Agency Financial Report, which will be separately submitted to Congress.

APPENDIX A
WHISTLEBLOWER TIPS BY ALLEGATION TYPE
COMPARISON OF FISCAL YEARS 2016-2019



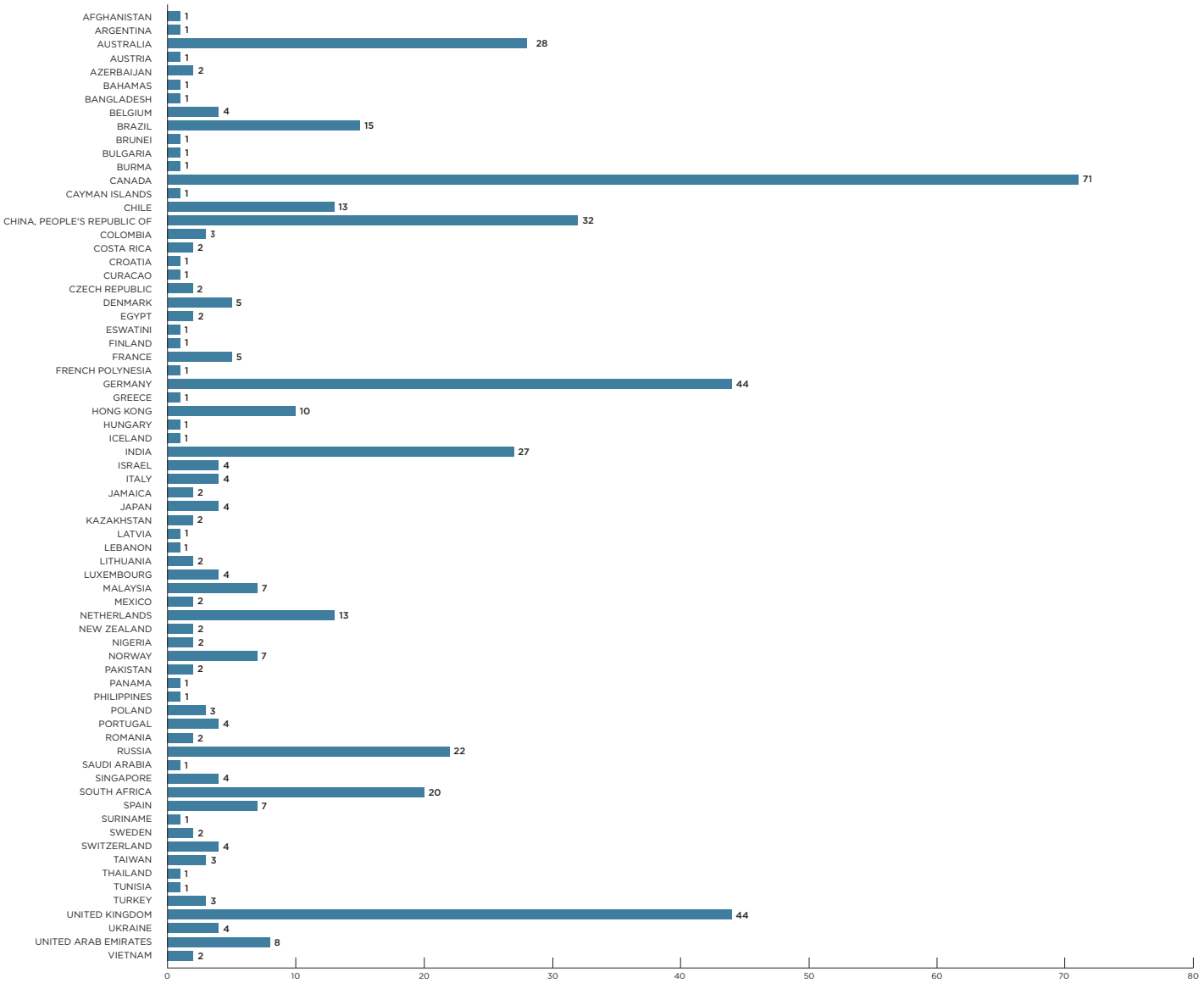
*The category of "Other" indicates that the submitter identified the whistleblower TCR as not fitting into any allegation category that is listed on the questionnaire. The "Crypto Currency" allegation category was introduced during the fourth quarter of FY 2018.

APPENDIX B
WHISTLEBLOWER TIPS RECEIVED BY GEOGRAPHIC LOCATION UNITED STATES AND ITS TERRITORIES, FISCAL YEAR 2019*



*Approximately 3,262 WB TCRs were submitted in the United States or a U.S. territory during FY 2019, which constitutes approximately 63 percent of the WB TCRs submitted during this period. In addition, approximately 1,471 WB TCRs, constituting approximately 28 percent of the WB TCRs submitted in FY 2019, were submitted with an unknown foreign or domestic geographical categorization or were submitted anonymously through counsel.

APPENDIX C
WHISTLEBLOWER TIPS RECEIVED BY GEOGRAPHIC LOCATION INTERNATIONAL, FISCAL YEAR 2019*



*The number of WB TCRs submitted from abroad during FY 2019 were approximately 479, constituting approximately 9 percent of the WB TCRs submitted during this period.

OFFICE OF THE WHISTLEBLOWER

Washington, DC

ANNUAL REPORT ON THE WHISTLEBLOWER PROGRAM AND CUSTOMER EDUCATION INITIATIVES

2019 Annual Report

October 2019

I. INTRODUCTION

Section 748 of the Dodd-Frank Wall Street Reform and Consumer Protection Act[1] amended the Commodity Exchange Act ("CEA") by adding Section 23, entitled "Commodity Whistleblower Incentives and Protection."[2] CEA Section 23 established a whistleblower program under which the Commodity Futures Trading Commission (the "Commission" or "CFTC") will pay awards, based on collected monetary sanctions and under regulations prescribed by the Commission, to eligible whistleblowers who voluntarily provide the Commission with original information about violations of the CEA that lead either to a "covered judicial or administrative action" or a "related action."[3] CEA Section 23 also established the Commodity Futures Trading Commission Customer Protection Fund ("Fund"), which is used to pay whistleblower awards and to fund "customer education initiatives designed to help customers protect themselves against fraud or other violations of [the CEA], or the rules and regulations thereunder."[4]

CEA Section 23(g)(5) requires the Commission to transmit an annual report to the Committee on Agriculture, Nutrition and Forestry of the Senate, and the Committee on Agriculture of the House of Representatives, on the following:

- Commission's whistleblower program, including a description of the number of awards granted and the types of cases in which awards were granted during the preceding fiscal year;

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1 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 748, 124 Stat. 1739 (2010).

2 7 U.S.C. § 26 (2012).

3 A "covered judicial or administrative action" is "any judicial or administrative action brought by the Commission under [the CEA] that results in monetary sanctions exceeding $1,000,000." 7 U.S.C. § 26(a)(1). The term "related action," when used with respect to any judicial or administrative action brought by the Commission under the CEA, means "any judicial or administrative action brought by an entity described in [7 U.S.C. § 26(h)(2)(C)(i)(I)-(VI)] that is based upon the original information provided by a whistleblower pursuant to [7 U.S.C. § 26(a)] that led to the successful enforcement of the Commission action." Id. § 26(a)(5).

4 7 U.S.C. § 26(g)(2).

- customer education initiatives that were funded by the Fund during the preceding fiscal year;
- balance of the Fund at the beginning of the preceding fiscal year;
- amounts deposited into or credited to the Fund during the preceding fiscal year;
- amount of earnings on investments of amounts in the Fund during the preceding fiscal year;
- amount paid from the Fund during the preceding fiscal year to whistleblowers;
- amount paid from the Fund during the preceding fiscal year for customer education initiatives;
- balance of the Fund at the end of the preceding fiscal year; and
- complete set of audited financial statements, including a balance sheet, income statement,[5] and cash flow analysis.

This report covers the period from October 1, 2018 through September 30, 2019 ("Period").

II. WHISTLEBLOWER PROGRAM AND WHISTLEBLOWER AWARDS

The Commission announced five whistleblower awards during the Period, amounting to more than $15 million, to individuals who voluntarily provided original information or analyses that led to successful enforcement actions. This total includes two awards based in part on related actions. During the Period, the Commission issued 106 Final Orders addressing 134 whistleblower award applications submitted on Form WB-APP. These Final Orders granted awards on five whistleblower applications and denied awards on the remaining 129 applications. The latter were denied because the applicants did not meet the requirements of 7 U.S.C. § 26 and 17 C.F.R. § 165.[6]

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[5] Federal Accounting Standards do not identify an "income statement" as a financial statement applicable to the Federal Government. Instead, the Federal Accounting Standards Advisory Board Statement of Federal Financial Accounting Concepts 2 (http://files.fasab.gov/ pdffiles/handbook_sffac_2.pdf) identifies the "statement of net cost" as the equivalent financial statement. A "statement of net cost" is included in the attached audited financial statements.

