U.S. Securities and Exchange Commission

Office of the Investor Advocate

FISCAL YEAR 2023

Report on Activities

ABOUT THIS REPORT AND DISCLAIMER

Section 4(g)(6) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. § 78d(g)(6), requires the Investor Advocate to file two reports per year with the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.[1] The two reports are the mid-year Report on Objectives covering the forthcoming Fiscal Year and the end-of-year Report on Activities covering the preceding Fiscal Year.

A Report on Objectives is due no later than June 30 of each year, and its purpose is to set forth the objectives of the Investor Advocate for the following Fiscal Year.[2] A Report on Activities is due no later than December 31 of each year.[3] The Report on Activities describes the activities of the Investor Advocate during the immediately preceding Fiscal Year.

Disclaimer: Pursuant to Exchange Act Section 4(g)(6)(B)(iii), 15 U.S.C. § 78d(g)(6)(B)(iii), this Report on Activities is provided directly to Congress without any prior review or comment from the Commission, any Commissioner, any other officer or employee of the Commission outside of the Office of the Investor Advocate or the Office of Management and Budget. This Report on Activities expresses solely the views of the Investor Advocate. It does not necessarily reflect the views of the Commission, the Commissioners, or staff of the Commission, and the Commission disclaims responsibility for this Report on Activities and all analyses, findings, and conclusions contained herein.

CONTENTS

"As innovation in financial products and services continues to accelerate, we believe our approaches to investor protection will also need to innovate in order to keep pace."

MESSAGE FROM THE INVESTOR ADVOCATE

IN MY FIRST MESSAGE AS INVESTOR ADVOCATE in June of this year, I highlighted my priorities for the Office of the Investor Advocate (OIAD):

- Improve our service to retail investors seeking assistance;
- Increase our engagements with investors and their representatives; and
- Enhance our research to identify evidence-based insights about retail investors.

The purpose of each of these goals is to better perform the functions that Congress has assigned to OIAD, and ultimately, to better serve the investing public.

In this Report on Activities on Fiscal Year 2023, I would like to update you on our progress on these priorities, as well as share some of what we have learned through this past year.

SERVICE TO INVESTORS

The most important function of the Office of the Ombuds is to address problems that retail investors may have with the Securities and Exchange Commission or with the self-regulatory organizations that the Commission oversees. In 2023, we managed 2,605 matters and responded to 2,828 additional contacts through the Ombuds' Office. This represents a greater than 500% increase in matters initiated by investors, and a more than 1,000% increase in contacts since the establishment of the Ombuds' Office in 2015. Separately, in the past fiscal year, the Investor Advocate received almost 900 investor inquiries which were responded to by staff.

As surprising as the growth may appear, it is important to note that these numbers do not represent a spike in inquiries and complaints. They represent a continuous progression in communications from individuals who are seeking assistance on a variety of issues over the last nine fiscal years. We observe that the number of investor communications with the Office of the Ombuds has increased over the same time period that there has been a rapid growth in new investors, new products, and new investing platforms. We believe that, as the number of retail investors continues to grow, along with the number and complexity of investment products and strategies available to retail investors, so will the demand for services from the Ombuds continue to grow. More importantly, the expanding retail investment landscape is also increasing the need for improved communications between regulators and the public.

ENGAGEMENTS WITH INVESTORS

To effectively perform its functions, the Office of the Investor Advocate actively seeks input from a broad variety of investors. In Fiscal Year 2023, we doubled the number of investor engagement activities that we hosted or substantially participated in, compared to the prior fiscal year. These engagements were designed to obtain feedback from investors, their representatives, and associated stakeholders on policy-related topics. Our report details some of our most productive engagements, and we intend in Fiscal Year 2024 to expand our in-person meetings with the public. In particular, we hope to continue our successful partnership with federal and state regulators in efforts to hear from retail investors about their investment experiences.

RESEARCH ABOUT INVESTORS

In Fiscal Year 2023, the Office of the Investor Advocate initiated and completed two significant research projects: one to study registered index-linked annuities (RILAs), and investors' understanding of these complex products, and another to evaluate mandatory arbitration clauses in investment advisory agreements. Our purpose in pursuing these and other research projects is to inform our policy recommendations whenever possible by providing objective, evidence-based insights about investors. As a result of our research in Fiscal Year 2023, we have included in this report several recommendations that our research indicates would benefit retail investors.

To summarize our findings and recommendations with regard to RILAs, we rarely have examined a more complex retail investment product. Congruent with the complexity of the product, we believe an enormous level of effort on the part of providers, regulators, and investors is needed to ensure RILAs are purchased by investors who can benefit from them. More broadly, we are concerned that the Commission's historical approach to disclosures may prove insufficient, not just for RILAs, but for many highly complex financial products. As innovation in financial products and services continues to accelerate, we believe our approaches to investor protection will also need to innovate in order to keep pace.

With regard to mandatory arbitration clauses, we are concerned that a number of characteristics of these clauses in advisory agreements are not in the best interest of retail investors. We make a number of recommendations to help promote a fairer, more balanced framework for arbitrations between advisers and their retail clients. In light of our concerns, we also strongly encourage investors to learn about the differences between arbitration and litigation, and to ask appropriate questions of their advisers where mandatory arbitration clauses are included in advisory agreements.

The Office of the Investor Advocate takes seriously the role it has been given in promoting the interests of investors, and we are grateful for the privilege of serving the investing public. As we approach the tenth anniversary of the establishment of the Office in 2024, we look ahead to further improving the value of our contributions to the Commission and to the service we provide investors.

Respectfully Submitted,

Cristina Begoña Martin Firvida

CRISTINA BEGOÑA MARTIN FIRVIDA
Investor Advocate

FISCAL YEAR 2023 SUMMARY

142 ENGAGEMENT ACTIVITIES

11 DATA COLLECTION ACTIVITIES completed

38 RULEMAKINGS and **127** SRO FILINGS reviewed

873 INVESTOR INQUIRIES

2,605 INVESTOR SUBMISSIONS to the Ombuds

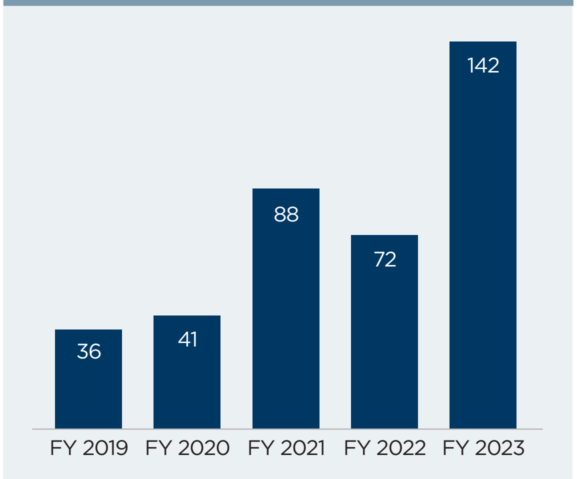
INVESTOR ENGAGEMENT

THE OFFICE OF THE INVESTOR ADVOCATE OIAD is statutorily mandated to assist retail investors, identify problems that investors may have, analyze the potential impacts on investors of rules or regulations, and make proposals to the Commission to promote the interests of investors.[4] OIAD's direct engagement with investors and their representatives support each of these mandates.

In Fiscal Year 2023, OIAD hosted or participated substantially in 142 investor engagement activities (Figure 1) designed to obtain feedback from retail investors on policy-related topics, and engaged with a variety of investors to help ensure their interests were represented across the Securities and Exchange Commission (SEC or Commission). OIAD has led various initiatives to engage directly with investors and integrate their interests into all of its functions, including:

- Meeting regularly with consumer and investor advocacy groups where retail investors are a main focus area;
- Keynoting the North American Securities Administrators Association's (NASAA) Senior Issues Committee annual conference, and meeting with older investor advocates at the state level;
- Facilitating a meeting with the Investor Advisory Committee on retail investor issues, including with leading industry and advocacy organizations;
- Engaging and collaborating with federal agencies, state regulators and industry partners, and international counterparts on issues related to investors, such as, the Consumer Financial Protection Bureau (CFPB); the Federal Trade Commission (FTC), the Departments of Veterans Affairs (VA), NASAA, the Securities Investor Protection Corporation (SIPC), and the Canadian Investor Protection Fund (CIPF), among others;
- Hosting a large public roundtable with NASAA and State partners to hear directly from investors; convening discussions with Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) agency Ombuds to address investor issues;[5] and

FIGURE 1. **Number of Engagements**



- Envisioning and initiating annual consultations with the SEC Division of Examinations, to include direct investor input into the Exam Priorities for Fiscal Year 2024.

Throughout Fiscal Year 2023, OIAD actively sought input from a broad range and variety of investors—including individual retail investors, smaller and regional investors groups and advocates, public and private pension funds, and other small and large money managers—as well as regulatory counterparts, non-profits, academic experts, and consumer groups.

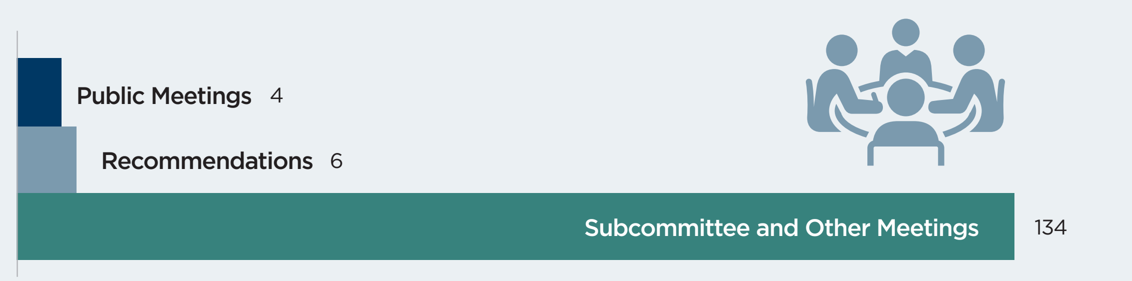
Notably, in July 2023, OIAD conducted a large public roundtable jointly with NASAA and the Wisconsin Department of Financial Institutions in Madison, Wisconsin. At the roundtable (which was also livestreamed on sec.gov) investors, investigators, and regulators shared their experiences of securities fraud and engaged in discussions related to identifying fraud and avoiding suspicious investments directly with senior Commission staff and Commissioner Mark Uyeda.

In September 2023, OIAD joined the Secretary of Veterans Affairs, the Honorable Denis McDonough, and other federal financial regulators, at the Joseph Maxwell Cleland Atlanta Department of Veterans Affairs Medical Center for a panel discussion on retail investor-related topics and investor advocacy.

In addition, OIAD supports the SEC Investor Advisory Committee (IAC), and the Investor Advocate participates in the IAC as a statutory member.[6] The IAC is one of two Commission advisory committees. It holds public meetings to discuss investor-related topics and is authorized by statute to make formal recommendations to the Commission. The IAC includes the following four subcommittees and one working group to help formulate its policies and recommendations: 1) Investor-as-Owner Subcommittee; 2) Investor-as-Purchaser Subcommittee; 3) Market Structure Subcommittee; 4) Disclosure Subcommittee; and 5) Access and Inclusion Working Group.

OIAD continues to provide broad administrative and organizational support, and technical assistance, upon their request, to the IAC. In Fiscal Year 2023, this included organizing four IAC public meetings, including the first in-person IAC Meeting since before 2021, and facilitating six IAC Recommendations (Figure 2).

FIGURE 2. **FY2023 Investor Advisory Committee Activities**



“POSITIER aims to provide deep insight into how investors and other stakeholders interact with the investment marketplace and how they are affected by SEC policy.”

RESEARCH AND INVESTOR TESTING

THE POLICY-ORIENTED STAKEHOLDER AND INVESTOR TESTING for Innovative and Effective Regulation (POSITIER) initiative was launched in 2017 to provide a toolkit to the Commission and OIAD for understanding investors and increasing the efficacy of policymaking activities.[7]

POSITIER aims to provide deep insight into how investors and other stakeholders interact with the investment marketplace and how they are affected by SEC policy. POSITIER researchers enable OIAD and the SEC to more thoroughly:

1. "Identify areas in which investors would benefit from changes in the regulations of the Commission or the rules of self-regulatory organizations";[8]
2. Conduct pre-adoption testing of potential policies, identifying areas in which investors would benefit from changes in regulation and allowing the Commission to "analyze the potential impact on investors of proposed regulations of the Commission. . . proposed rules of self-regulatory organizations . . . and . . . to the extent practicable, propose to the Commission changes in the regulations";[9]
3. Conduct "retrospective analysis of rules" to help ensure that policies are working as intended;[10]
4. Study investor behavior and outcomes to "identify problems that investors have with financial service providers and investment products";[11] and
5. Generate evidence for better organizational management and overall efficacy, particularly in the sense of "outcome" indicators of performance.

To accomplish these aims, POSITIER engages in high-quality, interdisciplinary research, focusing on questions and outcomes that provide meaningful impact on investors' lives. We work on long-term research projects of fundamental importance and with policymakers on applied projects to affect policies that are under consideration. In all our endeavors, we seek to provide insight in a cost-effective and rapid manner, so that insufficient time and money are not rationales for forgoing research and testing.

POSITIER's productivity is exceptional. Since POSITIER's founding in June 2017, we have conducted 51 survey and experimental projects, 15 qualitative data collection projects, and several analyses of market data. Our research has been cited in multiple rulemaking proposals, thereby having a direct impact on the investing public. Additionally, we have engaged in thought leadership by disseminating our work to policy and academic communities, increasing our impact by encouraging others to serve the interests of investors through advocacy, research, or direct outreach. In Fiscal Year 2023, highlights of our research group included:

- **Completion of a highly innovative and rigorous research project on registered index-linked annuities (RILAs) to inform a rulemaking proposal**. This project featured a fruitful partnership with the Division of Investment Management, leveraging the technical knowledge of that division while maintaining critical independence of OIAD's research team. The project was prompted by a directive from Congress to engage in investor testing in conjunction with a regulatory proposal regarding RILAs.[12] In completing the project, POSITIER conducted formative research to better situate investor testing, integrating analyses of market data and marketing materials. The project also helped demonstrate the potential and the efficacy of integrating independent and highly credible rapid-cycle investor research into agency policymaking. The report was heavily cited in the Commission's proposed rule.[13]
- **Final publication of our research on mutual fund visual aids in a special issue of the *Journal of Association for Consumer Research*, which concentrated on financial decision-making.**[14] This research was reviewed in detail in OIAD's Fiscal Year 2022 Report on Activities.[15] We believe that publication in a highly regarded peer-reviewed journal with broad appeal may increase the impact of this research throughout the federal government. Agencies working in similar consumer-facing domains will be able to draw lessons from this research and apply them in the context of consumer protection, and researchers interested in influencing policy may use the foundations laid in this publication to undertake additional research that benefits policymakers and investors.
- **Promotion of better evidence models across the federal government through a panel at the 2022 Association for Public Policy Analysis and Management (APPAM) conference**. APPAM is a premier national conference for research on public policy with two to three thousand attendees each year. Our panel discussed POSITIER's research and strategies for using evidence to promote informed policymaking, including lessons that government and academic researchers can use to improve the transmission of evidence to policy.
- **Elevation of investor-related research in multiple communities, including through the Boulder Summer Conference on Consumer Financial Decision Making, the Association for Psychological Science, and the University of Chicago American Marketing Association's Marketing and Public Policy Conference**. This outreach helps us thoroughly vet our research so that we can be confident in our findings, promote additional inquiry on investor issues, and aid other entities that may use our research to help promote investor protection.

As always, there is much more that could be done to serve the needs of investors and the Commission. Looking forward, we will continue to identify and analyze programs and policies that enable the public to make better investment decisions and reach their goals and will find avenues for POSITIER to collaborate with SEC staff on high-impact policy research. We will continue to examine interactions among individual investors, their decision context, key household factors, and macroeconomic trends. The rest of this year's report on investor testing presents results from several research projects, including insights for investors.

REGISTERED INDEX-LINKED ANNUITIES (RILAs)

What Are RILAs and How Do They Work?

RILAs are tax-deferred retirement savings vehicles that advertise potentially reduced market risk relative to investing directly in financial markets. Like many other retirement savings vehicles, money is first added to the overall vehicle and then the investor allocates that money to specific investments. Unlike many other retirement savings vehicles, because of their structure, withdrawal penalties, and other features, RILAs are complex, long-term, and illiquid products that typically require investors to make a significant number of complicated decisions with perhaps unintuitive consequences.

Investors fund purchases of a RILA contract through premium payments; the initial minimum amount required to purchase a RILA varies substantially from $10,000 to $25,000.[16] Premium payments and investment earnings are allocated by the investor to investment options. These investment options are shorter-term investments that often last 1, 3 or 6 years (a period typically referred to as the "investment term" or "term"); as such, these investment options may not individually last as long as the RILA contract itself. Thus, the investor may need to pick investments several times over the life of the contract.

Investment options track the performance of an index (e.g., the S&P 500 PR index, which tracks the S&P 500's price returns but not dividends). Investment options typically carry "insurance features" that can protect the investor against certain losses but may also limit investment gains. Due to the complexity of RILA products, including the insurance features described more fully below, there may be hundreds of possible investment options for an investor within a single insurance company's RILA contract.

