Office of the Investor Advocate

U.S. SECURITIES AND EXCHANGE COMMISSION

The Office of the Investor Advocate was established pursuant to Section 915 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, as codified under Section 4(g) of the Securities Exchange Act of 1934, 15 U.S.C. § 78d(g).

OFFICE OF THE INVESTOR ADVOCATE

REPORT ON ACTIVITIES

FISCAL YEAR 2014

THE OFFICE OF THE INVESTOR ADVOCATE was established pursuant to Section 915 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), as codified under Section 4(g) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78d(g). Exchange Act Section 4(g)(2)(A)(ii) provides that the Investor Advocate be appointed by the Chair of the U.S. Securities and Exchange Commission (the "Commission" or the "SEC") in consultation with the other Commissioners and that the Investor Advocate report directly to the Chair.[1] On February 24, 2014, SEC Chair Mary Jo White appointed Rick A. Fleming as the Commission's first Investor Advocate.

Exchange Act Section 4(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.[2] A Report on Objectives is due not 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.[3] On June 30, 2014, the Office of the Investor Advocate issued its first Report on Objectives (the "2014 Report on Objectives"). The 2014 Report on Objectives contains a summary of the Investor Advocate's primary objectives for Fiscal Year 2015, beginning October 1, 2014.[4]

A Report on Activities is due no later than December 31 of each year.[5] The Report on Activities shall describe the activities of the Investor Advocate during the immediately preceding fiscal year. Among other things, the report must include information on steps the Investor Advocate has taken to improve the responsiveness of the Commission and self-regulatory organizations ("SROs") to investor concerns, a summary of the most serious problems encountered by investors during the reporting period, identification of Commission or SRO action that was taken to address those problems, and recommendations for administrative and legislative actions to resolve problems encountered by investors.[6]

The instant Report on Activities will describe the activities of the Office of the Investor Advocate from its inception to the end of Fiscal Year ("FY") 2014, a period of seven months. Specifically, the reporting period for this Report on Activities runs from February 24, 2014 to September 30, 2014 (the "Reporting Period").

Disclaimer: Pursuant to Section 4(g)(6)(B)(iii) of the Exchange Act, 15 U.S.C. § 78d(g)(6)(B)(iii), this Report is provided directly to Congress without any prior review or comment from the Commission, any Commissioner, any other officer or employee of the Commission, or the Office of Management and Budget. Accordingly, the Report 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 the Report and all analyses, findings, and conclusions contained herein.

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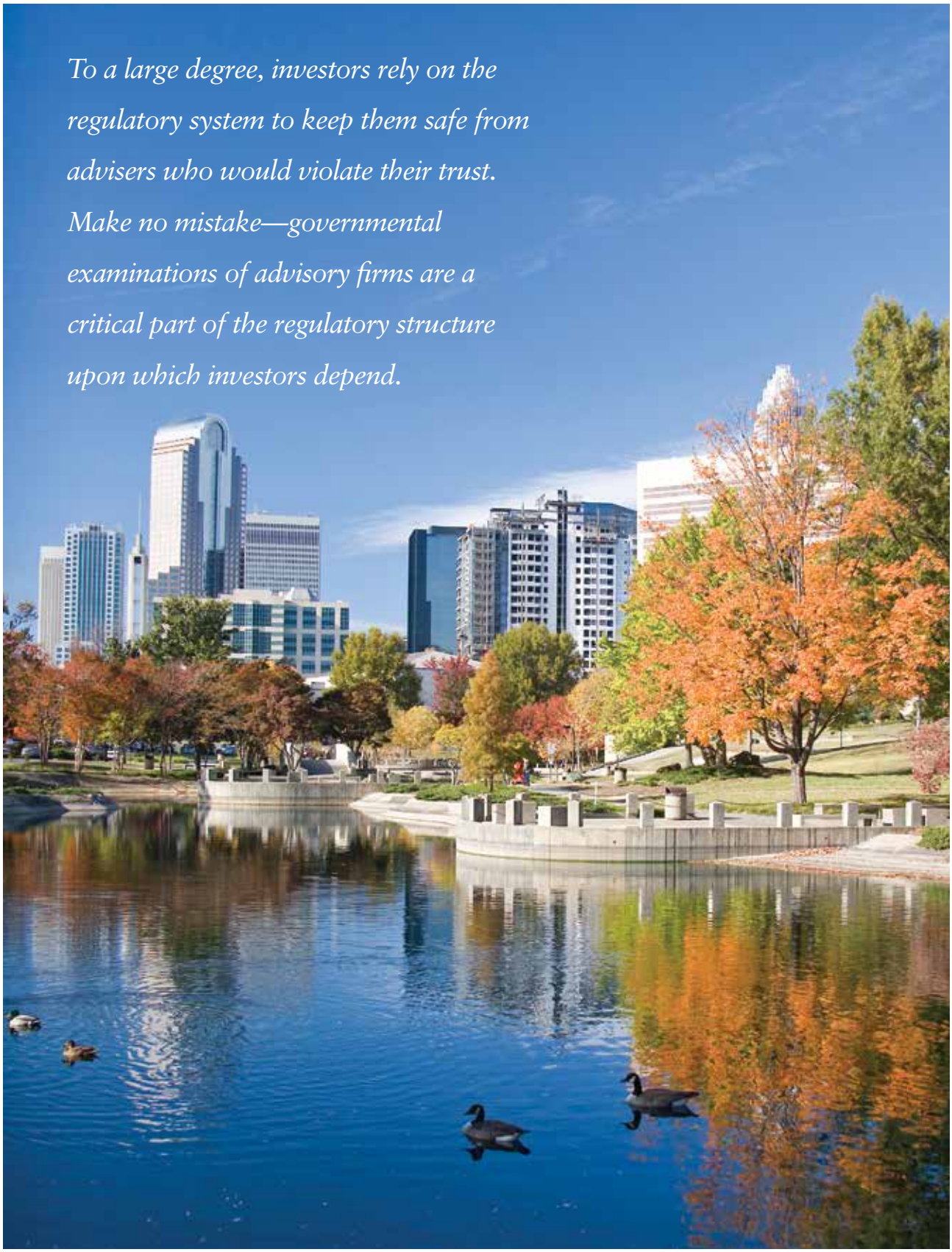
To a large degree, investors rely on the regulatory system to keep them safe from advisers who would violate their trust. Make no mistake—governmental examinations of advisory firms are a critical part of the regulatory structure upon which investors depend.