[6] Of the applications that were denied, 108 did not relate to a Notice of Covered Action ("NCA"), a final judgment in a "related action" (as defined in 17 C.F.R. § 165.2(m) (2019)), or a previously filed Form TCR, and so

Since the inception of the Whistleblower Program, the CFTC has issued 14 awards amounting to approximately $100 million. The Commission actions associated with those awards have resulted in sanctions orders totaling more than $800 million. Below is an overview of the whistleblower awards made by the Commission during the Period.

Award of More Than $2 Million to Whistleblower for Independent Analysis

On March 4, 2019, the Commission announced an award of more than $2 million to a whistleblower who provided critical information through independent analysis of market data. The Commission granted the whistleblower's award application based on both a CFTC covered action and a related action brought by another federal regulator.[7]

Award of Approximately $1.5 Million to Whistleblower Based on Covered and Related Actions

On May 6, 2019, the Commission announced an award of approximately $1.5 million to a whistleblower who provided information that caused the Commission to open its investigation, and who provided substantial assistance to the Commission's investigation as it proceeded. In this matter, too, the Commission granted the whistleblower's award application based on both a CFTC covered action and a related action brought by another federal regulator. The whistleblower also sought to report his or her concerns internally prior to reporting to the CFTC, which weighed in favor of a higher award percentage.[8]

Award of Approximately $2.5 Million to Whistleblower, Factoring in Delayed Report

On June 24, 2019, the Commission announced an award of roughly $2.5 million to a

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were addressed through a streamlined process under 17 C.F.R. § 165.7(e).

[7] See CFTC Whistleblower Award Determination 19-WB-01 (Mar. 4, 2019); CFTC Press Rel. No. 7882-19, "CFTC Announces Whistleblower Award Totaling More Than $2 Million." https://www.cftc.gov/PressRoom/PressReleases/7882-19.

[8] See CFTC Whistleblower Award Determination 19-WB-02 (May 6, 2019); CFTC Press Rel. No. 7924-19, "CFTC Announces Approximately $1.5 Million Whistleblower Award." https://www.cftc.gov/PressRoom/PressReleases/7924-19.

whistleblower. The award amount reflected the significance of the whistleblower's information in causing the case to be opened and in leading to its successful resolution through the whistleblower's providing documents, statements, and analyses. But in determining the appropriate award, the Commission took into account the whistleblower's delay in reporting to the CFTC.[9]

Award of Roughly $2 Million to Joint Whistleblowers

On July 1, 2019, the Commission announced an award amounting to approximately $2 million to two whistleblowers who jointly provided the agency with significant information that prompted the CFTC to open an investigation. The joint whistleblowers further assisted the Commission by sitting for multiple interviews and producing numerous documents—which assistance was highly informative and formed the basis of the CFTC's investigation.[10]

Award of Approximately $7 Million to Individual Whistleblower

On September 27, 2019, the Commission announced an award amounting to around $7 million to a whistleblower who caused the agency to open an investigation. While not all of the information provided by the whistleblower proved to be accurate, the relevant information still led the CFTC to investigate a violation of the CEA.[11]

A. Whistleblower Tips and Complaints

The Commission's Whistleblower Office ("WBO") received 455 whistleblower tips and complaints on Form TCR during the Period, by mail, facsimile, or through the Commission's

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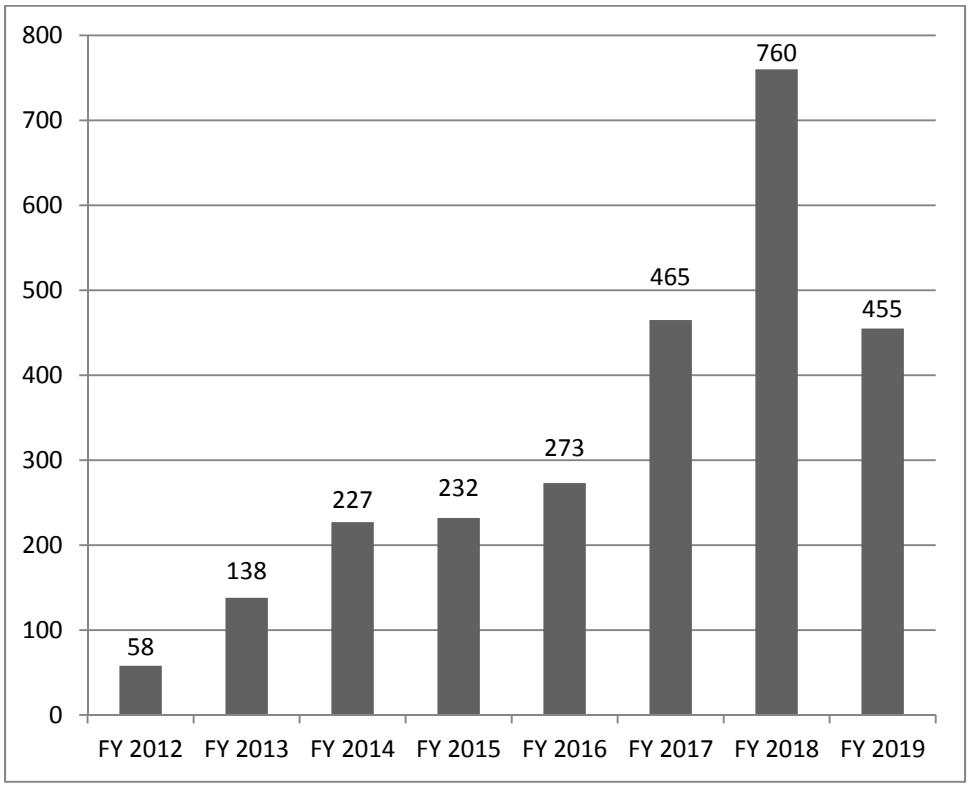
[9] See CFTC Whistleblower Award Determination 19-WB-03 (June 24, 2019); CFTC Press Rel. No. 7943-19, "CFTC Announces Approximately $2.5 Million Whistleblower Award." https://www.cftc.gov/PressRoom/PressReleases/7943-19.

[10] See CFTC Whistleblower Award Determination 19-WB-04 (July 1, 2019); CFTC Press Rel. No. 7953-19, "CFTC Announces $2 Million Award to Joint Whistleblowers." https://www.cftc.gov/PressRoom/PressReleases/7953-19.

[11] See CFTC Whistleblower Award Determination 19-WB-05 (Sept. 27, 2019); CFTC Press Rel. No. 8022-19, "CFTC Announces Approximately $7 Million Whistleblower Award." https://www.cftc.gov/PressRoom/PressReleases/8022-19.

web portal.[12] On top of this total, whistleblowers submitted an additional 88 supplements to their Form TCRs during the Period. Figure 1 shows the number of Form TCRs received each fiscal year ("FY") since FY 2012. Although the total number of Form TCRs received over the course of the Period is down from FY 2018, it is just about even with the total received in FY 2017. The spike in FY 2018 may be attributable to increased popular interest in virtual currencies and certain CFTC publicity around them, which encouraged members of the public to report virtual currency fraud through the Whistleblower Program.[13]

Figure 1: Form TCRs received by WBO, by fiscal year



[12] File a Tip or Complaint: https://www.whistleblower.gov/overview/submitatip.

[13] See, e.g., Customer Advisory: Beware Virtual Currency Pump-and-Dump Schemes, available at https://www.cftc.gov/idc/groups/public/@customerprotection/documents/file/customeradvisory_pumpdump0218.pdf; CFTC Press Rel. No. 7697-18, "CFTC Issues First Pump-and-Dump Virtual Currency Customer Protection Advisory." https://www.cftc.gov/PressRoom/PressReleases/pr7697-18.

The WBO also received an additional 137 separate non-whistleblower tips and complaints during the Period,[14] most often by email to whistleblower@cftc.gov. When appropriate, the WBO communicates with non-whistleblower correspondents and invites them to become whistleblowers by submitting a Form TCR. The WBO forwards all tips and complaints to the Commission's Division of Enforcement for evaluation and disposition.

During the Period, the WBO received tips and complaints regarding activities such as Bank Secrecy Act violations; failures to register; false reporting; foreign bribery; fraud involving virtual currencies, precious metals, foreign currency exchange, or binary options; inadequate risk controls; insider trading or front-running; money laundering; retaliation against employees; as well as spoofing and other forms of disruptive trading or market manipulation.