RILAs are structured in two phases: (1) an accumulation phase, during which the investor puts money into the contract and invests in one or more investment options that track the performance of an index, followed by (2) an annuitization phase, during which the assets are turned into a stream of payments to the owner or returned to the investor in a lump sum.

Both RILA contracts and their investment options typically have significant financial penalties for investors that greatly limit investors' liquidity on the investments. Three of the most common financial penalties are:

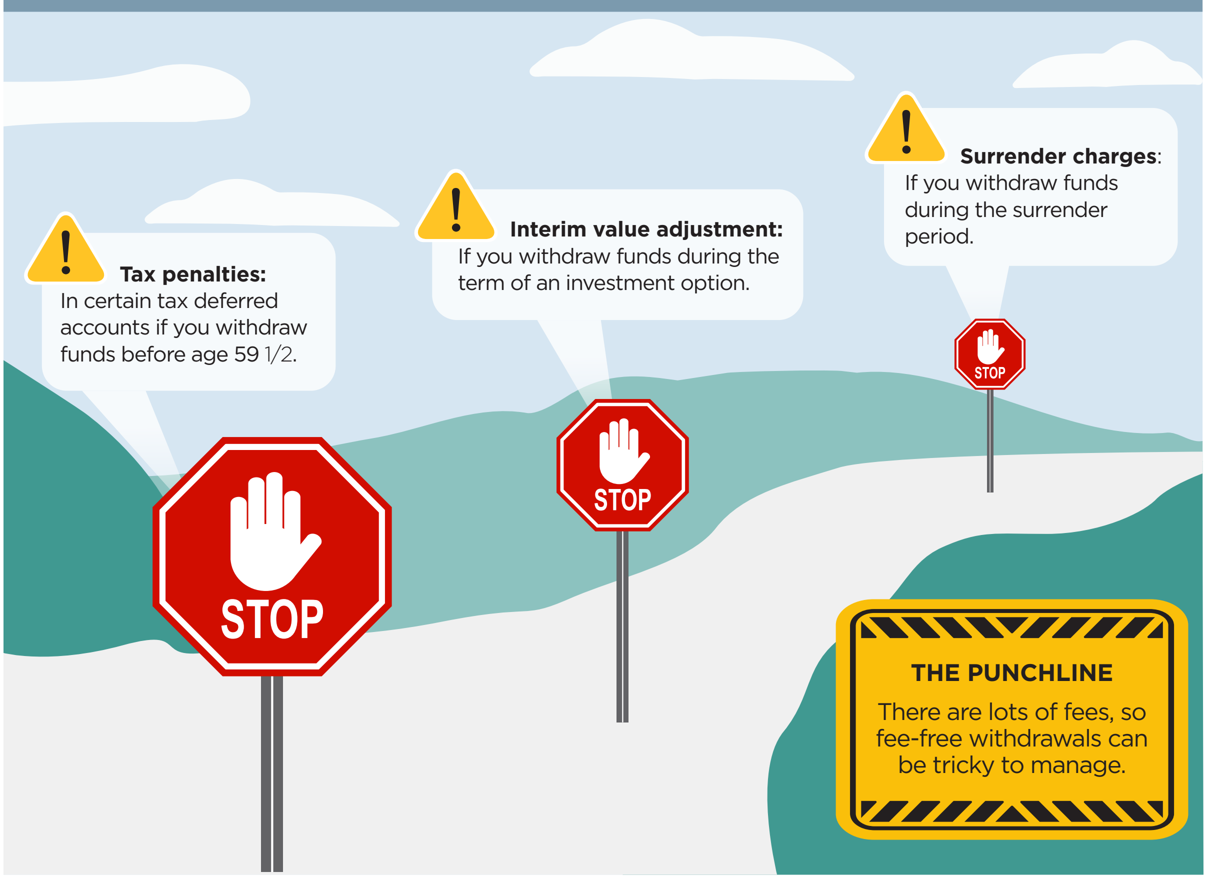
- **Surrender charges:** A RILA contract can define a "surrender charge period," typically 6 to 9 years long. During this period, the insurer charges high penalties for withdrawing money from the contract; penalties typically start around 9% to 10% and decrease over the surrender charge period. Often the surrender charge period is much longer than an investment option's term, requiring investors to hold investments for multiple investment terms to avoid surrender charges.
- **Interim value adjustments and mid-term withdrawals:** These penalties occur when money is withdrawn from an investment option before the end of its term (either when money is withdrawn from the contract or moved out of an investment option to another option while remaining in the contract). These penalties may be substantial and cause the investor to forfeit up to 90% of their money. Investors wanting to avoid these penalties may need to wait several years before changing indexes or withdrawing their money.

- **Tax penalties:** In addition to other tax implications, tax penalties may arise when the investor withdraws money from the RILA contract before age 59½.[17] Due to this age-based tax penalty, a younger investor that puts money into a RILA may need to wait many years before accessing their money without penalty.

To avoid any penalties, an investor would typically need to meet at least three conditions: (1) hold the investment through the surrender period; (2) withdraw money only at the end of each investment option's investment term; and (3) hold the investment until age 59½ or later (Figure 3). As a result, it is possible that penalty periods may be challenging to synchronize with a penalty-free withdrawal because, for example, an 8-year surrender charge period might expire in a way that does not immediately align with money that is invested in two consecutive 6-year investment options.

Of course, individual investors may face more complex scenarios involving additional taxes or withdrawal penalties, further increasing the complexity of their choices. For example, individual investors may need to consider factors including the type of account in which they hold a RILA, how it is funded, how to best deal with rollovers, and how to deal with aligning account withdrawals with other taxes that may arise. There is much that investors may need to learn and take account of in order to make these products useful for meeting their goals, and there

FIGURE 3. **Potential Fees and Charges: There are Many**



is much that regulators may need to study and be aware of in order to fulfill an investor protection mission. The bottom line is that to avoid charges and penalties, an investor likely needs to select and manage a RILA contract for multiple years, requiring the investor to make many complex decisions about investment options over the life of the contract.

Annual fees are charged in some RILA investments, but the practice is not as prevalent as annual fees in the mutual fund industry, for example. As an alternative to charging annual fees, providers will often make money in other ways such as by earning more on their own investments than they promise to pay investors.

Finally, it is noteworthy that the RILA investor is not directly invested in the index, but rather a promise by the insurance carrier to pay at a rate that aligns with the price gains in the index. Because of this structure, the solvency of the carrier may be relevant to the value of the promise.

RILA Insurance Features

RILAs offer insurance features that potentially limit losses of an investment relative to the underlying index. At the same time, the insurance features also limit the potential gains. Importantly, the insurance features generally apply not to the contract as a whole, but only to a single investment option for a certain number of years (that is, for the particular investment option's "investment term"). Moreover, the details of these features can change when investors keep their RILA contract for a long time; that is, each time an investor picks from a RILA investment menu, they may face a different set of investment options with a different set of insurance features. Investors facing a lack of desirable investment options at such reinvestment periods would need to weigh these options against potentially large charges and penalties for withdrawing money.

When making a purchasing decision, an investor who believes a RILA is right for them must pick an insurance company issuer and contract and choose how to allocate investment dollars to investment options within the contract. Investment options come from a menu that specifies the bounds on the gains and losses that are applied to each investment option, the duration of the investment term, and the underlying index to which each investment option will be linked. Each of these attributes will affect the subsequent set of decisions the investor faces. In other words, a certain provider may offer only select indices, and a given index may only be associated with a certain combination of insurance features. An investor may have additional considerations to factor into these decisions, such as their expectations of when they will want to withdraw money from the contract, as well as potentially complex tax implications that might affect decisions about how to fund a RILA or withdraw money from it.

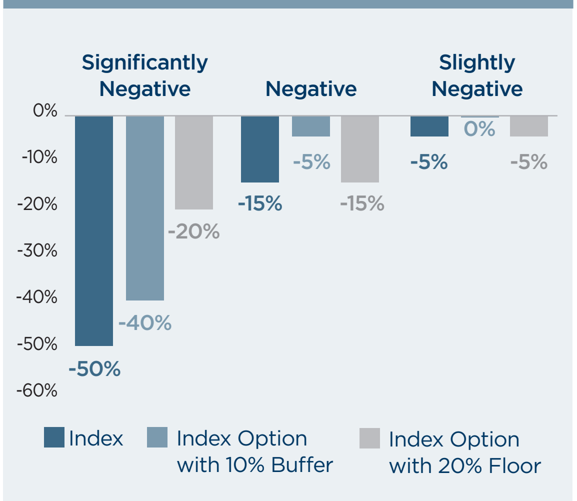
Insurance features may not provide protections against penalties that might be applied for early withdrawals or the other fees and penalties we discussed above.

There are two common insurance features that can limit the losses for an investment option, as illustrated in Figure 4.

- **Floors:** A floor is a maximum loss (typically a percentage) on the investment option. For example, a 20% floor will protect the investor from any loss greater than 20%, but the investor bears any losses up to 20%. A 5% floor would provide greater protection than a 20% floor.
- **Buffers:** A buffer absorbs losses on the investment option up to a certain point. It does not turn losses into gains. For example, with a 10% buffer, the insurance company absorbs

losses up to 10%, but the investor bears any additional losses. In other words, if the index decreased by 50%, a 10% buffer would reduce the loss to 40%. Alternatively, if the index decreased by 5%, a 10% buffer would reduce the loss to zero. A larger buffer therefore provides greater protection.

FIGURE 4. **Examples of Buffers and Floors in Different Negative Market Conditions**



Insurance features that limit losses vary in how they mitigate negative performance. For example, this figure illustrates that in the case where an investor has chosen a 10% buffer and the index decreased by 50% during a given investment term, the investor would only lose 40%. As shown, a variety of outcomes are possible.

In general, a buffer protects the investor from experiencing small losses for the investment option, but it does not protect them completely against large losses. In contrast, a floor protects an investor from experiencing large losses but does not protect against small losses. When deciding on floors or buffers and picking a level of protection, some operative questions would then seem to include: how often do index losses exceed the buffer? And how often does the index incur a loss that is larger than the floor?

Insurance features can also limit gains for an investment option:

- **Caps:** A cap is a maximum gain (percentage) on the investment option. It reduces the potential gains from investing in the option compared with investing in the components of the index to which it is linked (such as through an investment in an index mutual fund).
- **Triggers:** A trigger fixes gains to a specific rate so long as the index's gain is over a corresponding trigger "threshold." For example, consider an 8% trigger with a threshold of 0%. The RILA would return 8% as long as the index experiences any return above 0%, including above 8%. Thus, a trigger is more valuable when index returns are between the threshold and the trigger percentage (in this case, between 0% and 8%). A trigger below the index returns during the investment period is likely to limit gains relative to the index, whereas a high trigger could boost gains above the returns experienced by the index.

In general, both caps and triggers limit the returns on RILA investment options when there are large increases in the value of the underlying index. However, a trigger can provide higher returns than the underlying index when index returns are modest.

A final insurance feature may act on both gains and losses for an investment option but may also act on gains or losses alone:

- **Participation rates**: The participation rate acts as a multiplier on index performance. For example, a two-sided 85% participation rate reduces both gains and losses to 85% of the gains or losses on the underlying index. For example, a gain of 10% on the index would be reduced to a gain of 8.5% with the RILA, and a loss of 10% on the index would be reduced to a loss of 8.5% with the RILA. A participation rate can be over 100%, in effect creating a leveraged investment product. An investment option with a participation rate may also have caps or other limits on gains.

KEY TAKEAWAYS FROM THE RILA RESEARCH

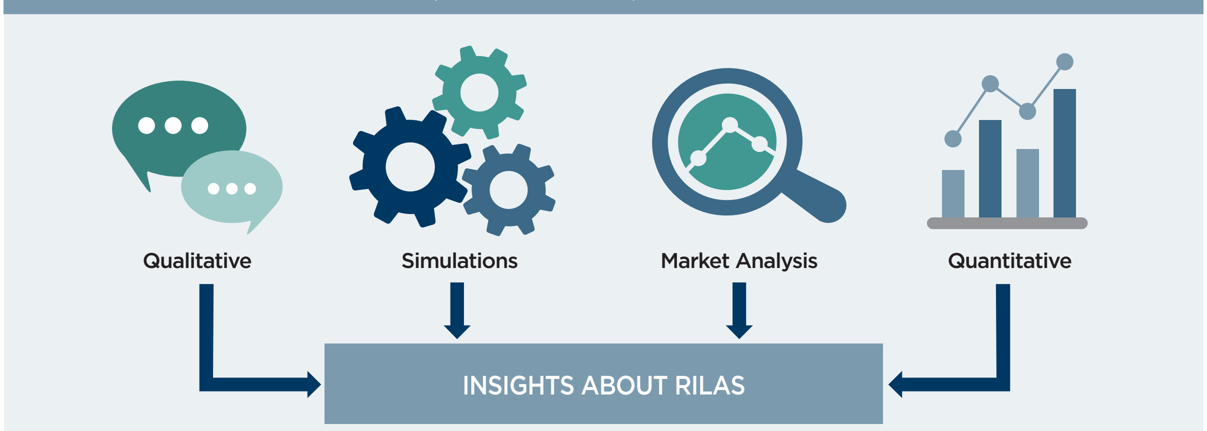
In Fiscal Year 2023, the POSITIER team conducted extensive research, including investor testing, to inform the design of a new registration form for RILA products.[18] This research was conducted in collaboration with the Division of Investment Management. The project was prompted by a directive from Congress[19] to conduct testing to help "ensure that a purchaser using the form receives the information necessary to make knowledgeable decisions"[20] and supplemented that testing with analyses of the RILA market to better understand the products.

The POSITIER team conducted four separate, interconnected research streams to understand RILA products (Figure 5):

1. Analysis of the existing market for RILA products—exploring potential investor returns under various market scenarios—to better understand the economic features of these products.
2. Review and analysis of RILA marketing materials to understand issuers' perspectives on the RILA value proposition and also to better understand how potential investors are approached.
3. Qualitative investor testing—in the form of 1-hour one-on-one interviews with 20 annuity owners and shoppers—to better understand comprehension, barriers to understanding, and reactions to initial versions of the Key Information Table (KIT), a hypothetical summary disclosure that contains information about RILA contracts and their features and risks.[21] Due to the in-depth and labor-intensive nature of this research approach, it is common practice to conduct a relatively small number of interviews.
4. Quantitative investor testing with thousands of consumers to assess potential form designs and to quantitatively assess comprehension.

Understanding the impacts of regulations on consumers is important to designing effective policy. Bringing insights from individuals and households to inform policymaking discussions requires significant technical expertise, an infrastructure to collect and analyze data under tight timelines, and the ability to translate research findings to policymakers. The POSITIER team engaged with the topic of RILAs before the rulemaking proposal was released. This work,

FIGURE 5. **RILA Research Methods (4 Methods Used)**



conducted at a much earlier stage than prior investor testing, helped ensure that data-driven insights informed the proposed rule.[22]

The research project yielded five key lessons about RILAs of relevance to investors.

Lesson #1: Complexity and Jargon Make RILAs Hard to Understand

RILAs are challenging for consumers to understand. The products are complex, and the jargon used to explain them is unfamiliar to even the most sophisticated consumers.[23] In our qualitative and quantitative testing, we provided consumers with hypothetical disclosure text and assessed their understanding of RILAs. We found that many consumers were confused by or unable to understand key terminology, such as investment term, interim value adjustment, and buffer.

Beyond the terminology, we found that many interview participants struggled to understand the details of the RILA contract presented in the hypothetical disclosures. These difficulties manifested both in their explanations of key concepts and in their application of the knowledge.

In quantitative testing, we asked consumers to answer true–false questions about the RILA materials that were presented. Despite the disclosures, consumers were only able to answer 58% of the questions correctly on average, which is only slightly better than what we would expect if the participants were randomly guessing. These results suggest that substantial conceptual barriers surround RILAs.

In sum, many participants remained unable to fully understand the implications of the RILA features and, thus, had limited ability to apply that information in decision-making.

Lesson #2: Insurance Features Greatly Affect How a RILA Performs and Investors' Chances of Losing Money

In our analysis of the RILA market, we considered how different RILA features could have influenced an investor's possible investment returns in recent history. We performed this analysis by applying currently available investment option insurance features to the historical returns of the indices that RILA issuers track. Our baseline simulations used a commonly offered investment option from the data (a one-year investment term, an 18% cap and 10% buffer) and our comparison options were slight modifications from that baseline.

These simulations compared the returns from investing in a RILA option with the returns of the index itself in order to understand the extent to which RILA insurance features would have mitigated losses and capped returns during the 1990 to 2019 period. We believe this analysis could be informative for people who are evaluating the potential economic value of the RILAs. In turn, more accurate assessments of economic value may help potential investors decide if and how to invest in a RILA.

Overall, our results suggest that the purchasers' choices of insurance features can significantly impact returns. Surprisingly, despite the emphasis on the insurance features as risk mitigation devices, during our historical simulation period, some RILA investment options would have actually increased risk and reduced returns versus investing directly in the underlying index.