MESSAGE FROM THE INVESTOR ADVOCATE

The Office of the Investor Advocate was created at the SEC on February 24, 2014. After consultation with each of the Commissioners, Chair Mary Jo White appointed me to serve as the Commission's first Investor Advocate. It is an honor to be entrusted with this responsibility.

In these first months of our existence, the Office has gradually grown to six staff members, and we have begun to perform three core functions. In April 2014, the Office assumed responsibility for providing staff and operational support to the SEC's Investor Advisory Committee. On September 5, 2014, we announced the appointment of Tracey L. McNeil as the agency's first Ombudsman, fulfilling a mandate of the Dodd-Frank Act. And since day one, we have been working hard to provide a voice for investors as policies are considered at the Commission, at self-regulatory organizations, and in Congress.

By statute, I am required to file two reports per year—a Report on Objectives due by June 30 and a Report on Activities due by December 31. The Report on Objectives looks ahead and lays out a policy agenda for the upcoming fiscal year, while the Report on Activities looks back at the prior fiscal year and reports on our actions, our policy recommendations, and the responses of the Commission and SROs to those recommendations. Because this Report on Activities covers only a portion of FY 2014, it is less comprehensive than the reports we will file in the future.

As a brand new Office, much of my time in FY 2014 was focused on building staff and attending to the myriad of details involved in starting the new Office. We also began engaging in outreach efforts, meeting with 13 organizations that represent a variety of investor interests and 10 organizations that represent various aspects of the industry. Based on those meetings, as well as on numerous SEC staff briefings covering a wide variety of topics, we developed a policy agenda for FY 2015 and have begun to study those issues in greater depth.

In light of these activities, we have not yet reached the point where we have begun to make policy recommendations concerning all of the issues on our agenda. There is, however, one notable exception. In the 2014 Report on Objectives, filed on June 30, 2014, I recommended that Congress provide sufficient resources to enable the SEC to conduct an adequate number of investment adviser examinations.

This is an issue that does not require a great deal of study to understand. In FY 2014, the SEC examined approximately 10 percent of investment advisers, which equates to an examination cycle of once every 10 years.[7] This level of coverage is simply inadequate to protect investors from fraudulent or

abusive practices like excessive or undisclosed fees, unauthorized trading, or outright theft.

Investors who seek the services of a registered investment adviser are attempting to do the right thing with their savings. These investors are not chasing exorbitant returns in a fly-by-night investment opportunity. Moreover, fraudulent or abusive practices by an investment adviser can be very difficult for an individual investor to detect, particularly if the adviser goes so far as to falsify account statements or other records. As I've seen throughout my career, most investment advisers live up to their fiduciary duty to clients, but a few "bad apples" can shatter the fragile retirement dreams of numerous clients.