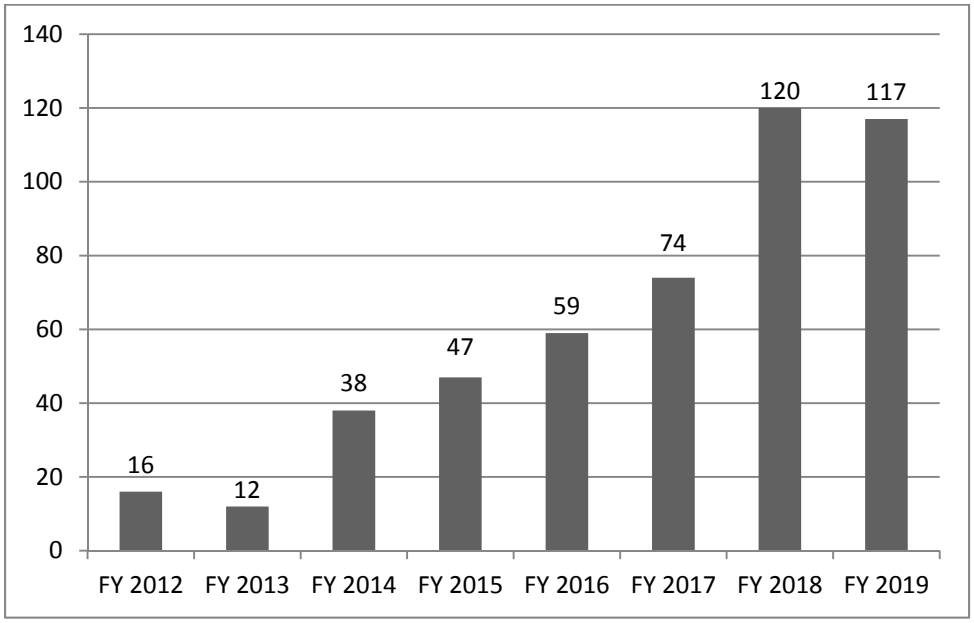
B. Whistleblower Award Applications

The WBO posts on its website NCAs for all final judgments and orders entered after July 21, 2010 that impose more than $1 million in monetary sanctions.[15] The WBO posted 31 NCAs during the Period, equal to the 31 NCAs posted in FY 2018. During the Period, the WBO received 117 whistleblower award claims on Form WB-APP. This is also about even with the corresponding figure for FY 2018. Figure 2 below shows the number of Form WB-APPs received each year since FY 2012.

[14] This total consists of 102 emails and other non-whistleblower tips and complaints as well as 35 TCRs referred to the Commission by the U.S. Securities and Exchange Commission.

[15] 17 C.F.R. § 165.7(a).

Figure 2: Form WB-APPs received by WBO, by fiscal year



C. Whistleblower Education and Outreach Efforts

During the Period, the WBO also continued its efforts to educate stakeholders about the Whistleblower Program through speeches, web postings, panel and seminar appearances, by answering questions about the program posed directly to the WBO, and by attending conferences and other industry gatherings. The WBO's goal is to inform various constituencies about the existence, benefits, and parameters of the program. Those constituencies include Commission staff, whistleblowers and their attorneys, industry and professional groups, other government agencies, self-regulatory organizations, academia, and potential whistleblowers—who may be traders as well as hedgers, farmers, ranchers, producers, commercial end users, or other market participants. To that end, during the Period, the WBO exhibited at eight industry conferences and trade shows relating to the markets that the CFTC oversees. These events included conferences focused on the global markets for futures, options, cleared swaps, and other derivatives; gatherings of professionals trained to spot fraud; as well as gatherings of participants in the high-frequency trading, blockchain, and virtual currency spaces. In addition, during the

Period, members of the WBO presented at seven public events attended by members of the global futures, options, and cleared swaps industry; corporate counsel; the whistleblower bar; and potential whistleblowers—with the aims of raising the profile of the program and enhancing those stakeholders' understanding of the program.

The WBO launched https://www.whistleblower.gov, in January 2016. The website educates the public about the Whistleblower Program, serving as a one-stop-shop for information about the Whistleblower Program to answer frequently asked questions and offer helpful guidance on navigating the program.[16] It also affords a convenient way for the public to submit both whistleblower tips about potential violations of the CEA and award applications—on Form TCR and Form WB-APP, respectively. Additionally, the website outlines whistleblower rights and protections and guides users through the process of filing a whistleblower tip and applying for an award. The website also provides users with easy access to the rules and regulations governing the CFTC's Whistleblower Program,[17] final award determinations, NCAs, and press releases, while encouraging users to sign up for automatically emailed CFTC Whistleblower Program updates. As of September 30, 2019, almost 61,000 individuals had registered to receive emails alerting them to updates on the Whistleblower Program website, such as the posting of new NCAs. During the Period, the website received nearly 250,000 page views.

During the Period, the WBO for the first time used its website to publish alerts on trending topics, starting with four: Bank Secrecy Act/anti-money laundering, foreign corrupt practices, insider trading, and virtual currencies.[18] The purpose of the alerts is to inform

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16 See, e.g., Things To Know: https://www.whistleblower.gov/news/thingstoknow.

17 The Whistleblower Program rules are codified at 17 C.F.R. pt. 165 (as amended by 82 Fed. Reg. 24,487, 24,496–521 (May 30, 2017)).

18 These alerts are available on the Whistleblower Program website's main landing page, https://www.whistleblower.gov, as well as on a dedicated alerts page, https://www.whistleblower.gov/whistleblower-alerts.

members of the public about how they make themselves eligible for both financial awards and certain protections while helping stop violations of the CEA. WBO staff also distributed relevant alerts at several of the events attended during the Period. These alerts have helped raise awareness of areas of particular interest to the Division of Enforcement.

D. Whistleblower Office Coordination on Confidentiality in Enforcement

The WBO also plays an important role in protecting whistleblower confidentiality while allowing the Commission to litigate judicial and administrative actions, and to coordinate its enforcement efforts with other government agencies and regulators. During the Period, the WBO considered 297 requests to produce documents from the investigation and litigation files of the Commission's Division of Enforcement. Among those, 155 requests involved whistleblowers, and the WBO found 34 requests to implicate whistleblower-identifying information. The WBO assisted the Commission's Division of Enforcement in preparing the documents by removing whistleblower-identifying information or otherwise taking steps to preserve whistleblower confidentiality. During the Period, the WBO also considered 106 requests from other government agencies and regulators to access documents from the Division of Enforcement's files. Among those, 41 requests involved whistleblowers, and the WBO found 18 requests to implicate whistleblower-identifying information. Again, the WBO assisted the Commission's Division of Enforcement in making the documents available outside the Commission consistent with the confidentiality obligations imposed by the CEA and the Whistleblower Program rules.

III. CUSTOMER EDUCATION INITIATIVES

The Office of Customer Education and Outreach ("OCEO") administers the CFTC's customer and public education initiatives. Among its duties, OCEO supports the Commission by

creating and distributing financial education messages and materials designed to help customers spot, avoid, and report fraud and other violations of the CEA.

OCEO focused much of its attention on virtual currency education in 2019. Virtual currencies continue to attract significant public interest, and remain an area where greater customer education and information is needed.

A. Virtual Currency Education

To communicate more effectively with younger traders or potential customers in virtual currency cash markets, the CFTC undertook a multimedia approach that included Customer Advisories, digital engagement, press engagement, brochures, in-person engagements, and strategic partnerships.

In October, OCEO teamed up with LabCFTC, the agency's engagement hub for the fintech innovation community, to present a two-day conference titled, *Fintech Forward: Innovation, Regulation and Education*. The conference convened innovators, regulators, market participants, and interested members of the public to examine the wide range of fintech issues impacting markets, including the types of fraud involving digital assets, security and customer protection, machine learning, cloud technologies, and regtech. More than 250 people attended the event in person and more than 1,200 people in 56 countries joined through a livestream webcast. Fintech Forward was also attributed with attracting nearly 700 new followers to the CFTC's Twitter feed, with nearly 1,500 Twitter engagements recorded.

The debut conference captured the attention of the mainstream media as well. More than a dozen media outlets covered the two days of panels and speakers. The conference also featured a "meet the regulators" forum that allowed innovators to make contacts with state, federal and international regulators.

OCEO continued to educate about virtual currencies though Customer Advisories and in-person engagements. Customer Advisories are designed to provide actionable information about current frauds and schemes in a two-page document that can be easily downloaded and shared. Supported by press releases, the advisories have gained significant traction. Virtual currency brochures are offered free[19] to stakeholders who share the materials with the public. Brochures and Customer Advisories are also distributed at public events.

B. Customer Outreach

Throughout the year, OCEO has participated in a number of public education events. These events ranged from exhibiting at an online financial writers conference to sharing information and resources with other educators such as military personal financial management counselors and public librarians. Outreach to educators, communications professionals, and other key stakeholders is a critical step in reaching customers and potential customers in our markets. These professionals order and share our materials and amplify our message to thousands more readers, listeners, or clients.

In September, OCEO teamed with LabCFTC to meet with financial bloggers, podcasters, influencers, and writers at FinCon19, the nation's largest personal finance and investment writers conference. The event drew an estimated audience of 2,500 digital content creators. OCEO distributed hundreds of brochures, advisories, and reports, and provided guidance in response to attendees' questions. OCEO also presented to more than 300 military personal financial management counselors during the Financial Readiness Training Symposium, hosted by the Department of Defense's Office of Financial Readiness, in May. OCEO provided the counselors with an introduction to the CFTC and its role in protecting customers from fraud and

[19] CFTC brochures are available for download or free order at https://orders.gpo.gov/cftcpubs.aspx.

manipulation in virtual currency markets, as well as provided information and resources they could pass on to military members and their families about fraud prevention and protection when considering trading or purchasing digital assets.