To illustrate the effect of insurance features on potential returns, Figure 6 summarizes the results of our simulations. Each panel presents the distribution of the simulated outcomes for one of four realistic 1-year investment term options that an investor may encounter. Specifically, we simulated investment returns associated with a $10,000 investment in a given RILA investment option that rolled over five times, for a total investment duration of 6 years. Simulations were repeated starting in each month from 1990 to 2013 (i.e., one simulation ran from January 1990 to January 1996, a second ran from February 1990 to February 1996, and so forth, ending with a final simulation from January 2013 to January 2019). In each panel, the height of each bar represents the number of simulations that resulted in a particular final investment balance. Specifically, results for the RILA investment option are shown in blue and results for the S&P 500 index are shown in yellow.

The investment options we examined in Figure 6 were:

- An 18% cap and 10% buffer (Panel A; note that this was similar to an investment option offered by many different issuers and was the main case we explored in our research)
- A 13.5% cap and 15% buffer (Panel B)
- A 10.9% trigger and 10% buffer (Panel C)
- A 19.5% cap and 20% floor (Panel D)

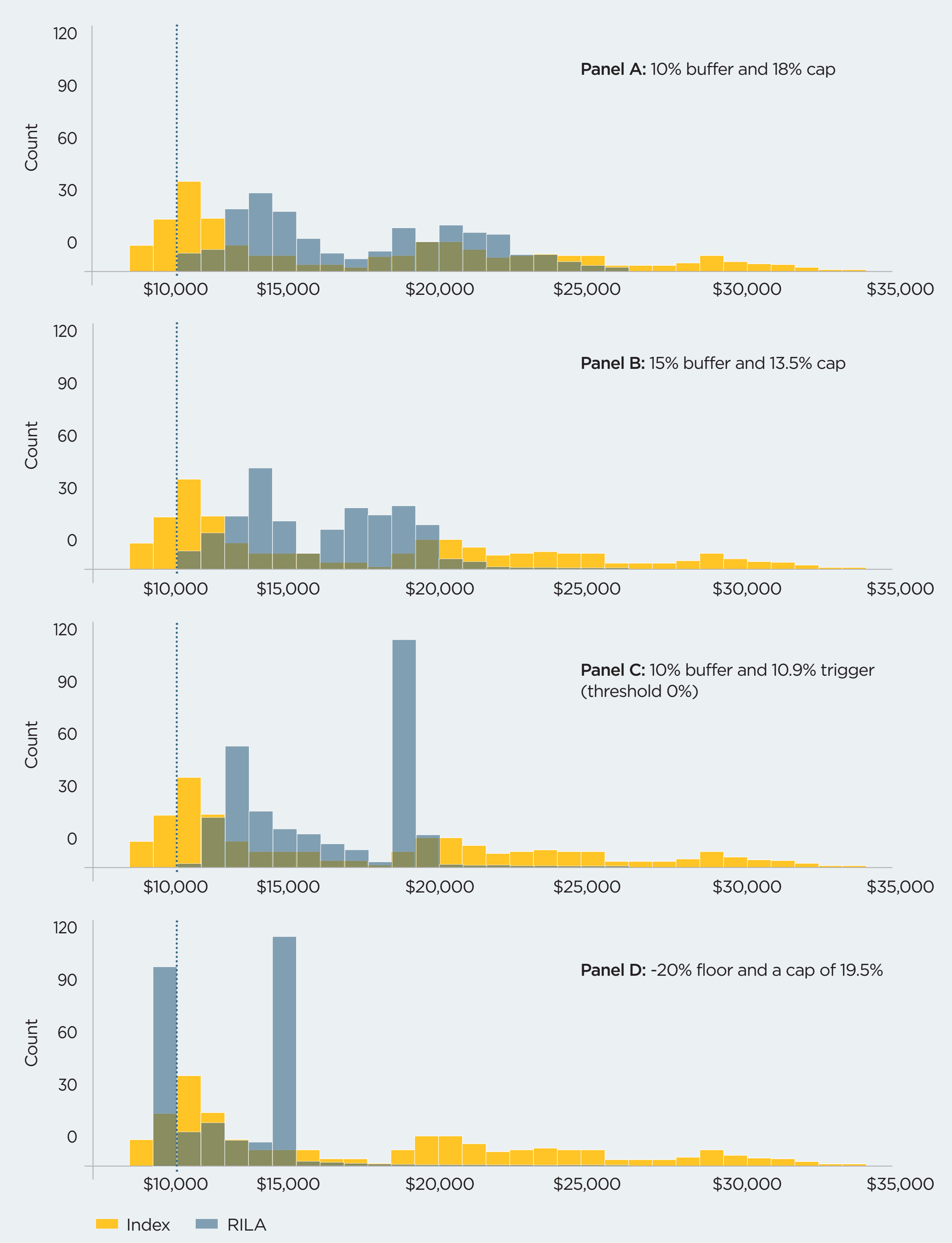
It is clear from Figure 6 that the RILA options we examined would have reduced the potential gains and the extent of the losses relative to the index. At the same time, potential returns to the RILA options differed significantly depending on the particular insurance features. For example, in Panel D (19.5% cap, 20% floor), the probability of losing money would have been 37% compared to 15% for investing directly in the index. Additionally, the highest possible gains would have been limited.

Lesson #3: The Timing of RILA Purchases Affect Investors' Chances of Losing Money

Our historical simulations also highlight an important result that may be unintuitive to potential investors: The precise timing of investments can have substantial impacts on how insurance protections are triggered. While timing is important to a certain extent in the case of purchase and sales decisions in many investments the issue is particularly acute for RILAs. Investment options purchased within a RILA are associated with a forced sale at the end of each investment term. In other words, RILA investors experience an adjustment in the value of their RILA holdings at the end of each investment term; thus, even if the underlying index is only temporarily depressed, investors cannot wait until a market recovery to realize gains. Put another way, although RILA products have a long-run investment purpose and investment options offer insurance protections on the realization of returns at the end of a term, RILA investors' investment options essentially place a bet on the realized value of the index on a specific end-of-term day.

General market fluctuations occur constantly and affect the value of many investment products. Yet, because RILA investments leave investors limited discretion over the timing of sales, timing-based changes in value are particularly important for these products. An investor purchasing a mutual

FIGURE 6. **Comparing Alternative Investment Options**



This figure displays simulated investment outcomes for different RILA investment options (as specified in each panel). The height of each bar represents the number of simulated realizations with that particular outcome.

fund or exchange-traded fund tracking the index, in contrast, could hold the fund for a longer period, with the possibility of avoiding losses due to a forced sale on a specific date.

As an example, consider the investment option from the left panel of Figure 7 (18% cap, 10% buffer). During the period from 1999 to 2000, the S&P 500 rose by 20%, but this RILA investment option's returns would have been capped at 18%; thus, by 2000, the RILA would have slightly trailed the index. The situation was different in the 2000 to 2002 period, when the index dropped in value. Over that period, the RILA's buffer would have reduced losses, allowing its cumulative value to exceed that of the hypothetical S&P 500 investment. By 2005, the $10,000 investment made in this RILA investment option in 1999 would have increased by 27% (ending at $12,730), whereas the index lost 1.5% (ending at $9,857).

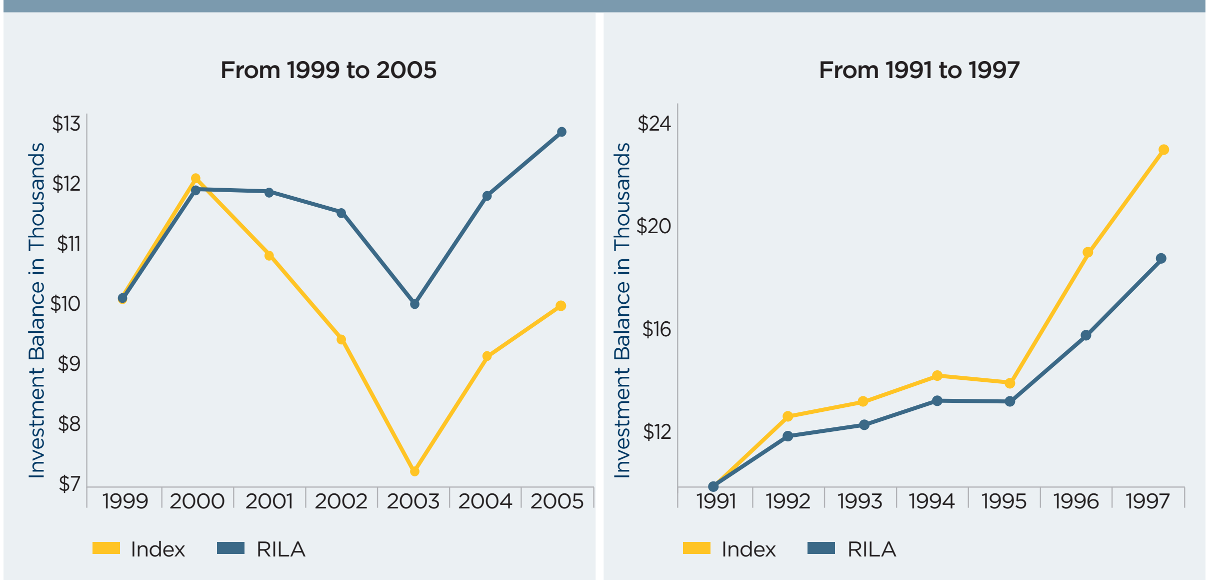
As a comparison, the right panel of Figure 7 shows a RILA with the same insurance features (18% cap, 10% buffer) held for a 6-year period starting in 1991. In this instance, at the end of 6 years, the RILA would have underperformed the S&P 500 index due to the 18% cap, which would have limited the returns in certain years when the index gained value. The final investment value of the RILA in 1997 would have been approximately $4,000 lower than the index.

Together, the two panels of Figure 7 illustrate the fact that the value of a RILA (and the value of a RILA *relative* to its index) can vary significantly depending on the time period during which it is chosen, even holding constant the insurance features.

Lesson #4: Increased Comprehension Is Possible Through Investor Testing

A quantitative test with thousands of consumers and qualitative tests with a smaller group of

FIGURE 7. **Simulated Value of a $10,000 Investment in a RILA Option Versus Direct Investment in the Associated Index over Different Time Periods**



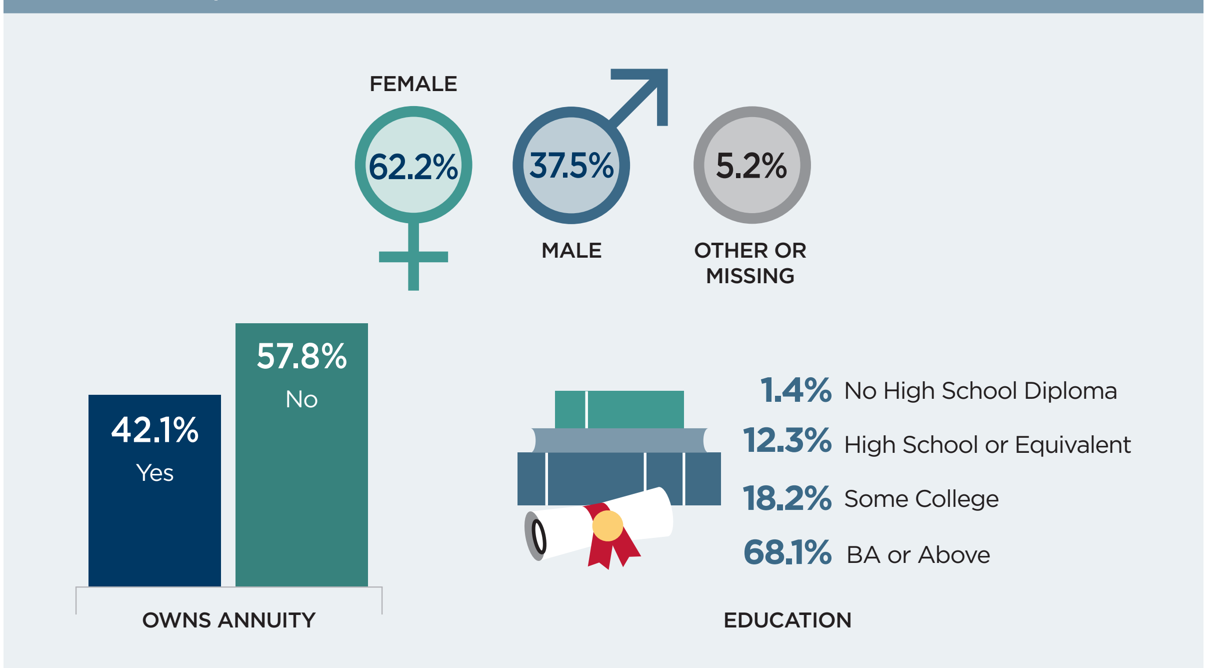
The RILA investment option in both graphs is the same: an S&P 500 price return–linked index with an 18% cap, 10% buffer, and a 1-year investment term. These two graphs illustrate the fact that the value of a RILA (and the value of a RILA *relative* to its index) can vary significantly depending on the time period during which it is chosen, even holding constant the insurance features.

individuals were conducted to explore how well potential investors understand RILAs and what changes could be made to improve comprehension. Our investor-focused testing research design consisted of 1-hour, one-on-one qualitative interviews with 20 individuals from around the country with varying levels of experience and sophistication, which enabled us to identify key ways that investors interact with RILA information and to identify areas of confusion. Using this qualitative research as a basis, we tested various disclosures more broadly with over 2,500 participants in a rigorous quantitative testing study. For that quantitative testing, we sampled a broad mix of investors who were diverse in terms of age, gender, education, and annuity ownership (Figure 8).

Although we generally found comprehension to be quite low, there were some variations on the disclosure materials that resulted in modest increases in comprehension. Our research was highly accelerated due to a compressed timeframe; nevertheless, our analyses demonstrated the promise of testing for improving disclosure while providing practical guidance to the rulemaking team.

One focus of the rule proposal was the use of a Key Information Table (KIT) to highlight aspects of RILAs with which investors might be unfamiliar. Our research design focused on two alternative versions of the KIT: a version with question-and-answer (Q&A) headings, and a version with non-Q&A headings. An additional dimension of the study tested the differential impacts of four potential introductions to preface the KIT: a “Benefits Only” introduction based on our review of RILA marketing materials; a “Key Terminology” introduction that referenced a number of key terms used in the KIT; a “Decision Focus” introduction that attempted to avoid the use of jargon and layer information to help participants unpack how a RILA works in digestible pieces (e.g. this version covered the purpose of a RILA before delving into more complex details of the products); and a control

FIGURE 8. **Participant Characteristics**

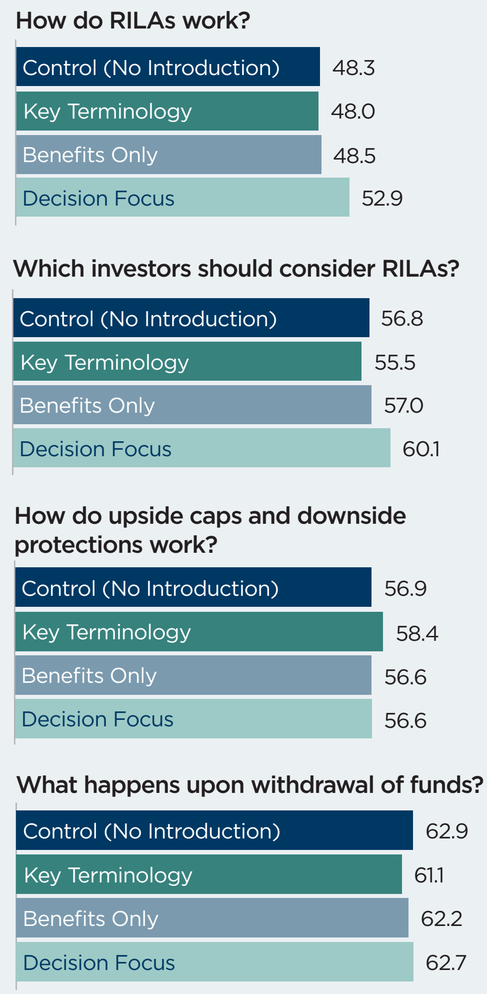


condition that provided no introduction at all. Thus, each participant viewed one of four introductions and one of two KIT versions, for a total of eight different combinations.