To a large degree, therefore, investors rely on the regulatory system to protect them from advisers who would violate their trust. Make no mistake—governmental examinations of advisory firms are a critical part of the regulatory structure upon which investors depend.

Recognizing the potential for a few bad actors to sully the reputation of all advisers, the advisory industry itself has supported increased funding for the SEC to conduct a greater number of investment adviser examinations. Indeed, as noted in the 2014 Report on Objectives, the advisory industry has been supportive of "user fees," whereby the SEC would require advisers to pay an annual fee specifically to fund additional investment adviser examinations.

It is encouraging that Congress recently took an important step forward in providing additional funding to the SEC for FY 2015. In the coming months, my Office will monitor the SEC's use of these resources and, while recognizing the many important and competing demands for those funds, we will advocate for a significant allocation to enhance the oversight of investment advisers.

We will also evaluate the impact of these increased resources in shortening the examination cycle for investment advisers. In reality, the recent increase in funding, while helpful, is likely insufficient to provide the full level of examination coverage that is needed. Therefore, we will assess any remaining need and will continue to explore potential efficiencies and funding mechanisms to further enhance investor protection in this area.

I am pleased to submit this first Report on Activities on behalf of the Office of the Investor Advocate, and I would be happy to answer any questions from Members of Congress. Congress has entrusted the Office of the Investor Advocate with important responsibilities, and we look forward to providing a strong, reasoned voice for investors as policies are considered in the coming year.

Sincerely,

Rick A. Fleming
Investor Advocate

REPORT ON ACTIVITIES

Functions of the Investor Advocate

According to Exchange Act Section 4(g)(4), 15 U.S.C. § 78d(g)(4), the Investor Advocate shall:

(A) assist retail investors in resolving significant problems such investors may have with the Commission or with SROs;

(B) identify areas in which investors would benefit from changes in the regulations of the Commission or the rules of SROs;

(C) identify problems that investors have with financial service providers and investment products;

(D) analyze the potential impact on investors of proposed regulations of the Commission and rules of SROs; and

(E) to the extent practicable, propose to the Commission changes in the regulations or orders of the Commission and to Congress any legislative, administrative, or personnel changes that may be appropriate to mitigate problems identified and to promote the interests of investors.

Reporting Obligation

According to Exchange Act Section 4(g)(6)(B), 15 U.S.C. § 78d(g)(6)(B), the Investor Advocate shall submit to Congress, not later than December 31 of each year, a report on the activities of the Investor Advocate during the immediately preceding fiscal year. This "Report on Activities" must include the following:

(I) appropriate statistical information and full and substantive analysis;

(II) information on steps that the Investor Advocate has taken during the reporting period to improve investor services and the responsiveness of the Commission and SROs to investor concerns;

(III) a summary of the most serious problems encountered by investors during the reporting period;

(IV) an inventory of the items described in subclause (III) that includes—

(aa) identification of any action taken by the Commission or the SRO and the result of such action;

(bb) the length of time that each item has remained on such inventory; and

(cc) for items on which no action has been taken, the reasons for inaction, and an identification of any official who is responsible for such action;

(V) recommendations for such administrative and legislative actions as may be appropriate to resolve problems encountered by investors; and

(VI) any other information, as determined appropriate by the Investor Advocate.

STEPS TAKEN TO IMPROVE INVESTOR SERVICES AND RESPONSIVENESS

Exchange Act Section 4(g)(6)(B)(ii)(II) requires the Report on Activities to include information on steps the Investor Advocate has taken during the Reporting Period to improve investor services and the responsiveness of the Commission and SROs to investor concerns. During FY 2014, the Investor Advocate has taken significant steps to accomplish this objective.[8] Most notably, the Investor Advocate appointed the SEC's first Ombudsman.

Section 919D of the Dodd-Frank Act, as codified in Exchange Act Section 4(g)(8), 15 U.S.C. § 78d(g)(8), requires the Investor Advocate to appoint an Ombudsman who will act as a liaison in resolving problems that retail investors may have with the Commission or an SRO. The Ombudsman also will establish safeguards to maintain the confidentiality of communications with investors.

On September 5, 2014, the Investor Advocate announced the appointment of Tracey L. McNeil as Ombudsman.[9] Ms. McNeil assumed her new duties effective September 22, 2014, and she has been working to establish appropriate systems for the intake and resolution of investor inquiries.