Another important stakeholder group is public librarians. Many public libraries distribute free government materials and provide financial education and fraud awareness programming in their communities. Working in cooperation with the Consumer Financial Protection Bureau, the CFTC has participated in three fraud awareness training programs for librarians in FY 2019 in New Jersey and Minnesota. These train-the-trainer programs are designed to educate librarians about how to present fraud education programs in their communities and introduce them to recent fraud trends and resources they could provide to patrons. In addition, OCEO speakers participated in two panel discussions during the American Library Association convention in Washington, D.C. in June. The convention panels reached nearly 100 librarians from communities across the United States.

IV. CUSTOMER PROTECTION FUND

As of September 30, 2019, the Fund had an ending balance of $125,439,162:

Description	**FY 2019**
Balance of the Fund at the beginning of the Period:	$158,337,598
Amounts deposited into, or credited to, the Fund during the Period:	$0
Amount of earnings on investments of amounts in the Fund during the Period:	$3,206,457
Amount paid from the Fund to whistleblowers during the Period for claims not reported in prior years:	($4,601,490)[20]
Amount paid from the Fund for customer education initiatives during the Period:	($1,112,843)
Amount of unpaid customer education initiatives expenses incurred during the Period:	($1,032,369)
Amount paid from the Fund for administrative expenses during the Period:	($2,136,209)[21]
Amount of unpaid administrative expenses incurred during the Period:	($1,072,537)[22]
Amount of unpaid claims to Fund resources accrued during the Period for whistleblower claims not reported in prior years:	($26,149,445)[23]
Balance of the Fund as of September 30, 2019:	$125,439,162

Attached as an Appendix to this report are the audited financial statements for the Fund, including a balance sheet, a statement of net cost, a statement of changes in net position, a statement of budgetary resources, and a supplementary cash flow analysis schedule.

[20] $8,384,664 was disbursed from the Fund for whistleblower awards during the Period. The cash disbursed included $3,783,174 in awards that were previously reported as pending claims as of September 30, 2018, and an additional $4,601,490 in new amounts awarded and disbursed during FY 2019.

[21] The administrative expenses of the WBO and OCEO are charged to the Fund pursuant to GAO Decision B-321788, 2011 WL 3510145 (Comp. Gen. Aug. 8, 2011).

[22] Unpaid administrative expenses include amortization of software which is not a future disbursement.

[23] The amount of unpaid claims to Fund resources of $26,149,445 consists of final whistleblower awards due and payable plus the amount of new awards preliminarily determined by the Commission as of September 30, 2019, but not issued as final awards during the Period.

TO: Heath P. Tarbert, Chairman
Brian D. Quintenz, Commissioner
Rostin Behnam, Commissioner
Dawn Stump, Commissioner
Dan Berkovitz, Commissioner

FROM: Miguel A. Castillo, *CPA, CRMA*
Assistant Inspector General for Auditing

DATE: October 23, 2019

SUBJECT: Audit of the CFTC Customer Protection Fund Financial Statements (Fiscal Year 2019)

Annually the Office of the Inspector General (OIG) engages an independent public accountant (IPA) to perform an audit of the CFTC Customer Protection Fund (Fund) financial statements. The balance of the Fund[1] as of September 30, 2019, was $125,439,162. We contracted Allmond & Company, LLC (Allmond & Co.) to audit the financial statements of the Fund as of September 30, 2019, and for the year then ended, to provide negative assurance on internal control and compliance with laws and regulations for financial reporting. We required that the audit be done in accordance with *U.S. Generally Accepted Government Auditing Standards* (GAGAS).

In its audit of the Fund, Allmond & Co. found:

- The financial statements were fairly presented, in all material respects, in conformity with *U.S. Generally Accepted Accounting Principles*.

In connection with the contract, we reviewed Allmond & Company's report and related documentation and inquired of its representatives. Our review, as differentiated from an audit of the financial statements in accordance with U.S. generally accepted government auditing standards, was not intended to enable us to express, and we do not express, opinions on CFTC's financial statements or internal control over financial reporting, or on compliance with laws and other matters. Allmond & Co. is responsible for the attached auditor's report dated October 18, 2019 and the conclusions expressed therein. However, our review disclosed no instances where Allmond & Co. did not comply, in all material respects, with GAGAS.

[1] Total net position.

Attached is a copy of Allmond & Co.'s unmodified (clean) opinion. Please call me if any questions at (202)418-5084.

Cc:

Jamie Klima, Chief of Staff
Kevin S. Webb, Chief of Staff
John Dunfee, Chief of Staff
Daniel Bucsa, Chief of Staff
Erik Remmler, Chief of Staff
Christopher Ehrman, Director. Whistleblower Office
Anthony C. Thompson, Executive Director
Keith A. Ingram, Accounting Officer
Melissa Jurgens, Chief, Executive Secretariat Branch
A. Roy Lavik, Inspector General
Judith A. Ringle, Deputy Inspector General and Chief Counsel

Independent Auditors' Report

Chairman and Inspector General of
U.S. Commodity Futures Trading Commission:

Report on the Financial Statements

We have audited the accompanying financial statements of the U.S. Commodity Futures Trading Commission (CFTC) Customer Protection Fund (CPF), which comprise the balance sheets as of September 30, 2019 and 2018; the related statements of net cost, changes in net position, and budgetary resources for the fiscal years then ended; and the related notes to the financial statements (hereinafter referred to as the financial statements).

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this responsibility includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the fiscal year 2019 and 2018 financial statements of CPF based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and the Office of Management and Budget (OMB) Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 19-03 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of entity' s internal control. Accordingly, we express no such opinion.

An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of U.S. Commodity Futures Trading Commission Customer Protection Fund as of September 30, 2019 and 2018, and its net cost of operations, changes in net position, and budgetary resources for the fiscal years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

Required Supplementary Information

The information in CPF's Annual Report to Congress and the Cash Flow Analysis are not a required part of the basic financial statements, but are supplementary information required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of CPF's financial statements. However, we did not audit this information and, accordingly, we express no opinion on it.

Other Reporting Required by Government Auditing Standards

Internal Control over Financial Reporting

In planning and performing our audit of CPF's financial statements as of and for the year ended September 30, 2019, in accordance with generally accepted government auditing standards, we considered CPF's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of CPF's internal control over financial reporting. Accordingly, we do not express an opinion on CPF's internal controls over financial reporting. We limited internal control testing to those necessary to achieve the objectives described in OMB Bulletin No. 19-03. We did not test all internal control relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatement on a timely basis. A material weakness is a deficiency, or combination of deficiencies, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency or a combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit the attention by those charged with governance.

Our consideration of internal control over financial reporting was for the limited purpose as described in

the first paragraph of this section, and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies and therefore material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our fiscal year 2019 audit we did not identify any deficiencies in internal control over financial reporting that we considered to be a material weakness, as defined above. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether CPF's fiscal year 2019 financial statements are free of material misstatements, we performed tests of CPF's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements, which noncompliance could have a direct and material effect on the determination of material amounts and disclosures in CPF's financial statements, and certain provisions of other laws specified in OMB Bulletin No. 19-03. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests of compliance as described in the preceding paragraph, disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 19-03.

Purpose of the Other Reporting Required by Government Auditing Standards

The purpose of the communication described in the Other Reporting Required by Government Auditing Standards section is solely to describe the scope of our testing of internal control and compliance with selected provision of applicable laws, regulations, contracts, and grant agreements, and the results of that testing, and not to provide an opinion on the effectiveness of CPF's internal control or on compliance. This communication is an integral part of an audit performed in accordance with U.S. generally accepted government auditing standards in considering in internal controls and compliance with laws, regulations, contracts, and grant agreements which could have a material effect on CPF's financial statements. Accordingly, this communication is not suitable for any other purpose.

Allmond & Company, LLC

Lanham, MD
October 18, 2019

FINANCIAL STATEMENTS FOR THE CUSTOMER PROTECTION FUND

REPORT TO CONGRESS

September 30, 2019

U.S. Commodity Futures Trading Commission
Customer Protection Fund Report to Congress: Financial Statements

Table of Contents

Commodity Futures Trading Commission
Customer Protection Fund
Balance Sheets
As of September 30, 2019 and 2018

	2019	2018
Assets		
Intragov ernmental:		
Fund Balance With Treasury (Note 2)	$ 13,148,336	$ 7,293,399
Inv estments (Note 3)	141,300,000	157,518,375
Prepay ments	221,818	-
Total Intragovernmental	154,670,154	164,811,774
General Property , Plant and Equipment, Net (Note 4)	50,126	93,090
Total Assets	$ 154,720,280	$ 164,904,864
Liabilities		
Intragov ernmental:		
Employ er Contributions and Pay roll Tax es Pay able	28,667	21,750
Total Intragovernmental	28,667	21,750
Accounts Pay able	8,670,172	1,361,602
Accrued Pay roll	112,825	89,881
Accrued Annual Leav e	189,308	180,158
Liability for Whistleblower Awards (Note 5)	20,280,146	4,913,875
Total Liabilities	29,281,118	6,567,266
Contingent Liabilities (Note 6)		
Net Position		
Cumulativ e Results of Operations - Funds from Dedicated Collections	125,439,162	158,337,598
Total Net Position	125,439,162	158,337,598
Total Liabilities and Net Position	$ 154,720,280	$ 164,904,864

The accompanying notes are an integral part of these financial statements.