Our quantitative study measured comprehension across 28 questions, which could be organized into four subscales: "How do RILAs work?" (these questions considered the basic purpose and structure of RILAs); "Which investors should consider RILAs?" (these questions asked about the potential appropriateness of a RILA in selected investment settings); "How do upside caps and downside protections work?" (these questions asked about the insurance features of a RILA); and "What happens upon withdrawal of funds?" (these questions asked about the liquidity aspects of RILAs, largely about how early withdrawal penalties work).[24]

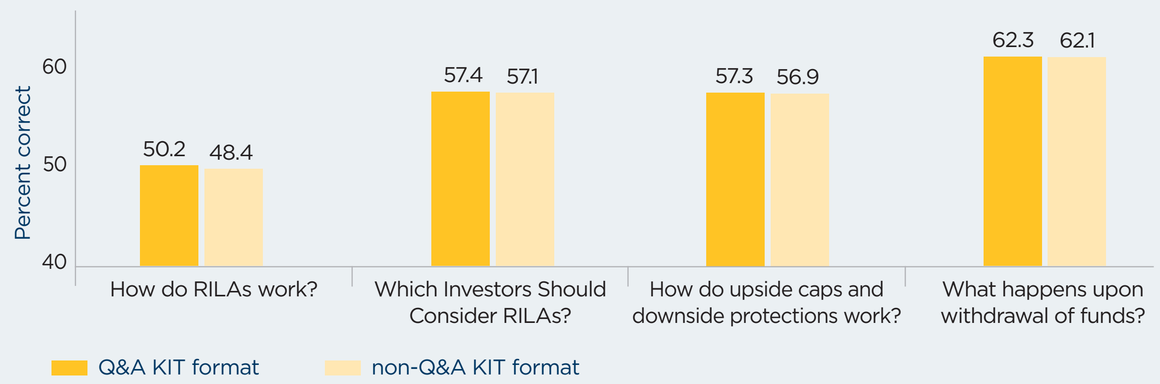
Figure 9 summarizes our quantitative study by subscale and introduction. Average comprehension on the "How do RILAs work?" subscale differed across the introductions, with the Decision Focus introduction having the highest comprehension (Figure 9). The differences between the Decision Focus and other introductions are all at least marginally significant, although the magnitudes of these differences are all modest. The "Which investors should consider RILAs?" subscale had differences across introductions with the Decision Focus having the highest average performance. All the other introductions have significantly worse average comprehension, although the magnitudes of these differences are modest. Performance on the "How do upside caps and downside protections work?" had no significant differences between introductions. Finally, on the "What happens upon withdrawal of funds?" subscale, average performance differed between the Key Terminology and the control introductions, with the Key Terminology doing significantly worse, again, with only a modest difference in magnitudes.

FIGURE 9. **Summary of Average Percentage of Questions Answered Correctly Across Introductions**



Four introductions were developed to observe investors' understanding of key concepts about RILAs. The first introduction, "Control" was a control scenario, which participants were given no information about RILAs. The second introduction, "Key Terminology" was designed to introduce participants to key terminology. The third introduction "Benefits Only" described potential benefits of owning a RILA. The fourth introduction, "Decision Focus" reduced the use of jargon and presented information in an order we believed to be more meaningful to new potential investors. Within each introduction, all participants answered questions categorized in four separate conceptual sub-scores: (1) How do RILAs work? (2) How do upside caps and downside protections work? (3) Which investors should consider RILAs? (4) What happens upon withdrawal of funds? Numerical values represent the average percentage of subscale questions answered correctly by participants assigned to the given introduction condition.

FIGURE 10. **Comprehension of RILAs across KIT Formats**



Participants were presented with one of two sets of KIT rows, with each row presented one at a time. The first set (Q&A) framed each row title as a question, and the second set (Non-Q&A) framed each row title as a statement. All participants answered questions categorized in four separate conceptual sub-scores: (1) How do RILAs work? (2) Which investors should consider RILAs? (3) How do upside caps and downside protections work? (4) What happens upon withdrawal of funds? Numerical values represent the average percentage of subscale questions answered correctly by participants assigned to the given condition.

Average comprehension across the two KIT formats (i.e., Q&A and non-Q&A headings), was similar, as shown in Figure 10. However, the Q&A format yielded greater comprehension on the "How do RILAs work?" subscale, albeit a quantitatively modest difference. Across the other three subscales the KIT formats did not result in different comprehension, Figure 10.

Our quantitative study provided additional suggestive evidence that the jargon used in the discussion of RILA products may also hamper comprehension, with possible downstream consequences on decision-making. When comparing the comprehension questions that included jargon versus those that did not, participants on average answered fewer of the jargon-laden questions correctly.

Overall, these results suggest that disclosure materials can improve comprehension, although modest changes were observed in this study.

Further research and study are needed to build on these findings and develop disclosures that help investors make decisions in line with their goals and interests.

Lesson #5: Limited Transparency is a Barrier to Understanding RILA Products

Although POSITIER constantly endeavors to make disclosures more accessible to a broad range of investors, we are mindful that different investors and other stakeholders may have different needs for detailed information. Our research efforts were greatly aided by our ability to design and run complex calculations and by having extensive access to highly informed individuals who have technical expertise with the products.

At the same time, our research would have benefitted from an increase in available data on RILA investments. We were unable to identify and access a data source that has reliable current and historical data on RILA product offerings, which impaired our team's ability to study certain aspects of RILAs. Moreover, we were unable to identify data that would help us assess the impact of early withdrawals on investors or on realized returns of actual investors. While some proprietary data sources may provide some insights for investors, the lack of readily available data makes it more difficult for potential investors to properly evaluate the benefits and costs of investing in RILAs and to select appropriate investment options for themselves.

Advocates and policymakers interested in the impacts of RILAs on investors may consider encouraging the development and maintenance of systematic, accessible and reliable data on RILA product offerings and usage by investors.

Concluding Thoughts on RILA Investor Testing

RILAs are a relatively new financial innovation that have been increasingly attracting investments since emerging in the early 2010s.[25] If used with attention to the substantial early withdrawal penalties, the products and some investment options may offer a set of benefits that appeal to certain investors. Our study provided extensive insights about these products that may be useful to investors, regulators, and the public. Although much more can surely be learned and communicated about RILAs, we believe our effort provides an enormous step forward on a rarely studied investment product that is expected to be increasingly sold.[26]

RILA products are complex and may require considerable effort on the part of providers, regulators, and investors to ensure they are purchased by investors who can benefit from them, and used in a way that realizes those benefits (for example, for long-term retirement savings and with careful attention to, among other things, early withdrawal penalties, tax consequences and an investor's appetite to make complex investment decisions over the life of the contract).

Our investor testing demonstrates that testing methods can effectively examine the relationship between disclosures and comprehension and point to ways to improve disclosures for investor decision-making (Lesson #4). While the proposed RILAs registration form was diligently developed with the aid of investor testing under tight time constraints, we remain concerned that a significant number of RILA investors will be unable to make fully informed decisions related to these products. With more time, it is possible that more effective RILA disclosures could be developed, communicating more useful and relevant information for investors' decisions. It is also possible, however, that any retail investor-friendly disclosure would be insufficient to capture the inherent complexity of RILAs.

More broadly, we are concerned that the Commission's historical disclosure-based regulatory regime alone may prove inadequate not just for RILAs, but for many highly complex financial products. As innovation in financial products and services continues to accelerate, we grow concerned whether the Commission's investor protection efforts will keep pace. Currently, a significant portion of such efforts rely on the assumption that full and fair disclosure by financial product sponsors is sufficient to allow investors to make fully informed decisions about investment products. Given the investor testing results discussed above, however, we believe it would be appropriate to explore whether that assumption holds true for highly complex financial products and whether alternative investor protection safeguards should be considered. We encourage our colleagues across the Commission to entertain new, innovative, data-driven, and investor-focused approaches to disclosures and investor protection related to complex financial products.

One potentially more desirable approach would be to provide shorter, layered disclosures that organize information in terms of decisions that an investor needs to make or questions an investor might plausibly have. Currently, investors receive disclosures on many aspects of a product or service and are expected to sift through many different topical areas to assemble information relevant to them for a particular decision. The situation can be more challenging for investors who may not know what information they need to know, as they may have difficulties identifying and assembling the relevant information.

Building on our RILA research, a particular avenue for improving disclosure could involve the creation of decision trees to help guide investors through the many complex decisions one must make when deciding to purchase an investment. In the case of RILAs, an investor must answer questions such as: Is a RILA right for me? Which insurance carrier should I purchase from? What index should my RILA track? What insurance features should I select? Each of these questions is complex, often require consideration of a set of subsidiary questions, and may require different information to answer.

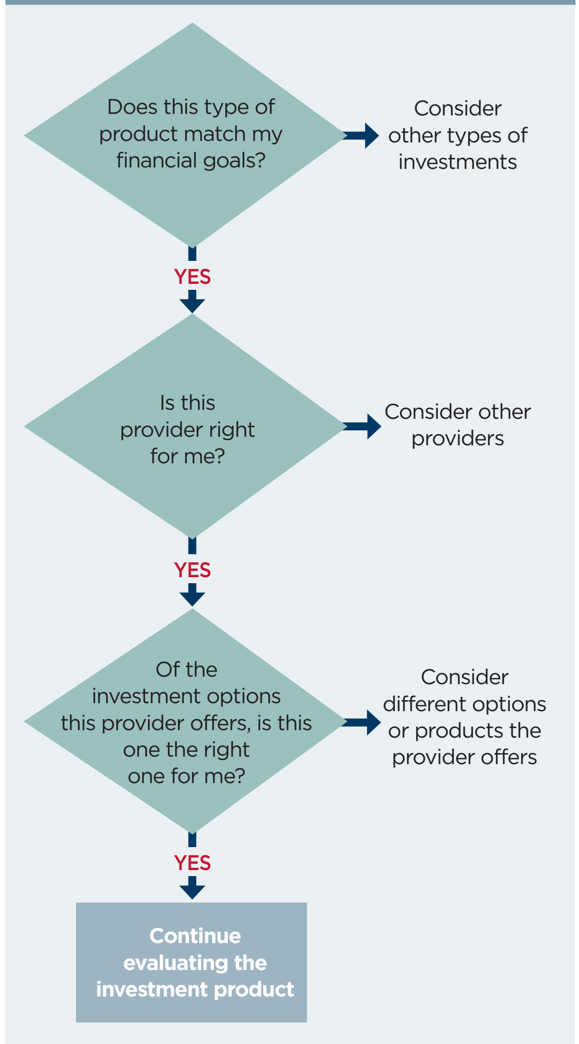
Figure 11 provides a sketch of how such a decision tree might work when evaluating an investment product. This diagram is provided for illustrative purposes only, given that each of the decision nodes on the diagram (diamonds) may itself involve a set of subsidiary decisions. Nevertheless, the illustration suggests a possible sequence of decision nodes for the purpose of discussion.

The first node asks investors to consider if this type of product is appropriate for their goals: How does the product work? Does it serve a purpose aligned with the investor's goals? Are there better options available? These questions seem fundamental to any investor product evaluation.

The second node asks if the product provider is right for the investor. Does the provider offer options that are appropriate for the investor? Could the financial viability of the provider be an issue? There are many factors that may go into such a decision.

The final node asks, "Of the investment options this provider offers, is this one the right one for me?" This last node embodies a layer of comparison shopping, where specific product features are relevant.

FIGURE 11. **Stylized Investor Decision Tree**



Of course, this illustrative decision tree is too generic to fully guide an investor, but it highlights some conceptual aspects of a decision tree. A good decision tree can produce an efficient organization of information and may help an investor to quickly identify if a product is not right for them.

Aside from providing a decision tool to an investor, how could such a decision tree guide the design of a disclosure? Standard disclosures are rarely written with a specific decision context in mind. Often, disclosures are structured with an assumption that an investor has already determined that the type of product or the provider is the right one for them—at best, essentially assuming the investor is at the last node of the illustrative decision tree. While the content of disclosures may to be extremely valuable to different types of investors, the structure of disclosures may make the content less useful to investors who are at different nodes in the decision tree. A decision tree model may help issuers organize the content of disclosures in a way that could more effectively inform investors.

We must also acknowledge the assistance investment professionals provide many retail investors when making financial decisions. In particular, investment professionals are likely to play an important role in ensuring the appropriateness of RILAs for investors, as RILAs are often professionally sold products. RILAs are frequently marketed to older investors; thus, it is reasonable to ask whether a highly illiquid investment is the right choice for a specific older investor. Given the costly nature of RILA penalties discussed above, information on how often they are levied would provide significant insights on how well investment professionals help investors during the purchasing process. If RILA products were to be recommended following proper analysis of an investor's situation, one would expect to find that charges and penalties would rarely be levied in practice (because the investor's likelihood of withdrawal would be thoroughly considered before a sale was made). Data on RILA withdrawals and household financial shocks are thus likely to be relevant to investors, financial intermediaries, and regulators. Unfortunately, as noted above, we lack transparency in the RILA market, which makes it difficult to ensure that investors are receiving the information they need to make decisions about these products.

Overall, we encourage the Commission to explore new, innovative, and data-driven approaches to investor protection related to complex financial products and to test disclosures that better assist investors and their decision-making. With respect to RILAs in particular, we look forward to analyzing public comments on the proposed RILAs registration form, and to working with our colleagues to help ensure that investors are enabled to make fully informed decisions.

STOCK MARKET EXPECTATIONS

Multiple nationally representative surveys ask investors to forecast future stock market movements, with the goal of understanding consumption, savings, and investment decisions. Typically, these surveys ask individuals to report the likelihood that the market will *increase* in value (e.g., the Federal Reserve Bank of New York's Survey of Consumer Expectations; the University of Michigan Health and Retirement Survey), which may be a natural way for most people to think about stock market movements.

In POSITIER research regarding stock market expectations, we identify a novel and counterintuitive effect regarding how these expectations are elicited.[27] Specifically, we show that when individuals are asked to predict the likelihood that the stock market will *increase* in value, they provide more pessimistic forecasts than when they are asked to make the inverse forecast about the likelihood the market will *decrease* in value. This difference implies that existing surveys may vary in accuracy depending on how questions are phrased, a point of crucial importance for investors' decision-making, since expectations are key to economic models.

Academic research has shown that individuals' perceptions of products as positive or negative are generally consistent with the way product attributes are framed. For instance, a company with an "85% success rate" will often be perceived more positively than one with a "15% failure rate."[28] Thus, the finding from the forecasting question—the probability of a stock market *increase* leads to more *pessimistic* forecasts—is particularly surprising.

The reverse framing effect for stock market expectations is stable over many contexts. In our research, we find the framing effect within nationally representative samples, for predictions of market performance over the next month and over the next year, and over several months of data collection. The difference is found when participants read information about prior market performance and when using additional variants on the wording of stock market questions. However, differences in forecasts are smaller among those who have greater financial literacy and greater comfort with making numerical judgments.

This research shows that investor and consumer forecasts may be meaningfully impacted by the way in which questions are asked. Furthermore, because the standard framing for a forecast question is to ask about the likelihood of market growth, our research suggests that many elicitations of investors' forecasts may underestimate investors' true beliefs about future market performance. Overly pessimistic expectations about future stock market performance could lead policymakers to believe a recovery from a down market is less likely than it actually is, or it could make policymakers less concerned about a period of stock market growth than would otherwise be warranted. Beliefs about stock market growth also contribute to inflation expectations among firm managers, with potential consequences on the prices of goods.[29]

We recommend that future elicitations use a neutral frame that simultaneously asks about the likelihood that the market will increase *and* the likelihood that the market will decrease. We believe that such elicitations will provide more accurate information on investors' expectations of the stock market.

Concluding Thoughts

Serious and robust evidence on investors' decision-making can have an enormous impact on policy proposals that affect investors' well-being. As described above, whether investors have the information necessary to make well-informed decisions is consequential for their financial outcomes; similarly, understanding investors' decisions can help the Commission determine whether policy interventions are appropriately crafted.

ADVOCACY FOR INVESTORS

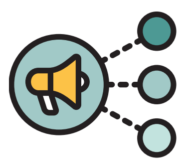
THIS SECTION OF OUR ANNUAL REPORT ON ACTIVITIES describes a selection of our policy activities on behalf of investors for the period from October 1, 2022 to September 30, 2023 (the Reporting Period).

PRIVATE MARKETS

As described in our prior Reports, the Office of the Investor Advocate has long focused on the issues surrounding the growth of the private markets in the United States.[30] The SEC regulates the private markets through, among other things, the regulation of offers and sales of securities by issuers, including private companies, pursuant to the exemptions from the registration process for securities offerings under the Securities Act of 1933. Over the past 15 years, the private markets have expanded considerably, with the amount of capital raised in these markets during this time exceeding the amount of capital raised in public registered offerings.[31] As we have previously noted, investing in the private markets may involve heightened risks compared to investing in the public markets, particularly for retail investors.[32] These risks may include reduced, incomplete or unreliable disclosure, illiquidity, and greater risk of fraud and/or investment loss. Nevertheless, the private markets, encompassing a variety of asset classes such as equity, debt, real estate, and private investment funds, have become a critical pathway for companies seeking to raise capital and a major source of investment opportunities and portfolio diversification for investors.

During Fiscal Year 2023, we closely monitored developments relating to the private markets, including pending legislative proposals in Congress, and evaluated their potential effects on investors. In addition, as discussed below, we engaged in outreach efforts, analyzed and shared research findings with Commission staff, and explored the issues and concerns raised by investors and others regarding the relative lack of available information on the private markets.

Outreach



During Fiscal Year 2023, the Office engaged internally and externally with the Commission, Commission staff, investors, and other stakeholders as part of our ongoing effort to gain a deeper understanding of the issues and different perspectives surrounding the private markets. This outreach effort included a number of events where retail investors recounted their experiences with private investments or otherwise voiced their concerns regarding these investments. We also had the opportunity to meet with various institutional investors and other market participants who shared their views on aspects of the private markets.