Exchange Act Section 4(g)(8)(D) requires the Ombudsman to submit a semi-annual report to the Investor Advocate that describes the activities and evaluates the effectiveness of the Ombudsman during the preceding year (the "Ombudsman's Report"). The Investor Advocate, in turn, is required to include the Ombudsman's Report within the Investor Advocate's reports to Congress. The Investor Advocate's next Report on Objectives, due June 30, 2015, will include the first Ombudsman's Report.

In addition to hiring an Ombudsman to improve the Commission's responsiveness to investor concerns, the Investor Advocate has taken steps to raise the profile of the SEC's Investor Advisory Committee (the "IAC" or "Committee"). By statute, the Investor Advocate is a member of the IAC,[10] and the Office of the Investor Advocate has accepted responsibility for providing operational and staff support for the Committee. Office of the Investor Advocate staff have facilitated numerous meetings between IAC subcommittees and agency staff, and the Investor Advocate routinely ensures that policymakers are aware of IAC recommendations regarding matters of critical importance to investors. For instance, the Office will conclude each of its reports to Congress with a summary of IAC recommendations and the Commission's responses to those recommendations. This Report on Activities is no exception.

MOST SERIOUS PROBLEMS ENCOUNTERED BY INVESTORS AND RECOMMENDATIONS FOR ADMINISTRATIVE OR LEGISLATIVE ACTION

Among the statutory duties of the Investor Advocate enumerated in Exchange Act Section 4(g)(4), the Investor Advocate is required to identify "problems" that investors have with financial service providers and investment products. Exchange Act Section 4(g)(6)(B) mandates that the Investor Advocate, within the annual Report on Activities, shall provide a summary of the most serious problems encountered by investors during the preceding fiscal year. The statute also requires the Investor Advocate to make recommendations for such administrative and legislative actions as may be appropriate to resolve those problems.[11]

To determine the most serious problems related to financial service providers and investment products, staff of the Office of the Investor Advocate have reviewed information from the following sources:

- Investor Alerts and Bulletins issued by the SEC, the North American Securities Administrators Association ("NASAA"), and the Financial Industry Regulatory Authority ("FINRA") during FY 2014;
- SEC enforcement actions and FINRA disciplinary actions during the Reporting Period;
- The 2014 NASAA Enforcement Report;[12]
- Data summarizing inquiries and complaints from investors submitted to the SEC's Office of Investor Education and Advocacy; and
- SEC and SRO staff reports providing guidance and interpretations relating to investment products.

The table below lists certain problematic products or practices during FY 2014 as reported by the SEC, NASAA, and FINRA. Although not exhaustive, the lists reflect some of the enforcement concerns of these organizations. Details regarding these products and practices are available on these organizations' websites.

Each of these products and practices presented problems for investors during the Reporting Period. However, based upon our review of the resources described above and conversations with numerous knowledgeable individuals, this Report on Activities identifies three of those products and practices that appear to have been the most problematic in FY 2014: private placement offerings, variable annuities, and non-traded real estate investment trusts.

In our review, we also considered products and practices that did not result in a significant number of enforcement actions during the Reporting Period but nevertheless represent emerging risks to investors. Two of these areas of growing concern are binary options and a practice known as "reverse churning."

Private Placement Offerings

The Securities Act of 1933 (the "Securities Act") prohibits an issuer from offering to sell its securities unless the offering has been registered with the SEC or qualifies for an exemption from the registration requirement.[16] Regulation D under the Securities Act provides a series of exemptions under which companies may raise capital from investors without having to comply with the regis tration requirement.[17] The most commonly used exemption under Regulation D is found in Rule

SEC[13]	NASAA[14]	FINRA[15]
▪ Non-traded REITs	▪ Binary Options	▪ Bitcoin—Virtual Currency
▪ Variable Annuities	▪ Marijuana Industry Investments	▪ High-Yield CDs
▪ Virtual Currency	▪ Stream-of-income Investments	▪ Variable Annuities
▪ Binary Options	▪ Digital Currency & Cybersecurity Risks	▪ Bonds—Reverse Convertibles
▪ Private Placement Offerings	▪ Regulation D/Rule 506 Private Offerings	▪ Pre-IPO Offerings
	▪ Pyramid and other Ponzi Schemes	▪ Frontier Funds
	▪ Real Estate Schemes, Including Those Using Promissory Notes	▪ Private Placements
	▪ Affinity Fraud	▪ Public Non-traded REITs
	▪ Internet Fraud, including Social Media and Crowdfunding	▪ Retirement Accounts
	▪ Oil & Gas Investments in the Fracking Era	

506, which provides an exemption for offerings sold primarily to accredited investors.[18] While a securities offering that is registered with the SEC is called a public offering, an offering that is exempt from SEC registration under Rule 506 is often referred to as a private placement offering.[19]