Commodity Futures Trading Commission
Customer Protection Fund
Statements of Net Cost
For the Years Ended September 30, 2019 and 2018

Net Costs of Operations	2019	2018
Gross Costs	$ 36,104,893	$ 41,446,286
Total Net Cost of Operations	$ 36,104,893	$ 41,446,286

The accompanying notes are an integral part of these financial statements.

Commodity Futures Trading Commission
Customer Protection Fund
Statements of Changes in Net Position
For the Years Ended September 30, 2019 and 2018

	2019	2018
CumulativeResults of Operations		
Beginning Balances, October 1	$ 158,337,598	$ 196,336,209
Budgetary Financing Sources:		
Nonex change Interest Rev enue	3,206,457	3,447,675
Total Financing Sources	3,206,457	3,447,675
Net Cost of Operations	(36,104,893)	(41,446,286)
Net Change	(32,898,436)	(37,998,611)
Total Cumulative Results of Operations, September 30	$ 125,439,162	$ 158,337,598

The accompanying notes are an integral part of these financial statements.

Commodity Futures Trading Commission
Customer Protection Fund
Statements of Budgetary Resources
For the Years Ended September 30, 2019 and 2018

	2019	2018
BUDGETARY RESOURCES		
Unobligated Balance from Prior Year Budget Authority , Net (Note 7)	$ 159,272,922	$ 236,280,890
Spending Authority from Offsetting Collections	3,024,893	3,209,206
Total Budgetary Resources	$ 162,297,815	$ 239,490,096
STATUS OF BUDGETARY RESOURCES		
New Obligations and Upward Adjustments	$ 20,862,226	$ 80,540,550
Unobligated Balance, End of Year		
Apportioned, Unex pired Accounts	141,435,589	158,636,895
Unapportioned, Unex pired Accounts	-	312,651
Unobligated Balance, End of Year (Total)	141,435,589	158,949,546
Total Budgetary Resources	$ 162,297,815	$ 239,490,096
OUTLAYS, NET		
Agency Outlay s, Net	$ 10,345,063	$ 76,767,593

The accompanying notes are an integral part of these financial statements.

Notes to the Financial Statements
For the Years Ended September 30, 2019 and 2018

Note 1. Summary of Significant Accounting Policies

A. Reporting Fund

The Commodity Futures Trading Commission (CFTC or the Commission) is an independent agency of the executive branch of the Federal Government. Its mission is to "protect market users and the public from fraud, manipulation, and abusive practices related to the sale of commodity futures and options, and to foster open, competitive, and financially sound commodity futures and options markets."

On July 21, 2010, the "Dodd-Frank Wall Street Reform and Consumer Protection Act" (the Dodd-Frank Act, or the Act) was signed into law, significantly expanding the powers and responsibilities of the CFTC. According to Section 748 of the Act, there is established in the Treasury of the United States a revolving fund known as the "Commodity Futures Trading Commission Customer Protection Fund" (the Fund). The Fund shall be available to the Commission, without further appropriation or fiscal year limitation, for a) the payment of awards to whistleblowers; and b) the funding of customer education initiatives designed to help customers protect themselves against fraud or other violations of this Act or the rules and regulations thereunder.

The Act requires CFTC to transmit to the Committee on Agriculture, Nutrition and Forestry of the Senate, and the Committee on Agriculture of the House of Representatives a report which includes a complete set of audited financial statements and supplementary information, including balance sheet, income statement, and cash flow analysis, no later than October 30, of each year.

B. Basis of Presentation

The financial statements have been prepared to report the financial position and results of operations for the Fund, as required by the Dodd-Frank Act. These statements have been prepared from the Fund's books and records, which are a component of the Commission's books and records, in conformity with U.S. generally accepted accounting principles (GAAP), as prescribed for the Federal government by the Federal Accounting Standards Advisory Board (FASAB) and in accordance with the form and content requirements contained in Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements*, as amended. Accounting standards allow certain presentations and disclosures to be modified, if needed, to prevent the disclosure of classified information.

The Fund was established in July 2010 and funded by transfers from CFTC's Civil Monetary Penalties, Fines and Administrative Fees receipt account. These transfers do not meet the criteria of reportable revenue as defined by the Statement of Federal Financial Accounting Standards (SFFAS) 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*.

The financial statements report on the Fund's financial position, changes in net position, net cost and budgetary resources. The books and records of the Fund served as the source of information for preparing the financial statements in the prescribed formats. All Fund financial statements and reports used to monitor and control financial resources are prepared from the same books and records. The statements should be read with the understanding that they relate to a fund controlled by CFTC, a component of the U.S. Government, a sovereign entity.

The Balance Sheet presents the financial position of the Fund. The Statement of Net Cost presents the Fund's operating results. The Statement of Changes in Net Position displays the changes in the Fund's net position, and the Statement of Budgetary Resources shows the spending authority of the Fund derived from the deposits eligible from civil monetary collections.

C. Fund Balance with Treasury

Fund Balance with Treasury is the aggregate amount of the Fund's balance with the U.S. Treasury. The balance in the Fund is available to pay current liabilities and finance authorized operations.

The Fund does not maintain bank accounts of its own, has no disbursing authority, and does not maintain cash held outside of Treasury. Treasury makes disbursements for the Fund.

D. Investments in U.S. Government Securities

The CFTC has authority to invest amounts in the Customer Protection Fund in market-based U.S. Treasury securities. Market-based Treasury securities are debt securities that the U.S. Treasury issues to Federal entities without statutorily determined interest rates. Although the securities are not marketable, the terms (prices and interest rates) mirror the terms of marketable Treasury securities. Investments are carried at their historical cost basis which approximates fair value due to their short-term nature.

The interest earned on the investments is a component of the Fund and is available to be used for expenses of the Fund. Additional details regarding investments are provided in Note 3. Investments.

E. General Property, Plant and Equipment, Net

The Commission capitalizes assets annually if they have useful lives of at least two years and an individual value of $25,000 or more. Bulk or aggregate purchases are capitalized when the individual useful lives are at least two years and the purchase is a value of $25,000 or more. Property, plant and equipment that do not meet the capitalization criteria are expensed when acquired. Depreciation for equipment and amortization for software is computed on a straight-line basis using a 5-year life. The Commission's assets are valued net of accumulated depreciation or amortization.

As of September 30, 2019, the Commission has capitalized as software the costs for development of a website for the CFTC Whistleblower Office. Additional details regarding general property, plant, and equipment are provided in Note 4. General Property, Plant and Equipment, Net.

F. Liabilities

The Fund's liabilities consist of actual and estimated amounts that are likely to be paid as a result of transactions covered by the Whistleblower Incentives and Protection regulation, and will be paid from available balances remaining in the Fund. In addition, the salaries and operating expenses of the Whistleblower's Office and Office of Customer Education and Outreach were funded through the Fund. Total accrued payroll is composed of amounts to be paid to Fund employees as well as the related intragovernmental payable for employer contributions and payroll taxes. The accrued annual leave liability is the amount owed to employees for unused annual leave as of the end of the reporting period. At the end of each quarter, the balance in the accrued annual leave account is adjusted to reflect current balances and pay rates. Sick leave and other types of non-vested leave are expensed as taken. The Fund's liabilities are considered current liabilities.

G. Funds from Dedicated Collections

The Fund contains dedicated collections that can only be used to operate a whistleblower program and support customer education initiatives. See Note 1.A. for a description of the purpose of the Fund and its authority to use the revenues and other financing sources. Deposits into the Fund are credited from monetary sanctions collected by the Commission in covered judicial or administrative actions not otherwise distributed to victims of a violation of the Dodd-Frank Act or the rules and regulations underlying such action, unless the balance of the Fund at the time the monetary judgment is collected exceeded $100 million. No new legislation was enacted as of September 30, 2019, that significantly changed the purpose of the dedicated collections or redirected a material portion of the accumulated balance.

H. Revenues and Other Financing Sources

The CFTC Customer Protection Fund is funded through monetary sanctions resulting from judicial or administrative action brought by the Commission under the Commodity Exchange Act. All collections are deposited into a receipt account. Eligible collections are transferred into the Fund from the CFTC's Civil Monetary Penalties, Fines and Administrative Fees receipt account.

Congress enacted the Dodd-Frank Act that provides the CFTC with the authority to establish the Fund. The Fund is available to the Commission, without further appropriation or fiscal year limitation. These funds are considered financing sources under U.S. Treasury Department guidelines. Per the Act, no sanction collected by the Commission can be deposited into the Fund if the Fund's balance exceeds $100 million. The CFTC may request the Secretary of the Treasury to invest Fund amounts in Treasury obligations. No eligible collections have been transferred into the Fund since it reached its legislative maximum during FY 2014.