For example, we have sought the views of investors and other parties on the issue of accredited investor status. A significant reason behind the continued growth of private markets is the increasing number of investors who qualify as "accredited investors" and are thus eligible to invest in private

TABLE 1. Accredited Investor Definition

Wealth	Net worth	Other Criteria
An individual qualifies as an accredited investor based on wealth when that person, either alone or together with a spouse or spousal equivalent, has a net worth that exceeds $1 million, excluding the value of the person's primary residence.	An individual qualifies as an accredited investor based on income when that person has had an annual income that exceeded $200,000 (or $300,000 with a spouse or spousal equivalent) in each of the prior two years and has a reasonable expectation of the same for the current year.	An individual can also qualify as an accredited investor through other measures of financial sophistication, for example, by holding in good standing certain professional certifications or designations. Entities can qualify as accredited investors by meeting certain criteria under the accredited investor definition.

offerings under a number of offering exemptions.[33] Individuals qualify as accredited investors based on certain wealth and income thresholds, which have not been adjusted for inflation since they were adopted in the 1980s, or through other measures serving as a proxy for financial sophistication (Table 1).

The views expressed by commentators on the accredited investor definition have varied widely, ranging from support for either an expanded or a more restrictive definition, or even advocating for the elimination of the definition altogether.[34] In this regard, we note that the panel discussion on accredited investor status at the Investor Advisory Committee's September 2023 meeting—one of four panel discussions held by the Investor Advisory Committee on private markets during Fiscal Year 2023—highlighted various perspectives and considerations in amending the definition.[35]

In view of the magnitude of the private markets and the significant and growing number of retail investors now able to invest in these markets as accredited investors, we expect that continuing and expanding this outreach effort will be a priority of the Office going forward as we endeavor to provide a voice for investors in this important area.

Investor Research

We believe that investor research may provide a helpful source of objective data for the Commission in making policy decisions with respect to the private markets. For example, during Fiscal Year 2023, our Office of Investor Research (OIR) analyzed survey data on the investment knowledge and economic vulnerability of retail investors, including accredited investors, in the context of income and wealth. OIR may explore the possibility of engaging in further research on topics relating to the private markets and investor welfare, drawing on its multidisciplinary research expertise in economics, finance, psychology, and communications. We believe that these and other potential areas of inquiry, if undertaken, could benefit the Commission in considering various policy approaches to improving the regulation of the private markets.

Information on Private Markets

Issuers conducting private offerings often utilize Regulation D, which sets forth various exemptions from the registration requirements of the Securities Act of 1933, including the widely used Rule 506(b) exemption.[36] In view of the significant size and opaque nature of the private markets, some commentators have urged the Commission to enhance the requirements of Form D, the notice of an offering under Regulation D that is filed with the Commission.[37] These commenters point to, among other things, the lack of transparency in the private markets, the limited information currently required to be provided in the form, and the degree of issuer noncompliance regarding this filing requirement.[38] Conversely, other commentators have raised concerns about the increased burdens and costs associated with enhancing Form D, such as the amount and nature of the additional information that would potentially be made public through Form D filings.[39] During Fiscal Year 2023, we sought to deepen our understanding of the issues surrounding Form D as well as potential approaches to improving the quality of information available on private offerings both to the Commission and to investors. We look forward to working with Commission staff as they consider whether to recommend additional action in this area.

EQUITY MARKET STRUCTURE

In 2023, the Commission continued working to enhance many aspects of the equity market. In general, our office sought to ensure that the needs of investors, both large and small, were considered during this ongoing process of enhancing the equity market.

As noted in our recent June 2023 Report on Objectives, in December 2022, the Commission proposed a set of four significant rulemakings intended to improve the environment for retail and institutional trading in the modern market.[40] The proposed rules would: (1) establish a Commission-level best execution regulatory framework; (2) require certain retail orders to be exposed to competition in open public auctions: (3) amend existing rules to narrow "tick sizes" for quoting and trading certain stocks, lower market access fee caps, and accelerate transparent pricing; and (4) amend execution quality disclosure requirements for market centers. Through the perspective of our office's overall concern, we reviewed the proposals and public comments. We have considered the comments submitted in response to these proposals in order to consider how these amendments may help promote the interests of retail and institutional investors, whether they be adopted in whole, in part, or in some amended form. Over the last year, we have and will continue to encourage the Commission to consider commenters' suggested adjustments that appear most likely to benefit investors when finalizing these proposals. Our own Office of Investor Research also continues to consider how the presentation of disclosure data in this proposal could best serve investors.

We have also monitored a number of proposals from self-regulatory organizations on the topic of equity market structure. For example, FINRA requested public comment on possible enhancements to its own rules concerning the centralization of execution quality disclosure requirements for market centers operated by broker dealers.[41] Although this effort would enhance accessibility of a significant portion of the proposed disclosure reports, it would not eliminate search costs for those investors looking to compare and contrast all of the various reports. We continue to consider how to facilitate centralization in order to help investor decision making in this space.

Retail investors often contact OIAD to express concern regarding the practice of short selling, a trend that has increased over the last few years. We supported the Commission's efforts to enhance transparency in short selling[42] as well as the opaque network of stock lending and borrowing that facilitates the practice,[43] and look forward to the Commission and FINRA implementing these disclosure regimes over the next year. Maintaining a repository of relevant data should help improve the Commission's ability to monitor this area of the market, as well as provide the public with useful information about the practices. All investors should benefit from having free and readily accessible short sale-related data available through the Commission's website.

CYBERSECURITY

Over the years, the Office of the Investor Advocate has sought to ensure that the interests of investors are represented and considered with respect to the cybersecurity initiatives of the SEC. The increasing frequency and severity of cybersecurity incidents at public companies, funds, and other regulated entities have been well-documented, with significant costs ultimately being borne by investors.[44] With the U.S. economy growing ever more interconnected through digital technology and electronic communications, we expect that cybersecurity and its impact on investors will continue to be important area of focus in OIAD's activities.

During Fiscal Year 2023, OIAD analyzed and provided investor-focused feedback on the following Commission rulemaking proposals relating to cybersecurity in Table 2.

We are encouraged that the Commission has prioritized cybersecurity in its rulemaking efforts. Going forward, we will continue to consider public comments submitted in response to the pending cybersecurity proposals, and we look forward to working with Commission staff as they consider recommending additional action. We will also monitor the implementation of the recently

TABLE 2. **Investor-focused Feedback on These Rulemaking Proposals**

Investment Companies and Investment Advisers	Public Companies
In February 2022, the Commission proposed rules and amendments intended to enhance cybersecurity preparedness and improve the resilience of registered investment advisers, and registered investment companies and business development companies against cybersecurity threats and attacks.[45]	In July 2023, the Commission adopted final rules requiring public companies to disclose material cyber-security incidents on Form 8-K and provide enhanced disclosure of cybersecurity risk management, strategy, and governance in annual reports.[46]
Proposed Amendments to Regulation S-P	**Market Entities**
In March 2023, the Commission proposed amendments to Regulation S-P intended to enhance the protection of customer information by, among other things, requiring broker-dealers, investment companies, registered investment advisers, and transfer agents to provide notice to individuals affected by certain types of data breaches that may put them at risk of identity theft or other harm.[47]	In March 2023, the Commission proposed two rulemakings that are intended to protect the U.S. securities markets and investors in these markets from the threat posed by cybersecurity risks.[48] The proposed rules would: (1) require key market participants to take measures to protect themselves and investors from the harmful impacts of cybersecurity incidents; and (2) amend existing rules to expand the scope of entities subject to Regulation Systems Compliance and Integrity ("SCI") and update requirements to take account of the evolution of technology and trading.

adopted public company cybersecurity disclosure rules and anticipate sharing any feedback on these rules from our outreach activities with our Commission colleagues.

PROBLEMS ENCOUNTERED BY INVESTORS

Pursuant to Exchange Act Section 4(g)(6)(B)(III), we are required to provide a summary of the most serious problems encountered by investors during the prior fiscal year. Two of the more troubling problems encountered by investors, as summarized in other sections of this report, are RILAs and onerous mandatory arbitration provisions in investment advisory agreements. In addition, Figure 12 below summarizes some of the other serious problems that investors have encountered during Fiscal Year 2023, based on our consultation with sources both within and outside the Commission.

Each of the products and practices listed in Figure 12 represents an area of concern for investors during the Fiscal Year 2023. OIAD communicates regularly with various Divisions and Offices within the Commission, including with the Division of Enforcement, the Division of Examinations, and the Office of Investor Education and Advocacy, among others, to gain awareness of the problematic products and practices that such Divisions and Offices may discern in the course of their work. The Office also maintains regular communications with other regulators, such as FINRA, NASAA, PCAOB, and the Municipal Securities Rulemaking Board to maintain visibility into problematic products and practices that those regulators have confronted in their day-to-day responsibilities during the reporting period.

FIGURE 12. **Lists of Certain Problems Encountered by Investors During Fiscal Year 2023**

“It is our Office’s challenge, duty, and privilege to provide personalized assistance to the investors who seek our help, often as a point of first contact or as a last resort.”

MESSAGE FROM THE OMBUDS

EVERY DAY, INVESTORS ACROSS THE COUNTRY and around the world reach out to the Office of the Ombuds[53] for information and assistance in resolving issues related to the Commission and the SROs we oversee. These issues span the breadth of the federal securities laws and touch on the rules the Commission and SROs create, as well as the ways those rules are implemented and enforced. It is our Office's challenge, duty, and privilege to provide personalized assistance to the investors who seek our help, often as a point of first contact or as a last resort.

As the retail investor's confidential channel of communication with the Commission, our Office often learns of matters that impact large groups of investors and matters that have an outsized impact on an individual or small group of investors. In these circumstances, we do more than listen. We act. We inform and educate interested parties within the Commission about trending investor protection matters. We work with the Division of Enforcement to identify and thwart fraudulent schemes. We study and report on areas of widespread investor concern. We engage with SROs and individuals, offices, and divisions within the Commission to clarify existing practices, and, where appropriate, to highlight the harms these practices may cause retail investors.

Our Office operates independently of the Commission, yet we are bound by a core standard of impartiality that prevents us from taking sides on a given issue. Our obligation to remain impartial precludes us from directly advocating on behalf of retail investors. However, we remain singularly committed to amplify their voices, escalating their concerns when needed, and promoting the fair application of policies and procedures across the Commission and the SROs we oversee.

Fiscal Year 2023 brought significant change and challenge to the Ombuds' Office. Despite its small size, our team has met each challenge, exceeded expectations, and achieved significant milestones on behalf of retail investors. Among other accomplishments, our Office completed a landmark study of mandatory arbitration. We hosted a successful law school Investor Advocacy Clinic Summit—broadcast live to almost 2,000 viewers—providing clinic students the chance to discuss the importance of their work. We worked closely with the Office of Information Technology to implement substantial enhancements to our Ombudsman

Matter Management System (OMMS) platform, enhancements that will improve the user experience and the integrity of our data collection. But perhaps most importantly, we have personally helped over 2,600 investors, thwarting fraudulent schemes, providing useful information, and, sometimes, just listening. This is the heart of our work. It is work unlike any other, and, for this dedicated team, the work is its own reward.

We are grateful for the opportunity to personally serve the retail investor community in this unique role. In 2024, I hope that our Office will become a more active liaison for retail investors. We look forward to expanding upon and fortifying our relationships within the Commission, our relationships with stakeholders committed to investor protection, and especially our relationships with the investor communities that we serve.

Respectfully Submitted,

STACY A. PUENTE
Ombuds

WHO WE ARE

In March 2023, Investor Advocate Cristina Martin Firvida announced the appointment of Stacy A. Puente as Ombuds of the Securities and Exchange Commission.[54] Ms. Puente leads an experienced team of lawyers, each with differing subject matter expertise, all dedicated to providing personalized, tailored assistance to the retail investors that contact the Ombuds Office for help. Through direct engagement with investors, interested parties within the Commission, and external stakeholders committed to investor protection issues, the Ombuds Office fulfills its statutory role as the confidential liaison between retail investors and the Commission.[55]

This Ombuds' Report[56] discusses the work and efficacy of the Office for the Fiscal Year beginning October 1, 2022, through September 30, 2023.

WHAT WE DO

Exchange Act Section 4(g)(8), 15 U.S.C. § 78d(g)(8), requires the Investor Advocate to appoint an Ombudsman (Ombuds) to act as a confidential liaison in resolving retail investors' concerns and questions about the Commission and the self-regulatory organizations (SROs) the Commission oversees.[57]

The Ombuds is required by statute to:

(i) help retail investors resolve questions and complaints they may have with the Commission or with SROs the Commission oversees;
(ii) review and make recommendations regarding policies and procedures that encourage investors to present questions to the Investor Advocate regarding compliance with the securities laws;
(iii) take steps to ensure the confidentiality of investor communications with our Office; and
(iv) submit semiannual reports to the Investor Advocate that describe the activities and evaluate the effectiveness of the Office.[58]

In carrying out our objectives, the Ombuds team adheres to three core standards of practice, as illustrated in Figure 13.

FIGURE 13. **Ombuds: Three Core Standards of Practice**

Confidentiality
The Ombuds takes necessary steps to preserve the confidentiality of communications with investors, although communications may be disclosed where the investor consents, or where the investor alleges a violation of the securities laws or other exigent matter.

Impartiality
The Ombuds does not take sides on issues—instead, our Office fields investor questions and complaints to clarify issues, facilitate discussions, and identify options and resources that address investor issues or concerns.

Independence
Though the Ombuds reports directly to the Investor Advocate, our office is independent from the SEC. The Ombud's Report, included as a part of the Investor Advocate's semi-annual report to Congress, is filed without any prior review or comment from the Commission or other SEC staff.

HOW WE HELP

Figure 14 illustrates the process by which we receive and assist investors with their requests.

Additionally, we submit credible allegations of securities violations to the Division of Examinations and the Division of Enforcement for potential examination, investigation, or enforcement action. We study and report on issues of significant investor impact. We work with other offices and divisions across the Commission, as well as SROs, to assess the effects of specific policies or practices on retail investors. Last, we inform the Investor Advocate and other interested parties within the Commission about trending investor protection concerns.

How to Reach Us

Individuals and interested parties may contact our Office by email, telephone, and regular mail.[59] However, our primary means of corresponding with the public is through the OMMS,[60] an electronic portal for receiving, responding to, and managing data collected from investor submissions.

Through the diligent efforts of the SEC's Office of Information Technology, the Ombuds Office will launch a series of substantial enhancements to the existing OMMS system in Fiscal Year 2024. These enhancements are designed to increase ease of use for investors, expedite and standardize processes for Ombuds staff when responding to investor submissions, and more effectively track investor submissions by volume and other characteristics.

FIGURE 14. **Ombuds Process: Review, Research, Resolve**

Review

The Ombuds team reviews all incoming investor correspondence to determine if and how we may assist.

Research

The Ombuds team identifies the nature of the issue, conducts tailored research, and engages with appropriate personnel within the Commission or SROs to gather relevant information.

Resolve

The Ombuds team works to resolve investor questions and complaints by providing investors with requested information and access to additional resources, by escalating certain matters through appropriate channels, when necessary, and by monitoring outcomes.

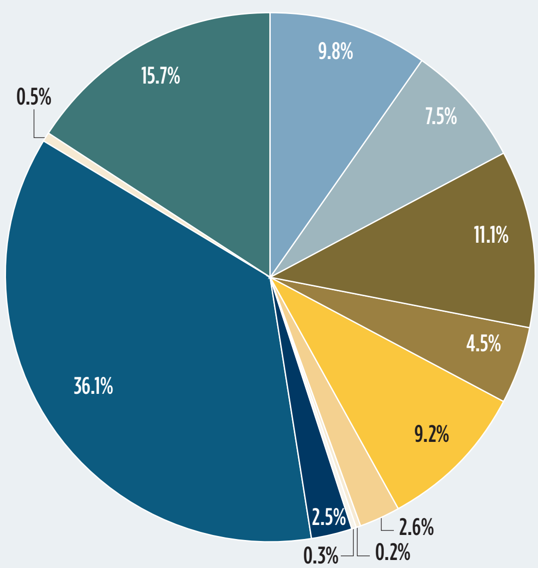
INVESTOR VOICES, BY THE NUMBERS

The Ombuds team maintains records in OMMS of all inquiries and responses handled by our Office. When a new matter is received, it is assigned a label or "Primary Issue Category," reflecting the nature of the issues raised in the submission. In tracking investor submissions by volume and by Primary Issue Category, OMMS may serve as an early warning system—identifying existing or potential problems on the horizon for retail investors.[61]

In Fiscal Year 2023, the Ombuds Office received and processed 2,605 matters. Figure 16 illustrates the number of investor matters received from October 1, 2022, to September 30, 2023, divided into the 12 Primary Issue Categories:[62]

In Fiscal Year 2023, the Ombuds team additionally reviewed and/or responded to 2,828 additional emails, phone calls, and other forms of correspondence relating to the 2,605 investor matters—for a combined total of 5,433 contacts with or on behalf of retail investors. Figure 16

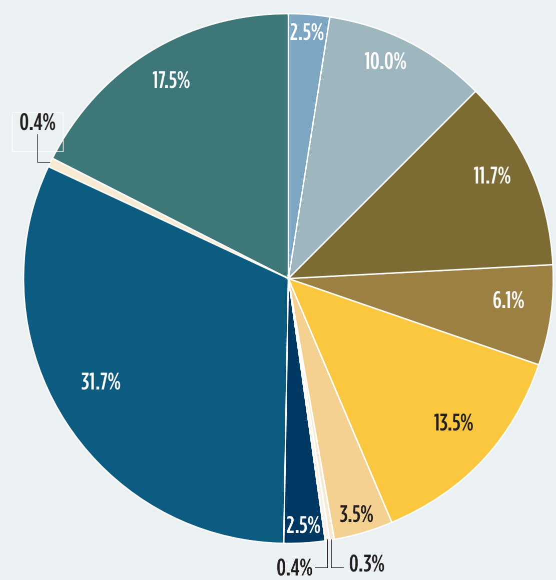
FIGURE 15. **Number of Investor Matters Received from October 1, 2022, to September 30, 2023**



- Atypical Matters (71)
- FINRA Complaints/Questions/Procedures (284)
- Non-SEC/Other Matters (330)
- SEC Investigations/Litigation/Enforcement Actions (172)
- Allegations of Securities Law Violations/Fraud (383)
- Securities Laws/Rules/Regs/Procedures (100)
- Securities Ownership (8)
- SRO Rules/Procedures (10)
- Company Disclosures and Information (71)
- Investment Products/Retirement Accounts (895)
- Organized Campaigns (10)
- SEC Questions/Complaints (494)

Total 2,828

FIGURE 16. **Number of Follow-up Contacts with Investors Arising from Their Initial Submission**



- Atypical Matters (255)
- FINRA Complaints/Questions/Procedures (194)
- Non-SEC/Other Matters (288)
- SEC Investigations/Litigation/Enforcement Actions (118)
- Allegations of Securities Law Violations/Fraud (240)
- Securities Laws/Rules/Regs/Procedures (68)
- Securities Ownership (6)
- SRO Rules/Procedures (8)
- Company Disclosures and Information (66)
- Investment Products/Retirement Accounts (941)
- Organized Campaigns (12)
- SEC Questions/Complaints (409)

Total 2,605

details the number of follow-up contacts with investors arising from their initial submissions, separated by Primary Issue Category.

An Early Warning System

From Fiscal Year 2022 to Fiscal Year 2023, the Ombuds observed a significant increase in submissions involving FINRA Complaints/Questions/Procedures and a related uptick in questions surrounding digital assets. We believe the increase in questions and concerns submitted to the Ombuds regarding these areas arises from investor dissatisfaction with the clarity, content, and timing of communications from regulators about financial industry rules, products, and market activity.

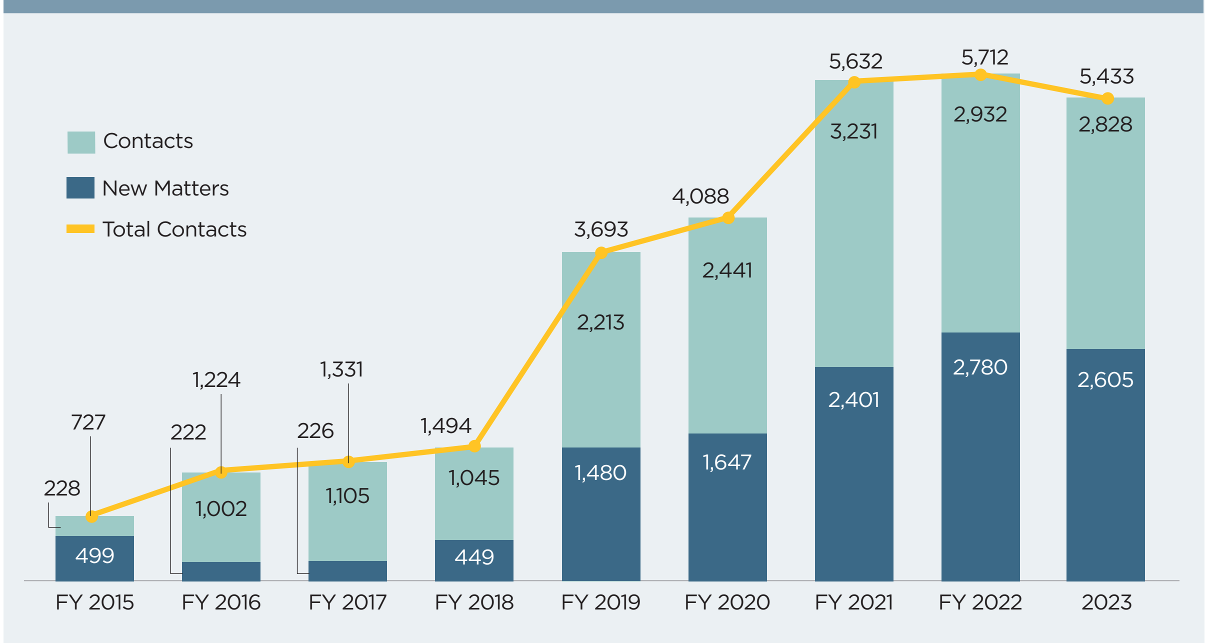
At the same time, as observed above in the discussion of RILAs,[63] OIAD's research suggests that disclosures about increasingly complex products may not sufficiently inform the investing public about the nature of and risks associated with these products.

We believe that the OIR study, viewed in conjunction with increasing investor complaints about regulatory messaging, prompts the question whether regulatory communications and industry disclosures are creating an imbalanced landscape for investors, where those with less effective access to information are at higher risk of loss due to less informed investment decisions. We echo the concerns stated in the Message from the Investor Advocate, that, as the number of retail investors continues to grow, so will the need for improved communications between regulators and the public, as well as the need for regulators to reexamine the existing disclosure regime for industry participants.[64]

Measuring Our Progress through the Years

Since the Office of the Ombuds was first established in 2014, the number of investor matters and investor contacts has steadily grown. Figure 17 illustrates the trend toward increased investor engagement with the Ombuds Office.

FIGURE 17. **Volume of OMMS matters and OMMS Contacts**



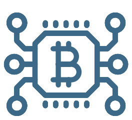
Between Fiscal Year 2015 and Fiscal Year 2023, there has been a 522 percent increase in the number of investor matters received, and a corresponding 1,240 percent increase in the number of investor contacts arising from these matters.

These numbers alone do not reflect the time and effort the Ombuds team invests in research, information gathering, internal and external collaboration to provide each investor with the tailored responses they seek.

The increase in our investor engagements may be due to an expanding sector of retail investors, amplified investor interest in Commission rules and enforcement efforts, and our Office's efforts to raise awareness of the assistance we provide. It is our intention to help an ever-growing number of investors—particularly those who need our help the most.

TRENDS AND NOTABLE MATTERS—FISCAL YEAR 2023

Digital Assets



Following the Commission's announcement of litigation against several crypto platforms, the Ombuds Office received many questions and comments from investors about crypto products. Some investors questioned the SEC's authority to regulate digital assets, while others supported the Commission's regulatory efforts, even calling for a Commission rulemaking to combat fraud relating to cryptocurrency and digital assets. Given the influx in crypto-related comments and complaints reported in Fiscal Year 2023, we are hopeful that the ongoing efforts of regulators and legislators in this space will help mitigate investor harm and increase investor confidence.

Short Selling and Threshold Lists

During Fiscal Year 2023, the Ombuds continued to receive a high volume of complaints about short sales in various exchange-traded securities. Many of these complaints focused on threshold lists—SRO-generated lists of certain equities with a "fail to deliver" position for five consecutive settlement days.[65] These investors often believed the inclusion of a security on a threshold list was evidence of abusive "naked shorting." The Ombuds provided investors information about Regulation SHO,[66] the Commission regulation governing the short sale of equities and clarified that the inclusion of an equity on a threshold list does not necessarily indicate the occurrence of abusive short selling or other impermissible trading.

SRO Communications with Investors

As noted above, many complaints received this Fiscal Year involved SRO communications with retail investors. These investors generally expressed concern that SROs were not providing clear or sufficient information directly to the retail public. Many investors held positions in securities impacted by SRO regulatory decisions and complained that SROS did not provide information about those regulatory decisions in a manner that was easily accessible and suitable for non-professionals. In addressing these investor concerns, the Ombuds engaged with staff in appropriate offices at the Commission to voice these investor concerns.

Discovery in FINRA Arbitration

In Fiscal Year 2024, Ombuds staff intends to complete and report the findings of its study of the incidence and potential effects of abusive discovery practices in the FINRA Dispute Resolution forum.

ENGAGING WITH THE PUBLIC

2023 SEC Investor Advocacy Clinic Summit Overview

On Wednesday, March 29, 2023, the Ombuds Office and the SEC Division of Enforcement's Retail Strategy Task Force (RSTF) hosted the fourth annual SEC Investor Advocacy Clinic Summit (Summit) as a virtual event. For the second consecutive year, the Summit was a joint endeavor between the Ombuds and RSTF. The event, livestreamed to over 1,800 external viewers on the SEC's website and to SEC staff internally, was intended to highlight the work of the law school clinics and raise public awareness of the services they provide. Students discussed the origin of the clinics and nature of their work, the role of mandatory arbitration in resolving brokerage disputes, two representative cases, resource allocation, and other challenges to the viability of the clinics.

All 11 U.S. law school investor advocacy clinics[67] shared their perspectives and engaged with SEC subject matter experts on pressing issues currently facing retail investors. Given the success of this and prior summits, we look forward to hosting the 2024 Summit as a signature feature of the Ombuds' commitment to retail investors and the work of the law school clinics.

Additional Engagement Activities

In addition to the Summit, Ombuds staff participated in and attended select securities industry events with the goal of improving our service to retail investors and educating external groups about the services our Office can provide. These events included informational meetings and listening sessions with the American Association of Justice, the American Association of Retired Persons, international regulators, and directors of the law school investor advocacy clinics. Ombuds staff also met periodically with the Coalition of Federal Ombudsmen, as well as the Public Investors Arbitration Bar Association (PIABA), FINRA, and the FINRA Ombuds.

Pursuant to the Office's study of mandatory arbitration among SEC-registered investment advisers, the Ombuds conducted interviews and engaged in discussions about mandatory arbitration with PIABA, FINRA Dispute Resolution Services, the American Association of Individual Investors, the Securities Industry and Financial Markets Association, the North American Securities Administrators Association, Better Markets, Financial Services Institute, the American Arbitration Association, and JAMS.

STUDY AND FINDINGS

Mandatory Arbitration among SEC-Registered Advisers

In our Report on Objectives for Fiscal Year 2023, the Ombuds Office acknowledged troubling anecdotal information about investor experiences with their advisers in mandatory arbitration.[68] Prompted by this information, we committed to initiating a study of mandatory arbitration among SEC-registered investment advisers (RIAs), to develop a "more complete understanding of RIA arbitration, and… identify any problematic issues impacting retail advisory clients."[69] What follows is a summary of this important study and its potential implications for advisory clients.

OVERVIEW

In January 2023, the Ombuds Office, in coordination with the Office of Investor Research and the Investor Advocate Office of Chief Counsel (hereafter, collectively, "Staff"), launched a study to evaluate: (1) the occurrence of mandatory arbitration clauses in SEC-registered investment adviser agreements; (2) the occurrence of certain restrictive terms in mandatory arbitration clauses, such as damage limitations and class action waivers; (3) the frequency of SEC-registered adviser arbitration; (4) the frequency of unpaid arbitration awards among SEC-registered advisers; and (5) the effects of mandatory arbitration clauses on clients harmed by their advisers.[70]

Staff reviewed a sample of investment advisory agreements and compiled data regarding the occurrence of mandatory arbitration clauses, as well as the occurrence of various restrictive terms. To correct any potential non-representativeness of this sample, Staff used inverse probability weighting to adjust this data.

Due to the lack of publicly available information about SEC-registered adviser arbitration, Staff could neither determine the frequency of adviser arbitration nor the frequency of unpaid adviser awards. Staff also could not identify a representative sample of advisory clients to determine the effects of mandatory arbitration clauses. Instead, as a proxy for the perspectives of advisory clients, Staff interviewed eight external stakeholder groups identified as having information relevant to the issue of mandatory arbitration, and/or as having publicly expressed opinion on the issue of mandatory arbitration. Their views, while anecdotal, provided insight into the potential harms and benefits of mandatory arbitration clauses for advisory clients.

SUMMARY OF FINDINGS

Occurrence of Mandatory Arbitration Clauses and Other Arbitration Terms

Based on the sample of 579 investment advisory agreements reviewed, Staff estimated that approximately 61 percent[71] of SEC-registered advisers serving retail investor clients incorporated mandatory arbitration clauses into their investment advisory agreements.

Of the agreements that contained mandatory arbitration clauses, Staff estimated the frequency with which advisers incorporated the specific terms in Table 3.

TABLE 3. **Frequency of Specific Provisions in Mandatory Arbitration Clauses**	
Agreement designates a particular dispute resolution forum:	92%
When designating a forum, advisers designated the following fora:	
American Arbitration Association (AAA)	83%
Financial Industry Regulatory Authority (FINRA) Dispute Resolution Services	10%
JAMS	6%
Other	1%
Agreement designates particular forum rules:	37%
When designating forum rules, advisers selected the following rules:	
AAA Commercial Rules	83%
JAMS Streamlined Rules and Procedures	3%
JAMS Comprehensive Rules and Procedures	2%
AAA Securities Arbitration Supplementary Procedures	1%
Agreement designates the arbitration venue:	60%
When designating arbitration venue, percent of agreements that did not consider client's location or place of business:	97%
Agreement precludes participation in class action	6%
Agreement limits claims the client may assert	5%
Agreement limits damages that may be awarded	11%
Agreement includes fee-shifting provision	18%

Frequency of Adviser Arbitration, Unpaid Awards

State-registered advisers, investment adviser representatives, and SEC-registered advisers are not uniformly required to disclose information about arbitrations with their clients.[72] Moreover, SEC-registered advisers' preferred dispute resolution fora do not track the number of adviser arbitrations. For these reasons, Staff could not obtain data about the frequency of arbitration or unpaid awards among SEC-registered advisers.

As a related point, private arbitrators lack jurisdiction over the parties after an award is issued. Parties to an arbitration are expected to abide by the terms of the arbitrator's award.[73] However, when a party fails to comply with an arbitration award, the other party may need to enforce the award through the court system and litigate a dispute over an unpaid award. A survey of federal and state case law did not yield results upon which to reliably estimate the frequency of litigation involving unpaid arbitration awards among advisers.

Stakeholder Perspectives[74]

Stakeholders unanimously agreed that mandatory arbitration clauses benefited *advisers* by, among other things, simplifying the dispute resolution process through limited discovery[75] eliminating the right to appeal,[76] maximizing privacy during and after the arbitration, and increasing both predictability and efficiency through the designation of a known arbitration forum with familiar rules. Proponents of mandatory arbitration further asserted that advisory clients—like their advisers—experienced these same benefits.

In contrast, critics of mandatory arbitration argued that advisers experienced these benefits at the expense of clients. Because advisers unilaterally draft their advisory agreements, critics believed advisers often selected the forum, the rules, and the venue that would likely increase costs for the client and favor the adviser. They also asserted that the limited ability to exchange information during discovery might prevent clients from obtaining evidence to prove their claims, and the inability to appeal would likely preclude review of an arbitrator's decision. Critics also asserted the lack of uniform disclosure requirements for adviser arbitration information might allow recidivist advisers to conceal client allegations of wrongdoing from regulators and prospective clients.

Stakeholders agreed, to varying degrees, that advisers should consistently be required to disclose more complete information about customer arbitrations and unpaid awards. Proponents of mandatory arbitration argued that, while disclosure of all customer allegations might subject advisers to unwarranted reputational harm, full and fair disclosure of allegations the adviser deems material would create a competitive advantage for honest advisers and promote fairer markets. Critics of mandatory arbitration more broadly argued that advisers' fiduciary duty necessitated disclosure of customer arbitration information, irrespective of whether the adviser deemed the information material.

Several stakeholders also stated that differences between the adviser and broker[77] arbitration regimes disadvantaged advisory clients. For instance, some stated that certain provisions permissible in advisory agreements, such as class action waivers, damage limitations and claim limitations, are impermissible in agreements between brokers and their customers. These stakeholders further argued that such limiting terms negatively affect arbitral outcomes for advisory clients. Others stated that the costs associated with private adviser arbitration significantly exceed the costs associated with broker arbitration, and, in some instances, the high costs could preclude advisory clients from filing arbitration claims at all.

Comparison with Broker Arbitration

A comparison of relevant rules in the FINRA Code of Arbitration Procedure for Customer Disputes (FINRA Code) supported stakeholder concerns about the use of restrictive terms in advisory agreement mandatory arbitration clauses. While the FINRA Code applies uniformly to disputes between customers and their brokers and governs contractual provisions relating to mandatory arbitration,[78] advisers may choose the terms of their respective mandatory arbitration clauses.