I. Intra- and Inter-Agency Relationships

The CFTC is an independent Federal agency. The Commodity Futures Trading Commission Customer Protection Fund is a fund within the CFTC, and these financial statements present a segment of the CFTC financial activity. The financial events of the Fund are consolidated into the CFTC annual financial statements.

J. Use of Management Estimates

In addition to accruals for goods and services, management estimates were used to calculate overhead expenses in the amount of $1,487,000 and $1,092,000 that were allocated to the Fund for the years ended September 30, 2019, and 2018. These amounts were derived by multiplying management's estimated overhead cost per full-time equivalent (FTE) by the number of FTE charged to the Fund.

K. Limitations of the Financial Statements

The principal financial statements included in this report have been prepared to report the financial position and results of operations of the Fund, pursuant to the requirements of Section 748 of the Dodd-Frank Consumer Protection Act. While the statements have been prepared from the books and records of the CFTC in accordance with GAAP for Federal entities, these statements are in addition to the reports used to monitor and control the financial activity of the CFTC, which are prepared from the same books and records. The statements should be read with the understanding that they are for the Customer Protection Fund, a single fund within the CFTC.

Note 2. Fund Balance with Treasury

A. Reconciliation to Treasury

There are no differences between the fund balance reflected in the Fund's Balance Sheet and the balance in the Treasury account.

B. Fund Balance with Treasury

Fund Balance with Treasury as of September 30, 2019, and 2018, consisted of the following:

	2019	2018
Unobligated Fund Balance		
Av ailable	$ 751,948	$ 1,865,965
Obligated Balance Not Yet Disbursed	12,396,388	5,427,434
Total Fund Balance with Treasury	$ 13,148,336	$ 7,293,399

Note 3. Investments

The CFTC invests amounts deposited in the Fund in overnight short-term Treasury securities. Treasury overnight certificates of indebtedness are issued with a stated rate of interest to be applied to their par amount, mature on the business day immediately following their issue date, are redeemed at their par amount at maturity, and have interest payable at maturity.

The overnight certificates are Treasury securities whose interest rates or prices are determined based on the interest rates or prices of Treasury-related financial instruments issued or trading in the market, rather than on the interest rates or prices of outstanding marketable Treasury securities. The Commission may invest in other short-term or long-term Treasury securities at management's discretion

The Commission's investments as of September 30, 2019, and 2018, were $141,300,000 and $157,518,375, respectively. Related nonexchange interest revenue for the years ended September 30, 2019, and 2018, was $3,206,457 and $3,447,675, respectively.

Intragovernmental Investments in Treasury Securities

The Federal Government does not set aside assets to pay future claims or other expenditures associated with funds from dedicated collections deposited into the Customer Protection Fund. The dedicated cash receipts collected by the Commission as a result of monetary sanctions are deposited in the U.S. Treasury, which uses the cash for general Government purposes. As discussed above and in Note 1.D., the Commission invests the majority of these funds in Treasury securities. These Treasury securities are an asset of the Commission and a liability of the U.S. Treasury. Because the Commission and the U.S. Treasury are both components of the Government, these assets and liabilities offset each other from the standpoint of the Government as a whole. For this reason, the investments presented by the Commission do not represent an asset or a liability in the U.S. Government-wide financial statements.

Treasury securities provide the Commission with authority to draw upon the U.S. Treasury to pay future claims or other expenditures. When the Commission requires redemption of these securities to make expenditures, the Government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same manner in which the Government finances all expenditures.

Note 4. General Property, Plant and Equipment, Net

Property, Plant and Equipment as of September 30, 2019, and 2018, consisted of the following:

2019				
Major Class	Service Life and Method	Cost	Accumulated Amortization/ Depreciation	Net Book Value
IT Software	5 Years/Straight Line	214,824	(164,698)	50,126
		$ 214,824	$ (164,698)	$ 50,126

2018				
Major Class	Service Life and Method	Cost	Accumulated Amortization/ Depreciation	Net Book Value
IT Software	5 Years/Straight Line	214,824	(121,734)	93,090
		$ 214,824	$ (121,734)	$ 93,090

Note 5. Liability for Whistleblower Awards

As mentioned in Note 1A, the Fund will be used to pay awards to whistleblowers if they voluntarily provide original information to the CFTC that leads to the successful enforcement by the CFTC of a covered judicial or administrative action in which monetary sanctions exceeding $1 million are imposed. Whistleblowers are entitled to appeal any decisions by the Commission in regards to claims made against the Fund.

At the time the whistleblower voluntarily provides information to CFTC, they have no guarantee or promise that the Commission will exchange funds in return for that information. In accordance with federal accounting standards, the Commission records liabilities for these nonexchange transactions when they are due and payable. The Commission therefore records a liability for pending whistleblower payment after the whistleblower has been formally notified of an award and the related sanction, or some portion thereof, has been collected. The liability will be paid when the appeal period has ended and the whistleblower has provided necessary banking information. As of September 30, 2019, and September 30, 2018, the Commission recorded liabilities for pending payments to whistleblowers of approximately $20,280,146 and $4,913,875, respectively. During FY 2019, the Commission disbursed $8,384,664 in whistleblower awards, which included $3,783,174 from pending payments at the end of FY 2018 and $4,601,490 in new awards issued during the year. Accounts payable includes approximately $7,000,000 for awards that have been finalized as of September 30, 2019.

In addition to the pending payments to whistleblowers, the Commission had 14 additional whistleblower claims currently under review as of September 30, 2019. These additional claims, depending on whether the whistleblowers are determined to be eligible for an award and the related sanctions have been collected, could result in total future payments ranging from $0 to $29,286,750.

Note 6. Contingencies

Unasserted claims are actions or potential actions the Commission is aware of in which future events may result in claims against the Fund.

In accordance with Federal accounting standards, CFTC records contingent liabilities for any unasserted claim in which payment has been deemed probable and for which the amount of potential liability can be estimated. The Commission also discloses all claims for which payment is reasonably possible. There were no unasserted claims deemed probable or reasonably possible as of September 30, 2019.

Note 7. Statement of Budgetary Resources: Adjustments to Unobligated Balance Brought Forward, October 1

The Unobligated Balance Brought Forward from the prior fiscal year has been adjusted for recoveries of prior year paid and unpaid obligations. The Adjustments to Unobligated Balance Brought Forward, October 1, as of September 30, 2019, and 2018, consisted of the following:

	2019	2018
Unobligated Balance Brought Forward, October 1	$ 158,949,546	$ 234,774,938
Recoveries of Prior Year Obligations	323,376	1,505,952
Unobligated Balance from Prior Year Budget Authority, Net	$ 159,272,922	$ 236,280,890

Supplementary Schedule

Commodity Futures Trading Commission
Customer Protection Fund
Cash Flow Analysis
For the Period from October 1, 2018 to September 30, 2019

Cash as of October 1, 2018		$ 7,293,399
Cash flows from operating activities		
Paid Ex penses for Whistleblower and Consumer Education and Outreach Offices	$ (13,570,465)	
Refunds collected	570	
Net cash flows from operating activities		$ (13,569,895)
Cash flows from investing activities		
Redemptions of US Treasury Securities	$ 16,200,000	
Interest collected from inv esting in US Treasury Securities	3,224,832	
Net cash flows from investing activities		$ 19,424,832
Net increase/(decrease) in cash and cash equivalents		$ 5,854,937
Cash as of September 30, 2019		$ 13,148,336

SEC. 1. BUREAU WHISTLEBLOWER INCENTIVES AND PROTECTION.

The Consumer Financial Protection Act (12 U.S.C. 5481 et seq.) is amended by adding at the end of section 1017 the following:

"SEC. 1017A. WHISTLEBLOWER INCENTIVES AND PROTECTION.

(a) DEFINITIONS.- In this section:

(1) ADMINISTRATIVE PROCEEDING OR COURT ACTION.- The term 'administrative proceeding or court action' for the purposes of this section means any judicial or administrative action brought by the Bureau that results in monetary sanctions exceeding $1,000,000.

(2) FUND.- The term 'Fund' means the 'Consumer Financial Civil Penalty Fund' established under section 1017(d)(1).

(3) MONETARY SANCTIONS.- The term 'monetary sanctions', when used with respect to any administrative proceeding or court action means- any monies, including penalties, disgorgement, restitution, interest, ordered to be paid or other amounts of relief obtained under section 1055(a)(2).

(4) ORIGINAL INFORMATION.- The term 'original information' means information that:

(A) is derived from the independent knowledge or analysis of a whistleblower;

(B) is not known to the Bureau from any other source, unless the whistleblower is the original source of the information;

(C) is not exclusively derived from an allegation made in a judicial or administrative hearing, in a governmental report, hearing, or from the news media, unless the whistleblower is a source of the information; and

(D) is not exclusively derived from an allegation made in an audit, examination or investigation.

(5) SUCCESSFUL ENFORCEMENT.- The term 'successful enforcement', when used with respect to any administrative proceeding or court action brought by the Bureau, includes any settlement of such action.