As noted above, six percent of SEC-registered advisory agreements with mandatory arbitration clauses included class action waivers, five percent of agreements limited the types of claims that could be asserted, and 11 percent limited the types of damages that a client may seek in the arbitration. In contrast, the FINRA Code prohibits usage of class action waivers,[79] prohibits language that limits a party's ability to file "any claim" in arbitration,[80] and prohibits language that limits the ability of arbitrators to make "any award."[81]

Of the 60 percent of mandatory arbitration clauses that designated a venue for the arbitration hearing, 97 percent designated a location that disregarded the client's location. In practice, clients could be required to participate in an arbitration far from their place of residence, incurring travel and lodging expenses to attend in-person hearings. Under the FINRA Code, the default location for the arbitration venue is generally the hearing location nearest the customer's residence at the time of the events leading to the dispute.[82]

A notable percentage of advisory agreements with mandatory arbitration clauses also imposed requirements on the type and/or number of arbitrators—*e.g.,* requiring a panel of three arbitrators, or requiring arbitrators to be affiliated with the securities industry. Because each arbitrator is compensated separately, a panel of three arbitrators would predictably increase the cost associated with the arbitration. Several stakeholders also suggested that arbitrators with securities industry ties might be biased in favor of advisers. By comparison, the FINRA rules require panels to consist of a single arbitrator, unless the claim amount exceeds $100,000, or the parties jointly agree to a three-arbitrator panel.[83] In cases with one arbitrator, the FINRA Code requires the selection of a public arbitrator, unaffiliated with the securities industry, to preside over the dispute.[84] In cases with three arbitrators, the FINRA Code guarantees parties the ability to select a panel of all public arbitrators.[85]

Although arbitrators in FINRA DRS are not required to write opinions or provide explanations for an award, arbitrator awards must be in writing.[86] In contrast, many advisory agreements included provisions that prohibited arbitrators from providing written awards.

Staff's review also supported the notion that costs of adviser arbitration generally exceed those of broker arbitration. For instance, the frequent designation of commercial, or business-to-business, arbitration rules result in higher initial filing fees and other expenses for clients, potentially making the filing of a claim cost-prohibitive. Conversely, as noted above, the FINRA Code of Arbitration Procedure for *Customer* Disputes governs all disputes between brokers and their customers. In FINRA DRS, initial filings fees range from $50 (for matters valued up to $1,000) to a maximum of $2,300 (for matters valued over $5,000,000).[87] By comparison, under the AAA Commercial Arbitration Rules, clients bringing a matter valued at $75,000 or less must pay an initial filing fee of $925 if the panel consists of one arbitrator.[88] AAA commercial arbitrations with three or more arbitrators are subject to a minimum initial filing fee of $4,400.[89] In many instances, this filing fee alone might prevent clients from bringing claims against their advisers.

RECOMMENDATIONS AND CONCLUSIONS

Recommendations Regarding the Use of Restrictive Terms in Mandatory Arbitration Clauses

Based on Staff estimates, most investment advisory agreements contain mandatory arbitration clauses, and some contain restrictive terms that could drive up the costs of arbitration for advisory clients, and/or negatively affect the arbitration process or arbitration outcomes for advisory clients. Table 3 reflects the approximate frequency with which such terms are included in advisory agreements.

We note that the Investment Advisers Act of 1940 (Advisers Act) establishes a federal fiduciary duty for investment advisers, fundamental to advisers' relationships with their clients.[90] An investment adviser's fiduciary duty comprises a duty of care and a duty of loyalty, which require an adviser to, at all times, act in the best interests of the client, and prohibit an adviser from placing its own interests ahead of the client's interests.[91] The adviser's fiduciary duty is broad and applies to the entire relationship between the adviser and its client.[92] It "follows the contours of the relationship between the adviser and its client, and the adviser and its client may shape that relationship by agreement, *provided that there is full and fair disclosure and informed consent*."[93] The fiduciary duty is enforceable through the antifraud provisions of the Advisers Act, which generally prohibit an adviser from "engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client."[94]

The Commission has made clear that, while an adviser's fiduciary duty may be shaped by agreement, the duty may not be waived.[95] The Commission has additionally stated that, where certain clauses in retail advisory agreements purport to relieve an adviser from liability for nonwaivable claims, such clauses are likely to mislead retail clients into not exercising their legal rights in violation of the Advisers Act antifraud provisions.[96] Recently, the Commission found that an adviser willfully violated the Advisers Act antifraud provisions by including such a "hedge" clause in its advisory agreement.[97] In so finding, the Commission noted the adviser had no policies and procedures to assess a client's sophistication in the law or to explain the meaning of the clause, provided no enhanced disclosures regarding when a client may retain a right of action, and offered no evidence that the clause would be understood by retail clients.[98]

In similar manner, it is the view of the Office of the Investor Advocate that if an adviser includes language in an advisory agreement preemptively limiting the damages available to clients in arbitration, or limiting the types of claims that clients may assert against the adviser in an arbitration, such limiting language might mislead retail clients into not exercising their legal rights and would constitute a breach of the adviser's fiduciary duty in violation of the antifraud provisions of the Advisers Act.[99] We further believe that contractual provisions precluding clients from participating in class action lawsuits, designating an arbitration venue without regard to a client's physical location, invoking commercial arbitration rules intended for business-to-business disputes, and/or imposing fee shifting provisions that unilaterally impose the costs and fees of an arbitration on the client have the obvious and likely intended effect of increasing the cost and inconvenience of arbitration for advisory clients. It is therefore also our view that, where such provisions are included in an advisory agreement, absent evidence the adviser has made effort to gauge whether the client understands these provisions and the client has provided informed consent, the adviser is placing its interests ahead of the client's interests in violation of the fiduciary duty.

Recommendations Regarding Disclosure of Arbitration-Related Information

An absence of information prevented Staff from generating reliable statistics about the frequency of SEC-registered adviser arbitration or the number of unpaid arbitration awards. This absence of information is attributable to: (1) a lack of express arbitration-related disclosure requirements for SEC-registered advisers; and (2) the privatized nature of adviser arbitration. Both factors interact to obscure SEC-registered investment advisers' arbitration-related information from the view of investors and regulators, as described below.

State-registered advisers and individual adviser representatives are required to disclose their involvement in certain types of client arbitrations in standardized disclosure forms.[100] By comparison, SEC-registered advisers are not specifically required to disclose information about arbitrations with clients; rather an adviser must only disclose facts it deems material to the advisory relationship.[101] The Commission previously considered whether to require advisers to disclose arbitration information in their Forms ADV, but determined not to require such disclosure, as arbitration settlements or awards might not reflect a finding that an adviser had violated the law, and disclosure might cause unwarranted reputational harm to the adviser.[102] However, the Commission suggested that advisers should "carefully consider whether particular arbitration awards or settlements do, in fact, involve or implicate wrongdoing and/or reflect on the integrity of the adviser, and should be disclosed to clients in the brochure or through other means."[103] The Commission also stated it would "continue to assess whether we should require that these events be reported by firms registered with us."[104]

It is the view of the Investor Advocate's Office that an adviser's involvement in a client arbitration is often material to the advisory relationship and should be a requisite disclosure in certain circumstances. We note that the Commission's prior concerns about reputational harms arising from arbitration-related disclosures would apply equally to state-registered advisers, investment adviser representatives, and brokers, all of which are required to disclose certain arbitration-related information. We therefore believe that SEC-registered advisers should similarly disclose this information. We further believe that, to the extent practicable, arbitration-related disclosures should be harmonized across adviser types to decrease investor confusion and promote regulatory clarity.

We further note, however, that the privatized nature of adviser arbitration poses a significant obstacle in any attempt to assess the truth or falsity of advisers' arbitration-related disclosures. As illustrated in Table 3, advisers often choose to arbitrate with clients in private dispute resolution fora such as AAA and JAMS. The SEC lacks jurisdiction over these private fora, and therefore cannot easily obtain information with which to confirm the existence or outcome of an adviser's arbitration. These fora also do not aggregate or otherwise make publicly available information about adviser arbitration. In the absence of this information, regulators would ostensibly need to rely on the integrity of an adviser's arbitration-related self-disclosures to determine whether the adviser satisfied its disclosure obligations.

Conclusions

We believe precluding advisers from using restrictive terms in mandatory arbitration clauses that negatively affect investors would help create a fairer, more balanced framework for arbitrations between advisers and their retail clients. We further believe that establishing arbitration-related disclosure requirements for SEC-registered advisers would better enable investors and regulators to evaluate advisers' prior conduct, and to prevent recidivist adviser misconduct. However, we do not believe the implementation of these recommendations will resolve broader fairness concerns associated with adviser arbitration. Where advisory clients are compelled to arbitrate disputes in a private dispute resolution forum, where the SEC cannot help to ensure that appropriate procedural protections for investors exist in that forum, and where the SEC cannot easily obtain information about underlying arbitrations in that forum, it is our view that retail investors might face procedural disadvantages that negatively impact arbitral outcomes. Moreover, any such disadvantages or negative outcomes would not be measurable or observable, given the opaque nature of privatized arbitration and lack of information exchange between the SEC and private dispute resolution fora.

We note that Congress granted the SEC the authority to "prohibit, or impose conditions or limitations on the use of agreements that require customers or clients of any investment adviser to arbitrate any future dispute between them arising under the Federal securities laws, the rules and regulations thereunder, or the rules of a self-regulatory organization if it finds that such prohibition, imposition of conditions, or limitations are in the public interest and for the protection of investors."[105] In light of this explicit authority, we recommend that the Commission consider temporarily suspending the use of mandatory arbitration clauses in advisory agreements until further exploration of the associated costs and benefits to advisory clients is undertaken.

As detailed in Figure 18, we strongly encourage investors to learn about the differences between arbitration and litigation,[106] and to ask appropriate questions of their advisers where mandatory arbitration clauses are included in advisory agreements.

FIGURE 18. **What You Can Do . . .**

Review your advisory agreement for restrictive and unfair terms, or language that might violate your right to recover damages if you are harmed by your adviser. Contact the SEC Ombuds to report these types of provisions in your advisory agreement.

Ask your adviser whether they are or have been **named in an arbitration or civil litigation**. If they have, ask for details. If you are uncomfortable with their responses, Consider hiring another adviser.

Search the **Investment Advisers Public Disclosure (IAPD) database** on the SEC website for arbitration and civil litigation information about a state-registered adviser or investment adviser representative.

Ask your state securities regulator for more **information about your state securities adviser or investment** adviser representative. For a full list of state securities regulators in the U.S., visit the North American Securities Administrators Association website.

Endnotes

1 Exchange Act § 4(g)(6), 15 U.S.C. § 78d(g)(6).
2 Exchange Act § 4(g)(6)(A)(i), 15 U.S.C. § 78d(g)(6)(A)(i).
3 Exchange Act § 4(g)(6)(B)(i), 15 U.S.C. § 78d(g)(6)(B)(i).
4 *See* Exchange Act § 4(g)(4)(B), 15 U.S.C. § 78d(g)(4)(B).
5 SEC, *SEC, NASAA, and Wisconsin DFI to Host Investor Roundtable in Madison, Wisconsin on July 25*, Release No. 2023-136 (Jul. 21, 2023), https://www.sec.gov/news/press-release/2023-136.
6 SEC, *U.S. Securities and Exchange Commission Investor Advisory Committee, Meeting Agenda* (Sep. 21, 2023) https://www.sec.gov/about/advisory-committees/investor-advisory-committee/iac092123-agenda.
7 In this section of the report, we refer to the Office of Investor Research (OIR) and POSITIER synonymously.
8 *See* Exchange Act § 4(g)(4)(B), 15 U.S.C. § 78d(g)(4)(B).
9 *See* Exchange Act § 4(g)(4)(D-E), 15 U.S.C. § 78d(g)(4)(D-E).
10 *See* Exec. Order No. 13,563, 3 C.F.R. § 13563 (2011).
11 *See* Exchange Act § 4(g)(4)(C), 15 U.S.C. § 78d(g)(4)(C).
12 *See* U.S. House of Representatives, Consolidated Appropriations Act (2023), H.R. 2617, 117th Cong. (2022), https://www.congress.gov/bill/117th-congress/house-bill/2617. In that Act, Congress indicated that "the Commission shall prepare and finalize, new or amended rules, as appropriate, to establish a new form . . . on which an issuer of a registered index-linked annuity may register that registered index-linked annuity, subject to conditions the Commission determines appropriate . . . with respect to the registered index-linked annuity." In addition, Congress indicated that in designing the form, "the Commission shall . . . engage in investor testing; and incorporate the results of the testing required . . . in the design of the form, with the goal of ensuring that key information is conveyed in terms that a purchaser is able to understand."
13 *See* SEC, *Registration for Index-Linked Annuities; Amendments to Form N-4 for Index-Linked and Variable Annuities*, Release No. 33-11250 (Sept. 29, 2023) [88 FR 71088 (Oct. 13, 2023)], https://www.federalregister.gov/documents/2023/10/13/2023-21986/registration-for-index-linked-annuities-amendments-to-form-n-4-for-index-linked-and-variable.
14 *See* Brian Scholl et al., *A Picture is Worth a Thousand Dollars: Visual Aids Promote Investor Decisions,* Journal of the Association for Consumer Research (2023), Volume 8, Issue 4, 416-428, https://www.journals.uchicago.edu/toc/jacr/2023/8/4.
15 SEC, Office of the Investor Advocate, Report on Activities, Fiscal Year 2022 (Dec. 15, 2022), subsection titled "Helping Investors Make Decisions About Mutual Funds Using Visual Aids" in https://dcm.sec.gov/files/fy22-oiad-sar-activities-report.pdf.
16 Calculations based on Morningstar Intelligence Annuity Tool. See Morningstar, *Annuity comparison tool: Annuity intelligence*. Retrieved March 2023, from https://www.morningstar.com/products/annuity-intelligence.
17 *See generally* IRS, Publication 575 (2022), *Pension and Annuity Income*, https://www.irs.gov/publications/p575#en_US_2022_publink1000265471.
18 *See* Office of the Investor Advocate RILA report, *Investor Testing Report on Registered Index-Linked Annuities* https://www.sec.gov/files/rila-report-092023.pdf.
19 *Id*.
20 *See* U.S. House of Representatives, Consolidated Appropriations Act (2023), H.R. 2617, 117th Cong. (2022), https://www.congress.gov/bill/117th-congress/house-bill/2617.
21 The use of "KIT" in this document is consistent with its usage in *Investor Testing Report on Registered Index-Linked Annuities* at https://www.sec.gov/files/rila-report-092023.pdf. Specifically, all references to the KIT refer to different hypothetical disclosures used for testing purposes.
22 *See* SEC, *Registration for Index-Linked Annuities; Amendments to Form N-4 for Index-Linked and Variable Annuities*, Release No. 33-11250 (Sept. 29, 2023) [88 FR 71088 (Oct. 13, 2023)], https://www.federalregister.gov/documents/2023/10/13/2023-21986/registration-for-index-linked-annuities-amendments-to-form-n-4-for-index-linked-and-variable.
23 In prior efforts, POSITIER researchers discovered that jargon is an important barrier to investors' understanding of mutual funds. For additional information, see Chin et al., *Jargon in Fund Fee Disclosures* (SEC, Working Paper No. 2023-03, 2023), https://www.sec.gov/files/jargon-fund-fees-2021-01.pdf.
24 In the report, these subscales were respectively called: "How RILA Works"; "Appropriateness"; "Insurance"; and "Liquidity."
25 *See* A. M. Best, *Registered Index-Linked Annuities Gaining Foothold in VA Segment* (2019), https://news.ambest.com/newscontent.aspx?AltSrc=29&refnum=221068#:~:text=A%20new%20Best's%20Special%20Report,will%20outpace%20other%20individual%20annuity
26 Life Insurance Marketing and Research Association, *LIMRA: Annuities Forecast to Hover in Record Range of $300 Billion for Next Several Years* (2023), https://www.limra.com/en/newsroom/industry-trends/2023/limra-annuities-forecast-to-hover-in-record-range-of-$300-billion-for-next-several-years/.
27 *See* Alycia Chin et al., *Framing Effects in Expectations Beliefs about the Stock Market* (SEC, Working Paper No. 2023-02, 2023), https://www.sec.gov/files/sme.pdf.
28 *See* I.P. Levin et al., *All Frames Are Not Created Equal: A Typology And Critical Analysis Of Framing Effects*. Organizational Behavior and Human Decision Processes, (1998), 76(2), 149-188.

29 Saten Kumar et al., *Inflation targeting does not anchor inflation expectations: Evidence from firms in New Zealand*. Brookings Papers on Economic Activity, 2015 (Fall), 151-225.

30 *See*, e.g., SEC, Office of the Investor Advocate, Report on Activities, Fiscal Year 2020 (Dec. 29, 2020), available at https://www.sec.gov/files/sec-investor-advocate-report-activities-2020.pdf.

31 For example, in 2019, the estimated amount of capital reported as raised in private offerings under Rule 506(b) of Regulation D was $1.5 trillion, compared to a total of $1.2 trillion raised in registered offerings. SEC, Staff Report to Congress on Regulation A / Regulation D Performance (2020), at 16, https://www.sec.gov/files/report-congress-regulation-a-d.pdf.

32 *See* SEC, Office of the Investor Advocate, Report on Objectives, Fiscal Year 2024 (Jun. 29, 2023), available at https://dcm.sec.gov/files/fy24-oiad-sar-objectives-report.pdf.

33 For example, under Rule 506(b) of Regulation D, an issuer may sell securities to an unlimited number of accredited investors and up to 35 non-accredited investors who are financially sophisticated.

34 *See, e.g.*, Letter from the North American Securities Administrators Association, Inc. to Erik F. Gerding, Director, Division of Corporation Finance, SEC, RE: Private Market Reforms (Mar. 7, 2023), available at https://www.nasaa.org/wp-content/uploads/2023/03/2023-03-07-Letter-to-Erik-Gerding-Regarding-Private-Market-Reforms.pdf (last visited Oct. 19, 2023) [hereinafter NASAA Letter]; *Sophistication or Discrimination? How the Accredited Investor Definition Unfairly Limits Investment Access for the Non-wealthy and the Need for Reform*, Hearing Before the Subcomm. on Capital Markets, H. Comm. on Fin. Serv., 118th Cong. (2023), available at https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=408510; Andrew N. Vollmer, *Abandon the Concept of Accredited Investors in Private Securities Offerings* (Mercatus Working Paper, Oct. 2020), available at https://www.mercatus.org/research/working-papers/abandon-concept-accredited-investors-private-securities-offerings-0.

35 *See* SEC Investor Advisory Committee, Meeting Agenda (Sep. 21, 2023), available at https://www.sec.gov/about/advisory-committees/investor-advisory-committee/iac092123-agenda, and Webcast, SEC Investor Advisory Committee Meeting (Sep. 21, 2023), available at https://www.youtube.com/watch?v=mko5hUzhtRw and https://www.youtube.com/watch?v=x3PAWKr_Lyk [hereinafter Webcast: September 2023 IAC Meeting].

36 *See* SEC, *Investor Bulletin: Private Placements under Regulation D* (Aug. 2022), https://www.sec.gov/oiea/investor-alerts-and-bulletins/private-placements-under-regulation-d-investor-bulletin.

37 *See, e.g.,* NASAA Letter; Better Markets, *Special Report: The SEC Must Stop Bleeding Public Markets Dry* (Apr. 8, 2022), available at https://bettermarkets.org/wp-content/uploads/2022/04/BetterMarkets_Public_vs_Private_Markets_Report_April2022.pdf. (last visited Oct. 19, 2023); and Webcast: September 2023 IAC Meeting. *See also* Caroline A. Crenshaw, Commissioner, SEC, *Big "Issues" in the Small Business Safe Harbor: Remarks at the 50th Annual Securities Regulation Institute* (Jan. 30, 2023), available at https://www.sec.gov/news/speech/crenshaw-remarks-securities-regulation-institute-013023.

38 *Id.*

39 These concerns are expressed, for example, in a number of the comment letters submitted in response to the Commission's 2013 proposed amendments to Regulation D and Form D, which have not been adopted. *See* Comments on SEC, *Amendments to Regulation D, Form D and Rule 156*, Release No. 33-9416 (July 10, 2013) [78 FR 44806 (July 24, 2013)], https://www.federalregister.gov/documents/2013/07/24/2013-16884/amendments-to-regulation-d-form-d-and-rule-156.

40 *See* SEC, Newsroom, *SEC Proposals: Market Structure*, https://www.sec.gov/newsroom/market-structure-proposals-december-2022.

41 *See* FINRA, *FINRA Requests Comment on a Proposal to Require Members to Provide Rule 605 Order Execution Quality Reports to FINRA for Centralized Publication*, Regulatory Notice 23-10 (May 31, 2023), available at https://www.finra.org/rules-guidance/notices/23-10.

42 *See* SEC, *Short Position and Short Activity Reporting by Institutional Investment Managers*, Release No. 34-98738 (Oct. 13, 2023) [88 FR 75100 (Nov. 1, 2023)], https://www.federalregister.gov/documents/2023/11/01/2023-23050/short-position-and-short-activity-reporting-by-institutional-investment-managers.

43 *See* SEC, *Reporting of Securities Loans*, Release No. 34-98737 (Oct. 13, 2023) [88 FR 75644 (Nov. 3, 2023)], https://www.federalregister.gov/documents/2023/11/03/2023-23052/reporting-of-securities-loans.

44 *See, e.g.,* Federal Bureau of Investigation, *2022 Internet Crime Report* (Mar. 10, 2023), at 3, available at https://www.ic3.gov/Media/PDF/AnnualReport/2022_IC3Report.pdf (noting the FBI's Internet Crime Complaint Center received 800,944 complaints in 2022 with a potential total loss of more than $10.2 billion); *see e.g.,* Ponemon Institute and IBM Security, *Cost of a Data Breach Report 2023* (Jul. 24, 2023), https://www.ibm.com/reports/data-breach (noting the average cost of a data breach in 2023 was USD 4.45 million, a 15% increase over 3 years)*; see also* SEC, EXAMS Risk Alert, *Safeguarding Customer Records and Information at Branch Offices* (Apr. 26, 2023), https://www.sec.gov/files/risk-alert-safeguarding-info-branch-offices-042623.pdf.

45 *See* SEC, *Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies*, Release No. 33-11028 (Feb. 9, 2022) [87 FR 13524 (Mar. 9, 2022)], https://www.federalregister.gov/documents/2022/03/09/2022-03145/cybersecurity-risk-management-for-investment-advisers-registered-investment-companies-and-business.

46 SEC, *Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure*, Release No. 33-11216 (July 26, 2023) [88 FR 51896 (Aug. 4, 2023)], https://www.federalregister.gov/documents/2023/08/04/2023-16194/cybersecurity-risk-management-strategy-governance-and-incident-disclosure.

47 *See* SEC, *Regulation S-P: Privacy of Consumer Financial Information and Safeguarding Customer Information*, Release No. 34-97141 (Mar. 15, 2023) [88 FR 20616 (Apr. 6, 2023)], https://www.federalregister.gov/documents/2023/04/06/2023-05774/regulation-s-p-privacy-of-consumer-financial-information-and-safeguarding-customer-information.

48 SEC, *Regulation Systems Compliance and Integrity*, Release No. 34-97143 (Mar. 15, 2023) [88 FR 23146 (Apr. 14, 2023)], https://www.federalregister.gov/documents/2023/04/14/2023-05775/regulation-systems-compliance-and-integrity. *See* SEC, *Cybersecurity Risk Management Rule for Broker-Dealers, Clearing Agencies, Major Security-Based Swap Participants, the Municipal Securities Rulemaking Board, National Securities Associations, National Securities Exchanges, Security-Based Swap Data Repositories, Security-Based Swap Dealers, and Transfer Agents*, Release No. 34-97142 (Mar. 15, 2023) [88 FR 20212 (Apr. 5, 2023)], https://www.federalregister.gov/documents/2023/04/05/2023-05767/cybersecurity-risk-management-rule-for-broker-dealers-clearing-agencies-major-security-based-swap.

49 This list of problematic products identified by the SEC is based on staff analysis of the alerts and bulletins issued by the SEC's Office of Investor Education and Advocacy and the SEC's Division of Examinations during Fiscal Year 2022. See SEC, Office of Investor Education and Advocacy, Investor Alerts and Bulletins, https://www.sec.gov/investor/alerts (last visited Nov. 2, 2023); see also SEC, Division of Examinations, Risk Alerts, https://www.sec.gov/exams (last visited Nov. 2, 2023).

50 See NASAA, Top Investor Threats, https://www.nasaa.org/investor-education/fraud-center/top-investor-threats/ (last visited Nov. 2, 2023).

51 This list of red flags is based on educator fraud tools developed by the FINRA Foundation during FY 2023. See FINRA Foundation, https://www.conemifyoucan.org/fraud-tools/index.html (last visited Nov. 2, 2023).

52 PCAOB, *Investor Advisory—Exercise Caution with Third-Party Verification/Proof of Reserve Reports* (Mar. 8, 2023), https://pcaobus.org/resources/information-for-investors/investor-advisories/investor-advisory-exercise-caution-with-third-party-verification-proof-of-reserve-reports; Erica Y. Williams, Chair, PCAOB, Statement on Rise in Audit Deficiency Rates (Jul. 25, 2023), https://pcaobus.org/news-events/speeches/speech-detail/chair-williams-statement-on-rise-in-audit-deficiency-rates.

53 Exchange Act Section 4(g)(8), 15 U.S.C. § 78d(g)(8), requires the Investor Advocate to appoint an Ombuds to act as a confidential liaison in resolving retail investors' concerns and questions about the Commission and the self-regulatory organizations (SROs) the Commission oversees.

54 As used in this report, the term "Ombuds" may refer to the Ombuds, the Ombuds and staff in the Office of the Ombuds, and, at times, to staff, contractors, and interns in the Office of the Investor Advocate directly supporting the Ombuds function.

55 *See* Exchange Act Section 4(g)(8)(B)(i), 15 U.S.C. § 78d(g)(8)(B)(i).

56 Among other things, the Ombuds is required to "submit a semi-annual report to the Investor Advocate that describes the activities and evaluates the effectiveness of the Ombuds during the preceding year" (Ombuds' Report). *See* Exchange Act Section 4(g)(8)(D), 15 U.S.C. § 78d(g)(8)(D). The Ombuds' Report on Activities, submitted to Congress each December, describes the activities and discusses the effectiveness of the Ombuds during the preceding Fiscal Year.

57 Exchange Act § 4(g)(8)(B), 15 U.S.C. § 78d(g)(8)(B).

58 *See generally* Exchange Act Section 4(g)(8), 15 U.S.C. § 78d(g)(8).

59 Please visit our website at www.sec.gov/ombudsman for additional information.

60 The OMMS Form, a web-based, mobile-friendly form permitting the submission of inquiries, complaints, and documents directly to the Ombuds, guides the submitter through a series of questions specifically designed to elicit information concerning matters within the scope of the Ombuds' function. In addition, the OMMS Form allows submitters to easily upload and submit related documents for staff review. When an OMMS matter record is created, Ombuds staff can review the matter details and communicate with the investor via the OMMS platform, https://omms.sec.gov.

61 For further discussion on this point, see Ombuds Report section "OMMS as Early Warning System," *infra*.

62 To note, matters categorized as "Non-SEC/Other Matters" refer to matters outside the jurisdiction of the SEC, which fall within the jurisdiction of another regulatory agency. Matters characterized as "Atypical Matters" refer to matters where the submitter's characterization or description of the issue makes it difficult to determine the nature of the complaint.

63 *See* Report at Section Research and Investor Testing, Research Highlights from This Year, Registered Index-Linked Annuities at page 9.
64 *See* Report at Section Message of the Investor Advocate at page 1.
65 For more information on threshold securities, *see* SEC, Fast Answers—Threshold Securities, available at https://www.sec.gov/answers/threshold.
66 For more information on Regulation SHO, *see* SEC, *Short Sales*, Release No. 34-50103 (July 28, 2004) [69 FR 48008 (Aug. 6, 2004)], https://www.federalregister.gov/documents/2004/08/06/04-17571/short-sales.
67 Participating law schools included (in alphabetical order): Benjamin N. Cardozo School of Law, Cornell Law School, Fordham University School of Law, Howard University School of Law, New York Law School, Northwestern Pritzker School of Law, Pace University School of Law, Seton Hall University School of Law, St. John's University School of Law, University of Miami School of Law, and the University of Pittsburgh School of Law.
68 SEC, Office of the Investor Advocate, Report on Objectives, Fiscal Year 2023 (Jun. 30, 2022), at 27-28, available at https://dcm.sec.gov/files/sec-office-investor-advocate-report-objectives-fy2023.pdf.
69 *Id.* at 28.
70 The SEC Division of Investment Management, Division of Trading and Markets, Division of Examinations, Division of Economic and Risk Analysis, and the Office of the General Counsel also contributed to the contents of this study.
71 The margin of error for a 95% confidence interval on these estimates varies but is no greater than +/- 6 percentage points.
72 State-registered advisers and investment adviser representatives are required to disclose certain information about arbitrations with clients. *See* Uniform Application for Investment Adviser Registration, Form ADV Part 1B, Item 2.E (applicable to state-registered advisers); Uniform Application for Securities Industry Regulation or Transfer, Form U4, Item 14.I (applicable to individual adviser representatives). By comparison, SEC-registered advisers are not specifically required to disclose information about arbitrations with clients, but they must disclose "all material facts relating to the advisory relationship." *See* Uniform Application for Investment Adviser Registration, Form ADV Part 2, Uniform Requirements for the Investment Adviser Brochure and Brochure Supplements, General Instruction 3.
73 *See* American Arbitration Association, *What Happens after the Arbitrator Issues an Award* at 1 ("Many parties will voluntarily follow the arbitrator's decision; however, the AAA and the arbitrator do not have the authority to actually make a party do what the award says."), https://www.adr.org/sites/default/files/document_repository/AAA229_After_Award_Issued.pdf (last visited Sep. 15, 2023).
74 The stakeholders interviewed for purposes of this study include American Association of Individual Investors; Better Markets, Inc.; Financial Industry Regulatory Authority Dispute Resolution Services; Financial Services Institute, Inc.; Investment Adviser Association; North American Securities Administrators Association; Public Investors Advocate Bar Association; and Securities Industry and Financial Markets Association.
75 *See, e.g.*, FINRA, *The Neutral Corner*, Vol. 2-2011 (2011), at 1, https://www.finra.org/sites/default/files/Publication/p123535.pdf ("Discovery in FINRA arbitration is more limited than discovery under the Federal Rules of Civil Procedure or state discovery rules.")
76 *See supra* note 73, "What Happens after the Arbitrator Issues an Award," at 2, ("There is no right to appeal in arbitration like there is in court").
77 The term "broker" as used in this report refers to broker-dealers required to register with the SEC and with FINRA, along with their associated persons, as the term "associated person" is defined under FINRA Rule 1011(b).
78 FINRA Rule 12101.
79 FINRA Rule 12204(a).
80 FINRA Rule 2268(d)(2).
81 FINRA Rule 2268(d)(4).
82 FINRA Rule 12213.
83 FINRA Rule 12401. To note, claims of $50,000 or less must be adjudicated by one arbitrator.
84 FINRA Rule 12402(a). For the definition of a "public arbitrator," *see* FINRA Rule 12100(aa).
85 FINRA Rule 12403.
86 *See* FINRA, Decision and Award, https://www.finra.org/arbitration-mediation/decision-award#:~:text=Arbitration%20Award,date%20the%20record%20is%20closed.
87 FINRA Rule 12900.
88 American Arbitration Association, *Commercial Arbitration Rules and Mediation Procedures, Administrative Fee Schedules,* at 1 (Amended and Effective May 1, 2018), https://www.adr.org/sites/default/files/Commercial_Arbitration_Fee_Schedule_1.pdf (last visited Sep. 15, 2023).
89 *Id.* at 2.
90 *See* SEC, *Commission Interpretation Regarding Standard of Conduct for Investment Advisers* ("Fiduciary Interpretation Release"), Release No. IA-5248 (June 5, 2019) [84 FR 33669, 33670 (July 12, 2019)], https://www.federalregister.gov/documents/2019/07/12/2019-12208/commission-interpretation-regarding-standard-of-conduct-for-investment-advisers.
91 *Id.* at 33671.
92 *Id.* at 33670.
93 *Id.* at 33671 (emphasis added).
94 *Id. See also* 15 U.S.C. §80b-6(2).
95 *Id.* at 33672, n. 31.

96 *See id.* ("In our view, however, there are few (if any) circumstances in which a hedge clause in an agreement with a retail client would be consistent with those antifraud provisions, where the hedge clause purports to relieve the adviser from liability for conduct as to which the client has a nonwaivable cause of action against the adviser provided by state or federal law. Such a hedge clause generally is likely to mislead those retail clients into not exercising their legal rights, in violation of the antifraud provisions…").

97 *See In the Matter of Comprehensive Capital Management, Inc.,* Order Instituting Administrative Cease-and-Desist Proceedings Pursuant to Sections 203(e) and 203 (k) of the Investment Advisers Act of 1940, Making Findings and Imposing Remedial Sanctions, and a Cease-and-Desist Order, Admin. Proc. File No. 3-20700, Rel. No. 5943, at p. 5 (Jan. 11, 2022), available at https://www.sec.gov/files/litigation/admin/2022/ia-5943.pdf (hedge clause was "inconsistent with an adviser's fiduciary duty and the [Fiduciary Interpretation Release] because it may mislead [adviser's] retail clients into not exercising their legal rights.").

98 *Id.* at 72.

99 *See, e.g., id.* at 5 (where hedge clause stated, in part, that "[adviser] will not be liable for any incidental, indirect, special, punitive or consequential damages," the hedge clause was inconsistent with an adviser's fiduciary duty and violated the antifraud provisions of the Advisers Act because it might mislead retail clients into not exercising their legal rights).

100 *See infra* note 72.

101 *See id.*

102 *See* SEC, *Amendments to Form ADV* ("Form ADV Release"), Release No. IA-3060 (July 28, 2010) [75 FR 49233, 49240 (Aug. 12, 2010)], https://www.federalregister.gov/documents/2010/08/12/2010-19617/amendments-to-form-adv.

103 *Id.*

104 *Id.*

105 Investment Advisers Act of 1940, 15 U.S.C. § 80b-5(f).

106 *See, e.g.*, SEC, Investor Alert and Bulletin, *Broker-Dealer/Customer Arbitration* (Jun. 14, 2022), available at https://www.sec.gov/oiea/investor-alerts-and-bulletins/broker-dealercustomer-arbitration-investor-bulletin (describing general differences between litigation and arbitration with broker-dealers).

U.S. SECURITIES AND EXCHANGE COMMISSION

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