(6) WHISTLEBLOWER.- The term 'whistleblower' means any individual, or 2 or more individuals acting jointly, who provides original information relating to a violation of Federal consumer financial law, consistent with any rule or regulation issued by the Bureau under this section.

(b) AWARDS.-

(1) IN GENERAL.- In any administrative proceeding or court action the Bureau, subject to regulations prescribed by the Bureau and subject to subsection (c), shall pay an award

or awards to 1 or more whistleblowers who voluntarily provided original information that led to the successful enforcement of the covered administrative proceeding or court action in an aggregate amount equal to:

(A) not less than 10 percent, in total, of what has been collected of the monetary sanctions imposed in the action; and

(B) not more than 30 percent, in total, of what has been collected of the monetary sanctions imposed in the action.

(2) PAYMENT OF AWARDS.- Any amount paid under paragraph (1) shall be paid from the Fund.

(3) AWARD MAXIMUM.- Notwithstanding any other provision in this section, the maximum award to any single whistleblower is limited to $10,000,000.00.

(4) AWARD MINIMUM.- In the event the Bureau is unable to collect at least $1,000,000 of the monetary sanctions imposed in the action, the Bureau shall provide for an award to any single whistleblower equal to 10 percent of the amount collected or $50,000, whichever is greater.

(c) DETERMINATION OF AMOUNT OF AWARD; DENIAL OF AWARD.-

(1) DETERMINATION OF AMOUNT OF AWARD.-

(A) DISCRETION.- The determination of the percentage amount of an award made under subsection (b) shall be in the discretion of the Bureau.

(B) CRITERIA.- In determining the percentage amount of an award made under subsection (b), the Bureau shall take into consideration:

(i) the significance of the information provided by the whistleblower to the successful enforcement of the administrative proceeding or court action;

(ii) the degree of assistance provided by the whistleblower and any legal representative of the whistleblower in an administrative proceeding or court action;

(i) the programmatic interest of the Bureau in deterring violations of Federal consumer financial law (including applicable regulations) by making awards to whistleblowers who provide information that leads to the successful enforcement of such laws; and

(iv) such additional relevant factors as the Bureau may establish by rule or regulation.

(2) DENIAL OF AWARD.- No award under subsection (b) shall be made-

(A) to any whistleblower who is, or was at the time the whistleblower acquired the original information submitted to the Bureau, a member, officer, or employee of an entity described in subclauses (I) through (V) of subsection (h)(1)(C)(i);

(B) to any whistleblower who is convicted of a criminal violation related to the administrative proceeding or court action for which the whistleblower otherwise could receive an award under this section;

(C) to any whistleblower who is found to be liable for the conduct in the administrative proceeding or court action, or a related action, for which the whistleblower otherwise could receive an award under this section;

(D) to any whistleblower who planned and initiated the conduct at issue in the administrative proceeding or court action for which the whistleblower otherwise could receive an award under this section;

(E) to any whistleblower who submits information to the Bureau that is based on the facts underlying the administrative proceeding or court action previously submitted by another whistleblower; and

(F) to any whistleblower who fails to submit information to the Bureau in such form as the Bureau may, by rule or regulation, require.

(d) REPRESENTATION.-

(1) PERMITTED REPRESENTATION.- Any whistleblower who makes a claim for an award under subsection (b) may be represented by counsel.

(2) REQUIRED REPRESENTATION.-

(A) IN GENERAL.- Any whistleblower who anonymously makes a claim for an award under subsection (b) shall be represented by counsel if the whistleblower submits the information upon which the claim is based.

(B) DISCLOSURE OF IDENTITY.- Prior to the payment of an award, a whistleblower shall disclose the identity of the whistleblower and provide such other information as the Bureau may require, directly or through counsel of the whistleblower.

(e) NO CONTRACT NECESSARY- No contract or other agreement with the Bureau is necessary for any whistleblower to receive an award under subsection (b), unless otherwise required by the Bureau by rule or regulation.

(f) APPEALS- Any determination made under this section, including whether, to whom, or in what amount to make awards, shall be in the discretion of the Bureau. Any such determination, except the determination of the amount of an award if the award was made in accordance with subsection (b), may be appealed to the appropriate court of appeals of the United States not more than 30 days after the determination is issued by the Bureau. The court shall review the determination made by the Bureau in accordance with section 706 of title 5.

(g) REPORTS TO CONGRESS.- Not later than October 30 of each year, the Bureau shall transmit to the House Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs a report on the Bureau's whistleblower award program under this section, including a description of the number of awards granted and the types of cases in which awards were granted during the preceding fiscal year.

(h) PROTECTION OF WHISTLEBLOWERS.-

(1) CONFIDENTIALITY.-

(A) IN GENERAL.- Except as provided in subparagraphs (B) and (C), the Bureau and any officer or employee of the Bureau, shall not disclose any information, including information provided by a whistleblower to the Bureau, which could reasonably be expected to reveal the identity of a whistleblower, except in accordance with the provisions of section 552a of title 5, United States Code, unless and until required to be disclosed to a defendant or respondent in connection with a public proceeding instituted by the Bureau or any entity described in subparagraph (C). For purposes of section 552 of title 5, United States Code, this paragraph shall be considered a statute described in subsection (b)(3)(B) of such section 552.

(B) EFFECT.- Nothing in this paragraph is intended to limit the ability of the Attorney General to present such evidence to a grand jury or to share such evidence with potential witnesses or defendants in the course of an ongoing criminal investigation.

(C) AVAILABILITY TO GOVERNMENT AGENCIES.-

(i) IN GENERAL.- Without the loss of its status as confidential in the hands of the Bureau, all information referred to in subparagraph (A) may, in the discretion of the Bureau, when determined by the Bureau to be necessary or appropriate, be made available to-

(I) the Department of Justice;

(II) an appropriate department or agency of the Federal Government, acting within the scope of its jurisdiction;

(III) a State attorney general in connection with any criminal investigation;

(IV) an appropriate department or agency of any State, acting within the scope of its jurisdiction; and

(V) a foreign regulatory authority.

(ii) MAINTENANCE OF INFORMATION.- Each of the entities, agencies, or persons described in clause (i) shall maintain information

described in that clause as confidential, in accordance with the requirements in subparagraph (A).

(2) RIGHTS RETAINED.- Nothing in this section shall be deemed to diminish the rights, privileges, or remedies of any whistleblower under section 1057, any other Federal or State law, or under any collective bargaining agreement.

(i) RULEMAKING AUTHORITY.- The Bureau shall have the authority to issue such rules and regulations as may be necessary or appropriate to implement the provisions of this section consistent with the purposes of this section.

(j) ORIGINAL INFORMATION.- Information submitted to the Bureau by a whistleblower in accordance with rules or regulations implementing this section shall not lose its status as original information solely because the whistleblower submitted such information prior to the effective date of such rules or regulations, provided such information was submitted after the date of enactment of this section.

(k) PROVISION OF FALSE INFORMATION.- A whistleblower who knowingly and willfully makes any false, fictitious, or fraudulent statement or representation, or who makes or uses any false writing or document knowing the same to contain any false, fictitious, or fraudulent statement or entry, shall not be entitled to an award under this section and shall be subject to prosecution under section 1001 of title 18, United States Code.

SEC. 2. AMENDMENT TO THE CONSUMER FINANCIAL CIVIL PENALTY FUND

The Consumer Financial Protection Act (12 U.S.C. 5481 et seq.) section 1017(d)(2) is amended by striking “under the Federal consumer financial laws.” and replacing with “under the Federal consumer financial laws and for awards authorized under section 1017A.”

116TH CONGRESS
2D SESSION

S. 3975

To amend the Consumer Financial Protection Act of 2010 to provide for whistleblower incentives and protection.

IN THE SENATE OF THE UNITED STATES

JUNE 17, 2020

Ms. CORTEZ MASTO (for herself, Mr. BROWN, Ms. WARREN, Ms. SMITH, Mr. DURBIN, Mr. MERKLEY, Mr. WYDEN, and Mr. BLUMENTHAL) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

To amend the Consumer Financial Protection Act of 2010 to provide for whistleblower incentives and protection.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the ''Financial Compensation for CFPB Whistleblowers Act''.

SEC. 2. BUREAU WHISTLEBLOWER INCENTIVES AND PROTECTION.

(a) IN GENERAL.—The Consumer Financial Protection Act (12 U.S.C. 5481 et seq.) is amended by adding at the end of section 1017 the following:

"SEC. 1017A. WHISTLEBLOWER INCENTIVES AND PROTECTION.

''(a) DEFINITIONS.—In this section:

''(1) ADMINISTRATIVE PROCEEDING OR COURT ACTION.—The term 'administrative proceeding or court action' means any judicial or administrative action brought by the Bureau that results in monetary sanctions exceeding $1,000,000.

''(2) FUND.—The term 'Fund' means the Consumer Financial Civil Penalty Fund established under section 1017(d)(1).

''(3) MONETARY SANCTIONS.—The term 'monetary sanctions' means, with respect to any administrative proceeding or court action, any monies, including penalties, disgorgement, restitution, interest, ordered to be paid or other amounts of relief obtained under section 1055(a)(2).

''(4) ORIGINAL INFORMATION.—The term 'original information' means information that—

''(A) is derived from the independent knowledge or analysis of a whistleblower;

''(B) is not known to the Bureau from any other source, unless the whistleblower is the original source of the information;

''(C) is not exclusively derived from an allegation made in a judicial or administrative hearing, in a governmental report, hearing, or from the news media, unless the whistleblower is a source of the information; and

''(D) is not exclusively derived from an allegation made in an audit, examination or investigation.

''(5) SUCCESSFUL ENFORCEMENT.—The term 'successful enforcement' includes, with respect to any administrative proceeding or court action brought by the Bureau, any settlement of such proceeding or action.

''(6) WHISTLEBLOWER.—The term 'whistleblower' means any individual, or 2 or more individuals acting jointly, who provides original information relating to a violation of Federal consumer financial law, consistent with any rule or regulation issued by the Bureau under this section.

''(b) AWARDS.—

''(1) IN GENERAL.—In any administrative proceeding or court action the Bureau, subject to regu-

lations prescribed by the Bureau and subject to subsection (c), shall pay an award or awards to 1 or more whistleblowers who voluntarily provided original information that led to the successful enforcement of the covered administrative proceeding or court action in an aggregate amount equal to—

"(A) not less than 10 percent, in total, of what has been collected of the monetary sanctions imposed in the action; and

"(B) not more than 30 percent, in total, of what has been collected of the monetary sanctions imposed in the action.

"(2) PAYMENT OF AWARDS.—Any amount paid under paragraph (1) shall be paid from the Fund.

"(3) AWARD MINIMUM.—If the Bureau is unable to collect at least $1,000,000 of the monetary sanctions imposed in the action, the Bureau shall provide for an award to any single whistleblower equal to the greater of—

"(A) 10 percent of the amount collected; or

"(B) $50,000.

"(c) DETERMINATION OF AMOUNT OF AWARD; DENIAL OF AWARD.—

"(1) DETERMINATION OF AMOUNT OF AWARD.—

"(A) DISCRETION.—The determination of the percentage amount of an award made under subsection (b) shall be in the discretion of the Bureau.

"(B) CRITERIA.—In determining the percentage amount of an award made under subsection (b), the Bureau shall take into consideration—

"(i) the significance of the information provided by the whistleblower to the successful enforcement of the administrative proceeding or court action;

"(ii) the degree of assistance provided by the whistleblower and any legal representative of the whistleblower in an administrative proceeding or court action;

"(iii) the programmatic interest of the Bureau in deterring violations of Federal consumer financial law (including applicable regulations) by making awards to whistleblowers who provide information that leads to the successful enforcement of such laws; and

"(iv) such additional relevant factors as the Bureau may establish by rule or regulation.

"(2) DENIAL OF AWARD.—No award under subsection (b) shall be made—

"(A) to any whistleblower who is, or was at the time the whistleblower acquired the original information submitted to the Bureau, a member, officer, or employee of an entity described in subclauses (I) through (V) of subsection (h)(1)(C)(i);

"(B) to any whistleblower who is convicted of a criminal violation related to the administrative proceeding or court action for which the whistleblower otherwise could receive an award under this section;

"(C) to any whistleblower who is found to be liable for the conduct in the administrative proceeding or court action, or a related action, for which the whistleblower otherwise could receive an award under this section;

"(D) to any whistleblower who planned and initiated the conduct at issue in the administrative proceeding or court action for which

the whistleblower otherwise could receive an award under this section;

''(E) to any whistleblower who submits information to the Bureau that is based on the facts underlying the administrative proceeding or court action previously submitted by another whistleblower; and

''(F) to any whistleblower who fails to submit information to the Bureau in such form as the Bureau may, by rule or regulation, require.

''(d) REPRESENTATION.—

''(1) PERMITTED REPRESENTATION.—Any whistleblower who makes a claim for an award under subsection (b) may be represented by counsel.

''(2) REQUIRED REPRESENTATION.—

''(A) IN GENERAL.—Any whistleblower who anonymously makes a claim for an award under subsection (b) shall be represented by counsel if the whistleblower submits the information upon which the claim is based.

''(B) DISCLOSURE OF IDENTITY.—Prior to the payment of an award, a whistleblower shall disclose the identity of the whistleblower and provide such other information as the Bureau

may require, directly or through counsel of the whistleblower.

''(e) NO CONTRACT NECESSARY.—No contract or other agreement with the Bureau is necessary for any whistleblower to receive an award under subsection (b), unless otherwise required by the Bureau by rule or regulation.

''(f) APPEALS.—Any determination made under this section, including whether, to whom, or in what amount to make awards, shall be in the discretion of the Bureau. Any such determination, except the determination of the amount of an award if the award was made in accordance with subsection (b), may be appealed to the appropriate court of appeals of the United States not more than 30 days after the determination is issued by the Bureau. The court shall review the determination made by the Bureau in accordance with section 706 of title 5.

''(g) REPORTS TO CONGRESS.—Not later than October 30 of each year, the Bureau shall transmit to the House Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs a report on the Bureau's whistleblower award program under this section, including a description of the number of awards granted and the types of cases in which awards were granted during the preceding fiscal year.

"(h) PROTECTION OF WHISTLEBLOWERS.—

"(1) CONFIDENTIALITY.—

"(A) IN GENERAL.—Except as provided in subparagraphs (B) and (C), the Bureau and any officer or employee of the Bureau, shall not disclose any information, including information provided by a whistleblower to the Bureau, which could reasonably be expected to reveal the identity of a whistleblower, except in accordance with the provisions of section 552a of title 5, United States Code, unless and until required to be disclosed to a defendant or respondent in connection with a public proceeding instituted by the Bureau or any entity described in subparagraph (C). For purposes of section 552 of title 5, United States Code, this paragraph shall be considered a statute described in subsection (b)(3)(B) of such section 552.

"(B) EFFECT.—Nothing in this paragraph is intended to limit the ability of the Attorney General to present such evidence to a grand jury or to share such evidence with potential witnesses or defendants in the course of an ongoing criminal investigation.

"(C) AVAILABILITY TO GOVERNMENT AGENCIES.—

"(i) IN GENERAL.—Without the loss of its status as confidential in the hands of the Bureau, all information referred to in subparagraph (A) may, in the discretion of the Bureau, when determined by the Bureau to be necessary or appropriate, be made available to—

"(I) the Department of Justice;

"(II) an appropriate department or agency of the Federal Government, acting within the scope of its jurisdiction;

"(III) a State attorney general in connection with any criminal investigation;

"(IV) an appropriate department or agency of any State, acting within the scope of its jurisdiction; and

"(V) a foreign regulatory authority.

"(ii) MAINTENANCE OF INFORMATION.—Each of the entities, agencies, or persons described in clause (i) shall main-

tain information described in that clause as confidential, in accordance with the requirements in subparagraph (A).

''(2) RIGHTS RETAINED.—Nothing in this section shall be deemed to diminish the rights, privileges, or remedies of any whistleblower under section 1057, any other Federal or State law, or under any collective bargaining agreement.

''(i) RULEMAKING AUTHORITY.—The Bureau shall have the authority to issue such rules and regulations as may be necessary or appropriate to implement the provisions of this section consistent with the purposes of this section.

''(j) ORIGINAL INFORMATION.—Information submitted to the Bureau by a whistleblower in accordance with rules or regulations implementing this section shall not lose its status as original information solely because the whistleblower submitted such information prior to the effective date of such rules or regulations, provided such information was submitted after the date of enactment of this section.

''(k) PROVISION OF FALSE INFORMATION.—A whistleblower who knowingly and willfully makes any false, fictitious, or fraudulent statement or representation, or who makes or uses any false writing or document knowing the

same to contain any false, fictitious, or fraudulent statement or entry, shall not be entitled to an award under this section and shall be subject to prosecution under section 1001 of title 18, United States Code.

''(l) UNENFORCEABILITY OF CERTAIN AGREEMENTS.—

''(1) NO WAIVER OF RIGHTS AND REMEDIES.—Except as provided under paragraph (3), and notwithstanding any other provision of law, the rights and remedies provided for in this section may not be waived by any agreement, policy, form, or condition of employment, including by any predispute arbitration agreement.

''(2) NO PREDISPUTE ARBITRATION AGREEMENTS.—Except as provided under paragraph (3), and notwithstanding any other provision of law, no predispute arbitration agreement shall be valid or enforceable to the extent that it requires arbitration of a dispute arising under this section.

''(3) EXCEPTION.—Notwithstanding paragraphs (1) and (2), an arbitration provision in a collective bargaining agreement shall be enforceable as to disputes arising under subsection (a)(4), unless the Bureau determines, by rule, that such provision is inconsistent with the purposes of this title.''.

(b) CONSUMER FINANCIAL CIVIL PENALTY FUND.—Section 1017(d)(2) of the Consumer Financial Protection Act of 2010 (12 U.S.C. 5497(d)(2)) is amended, in the first sentence, by inserting ''and for awards authorized under section 1017A'' before the period at the end.

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