Private placements are investment offerings that are highly illiquid, generally lack transparency and have little regulatory oversight.[20] The securities offered in a private placement are considered illiquid because they cannot be resold without registration or an exemption from registration,[21] and most securities acquired through private placements are considered "restricted securities" that must be held for at least a year before they can be resold.[22] Thus, in a private placement, retail investors risk being unable to access their invested funds when needed.[23] This illiquidity also could negatively impact the price at which a retail investor would be able to resell the securities.[24]

While public offerings are subject to the registration requirement, private placements, by contrast, are not reviewed by federal or state regulators. In a private placement offering, there is no presale review process to ensure that the risks associated with the securities being offered and other material facts about the entity raising capital are adequately disclosed to investors. While the offerings are subject to the antifraud provisions of state and federal law, which means that the issuer must disclose all material facts to investors, post-sale recovery of funds lost in a private placement may be difficult or impossible.[25]

During the Reporting Period, the SEC litigated a private placement case that illustrates the potential for harm in these types of offerings. In *SEC v. AIC*,[26] a Richmond, Virginia-based financial services holding company, a subsidiary brokerage firm, and their chief executive officer were found liable for fraud and were required to pay nearly $70 million.[27] The SEC's complaint alleged that the defendants conducted an offering fraud while selling AIC promissory notes and stock to numerous investors, many of whom were elderly

or unsophisticated brokerage customers.[28] In particular, the complaint alleged that the defendants misrepresented and omitted material information about the investments when pitching them to investors, including the safety and risk associated with the investments, the rates of return, and how the proceeds would be used by AIC.[29]

Private placements have also attracted attention at the state level. State securities regulators report that they frequently receive complaints from investors who have been victimized in private placements conducted under Rule 506.[30] According to NASAA, offerings under Rule 506 ranked as the most common product or scheme leading to enforcement actions by state securities regulators in 2011 and 2012.[31] Indeed, "[i]n those two years alone, NASAA members recorded 340 enforcement actions involving Rule 506 offerings, and private placements are commonly listed on [NASAA's] annual list of top investor traps."[32]

In addition to enforcement actions, the SEC has alerted investors to the dangers of private placement offerings. Among other things, the Commission has encouraged retail investors to research thoroughly the validity of these potential investments and to be wary of high-pressure sales tactics.[33] The SEC has cautioned that, if an issuer fails to answer an investor's questions adequately, the investor should "consider this a warning against making the investment."[34]

The Investor Advocate has not yet made any formal recommendation to the Commission regarding administrative actions that may alleviate the problems associated with private placements. The Investor Advisory Committee, however, has issued a set of relevant recommendations.[35] Among other things, the IAC recommended that the Commission adopt changes to Form D and make the filing of the form a precondition for claiming the Rule 506 exemption. In addition, the IAC recommended that the Commission require the filing of all advertising or solicitation materials that are used in connection with an offering under Rule 506(c).[36]

Recently, the IAC recommended that the Commission reconsider the definition of an "accredited investor."[37] To satisfy Rule 506, an issuer can sell securities to no more than 35 non-accredited investors, so the definition of an accredited investor constitutes an important limitation of Rule 506. The IAC recommended that the Commission should "carefully evaluate whether the accredited investor definition, as it pertains to natural persons, is effective in identifying a class of individuals who do not need the protections afforded by the [Securities] Act."[38] To the extent that the existing definition is not fulfilling this purpose, the IAC recommended that the Commission initiate a rulemaking to amend the definition.[39] According to the IAC, the revised definition should enable individuals to qualify as accredited investors based on their financial sophistication, or the Commission should consider alternative approaches such as limitations based upon a percentage of the investors' assets or income.[40]

On July 10, 2013, the SEC proposed a rule to enhance the Commission's ability to evaluate the development of market practices in Rule 506 offerings and to address concerns that may arise from the use of general solicitation in offerings under Rule 506(c).[41] The proposed rule would amend Form D and require the filing of the form as a condition of the exemption.[42] The Commission has twice sought public comment on the rule proposal, which remains pending.[43]

Variable Annuities

A variable annuity is an investment product with insurance features.[44] It allows an investor to select from a menu of investment choices, typically mutual funds, within the variable annuity. At a later date—such as retirement—it allows the investor to receive a stream of payments over time.[45] The value of the variable annuity will depend on how those underlying investment choices perform.[46] Because variable annuities are considered securities under federal law, they are registered with the SEC and sales must be conducted through entities and individuals who are regulated by the SEC and FINRA.[47]

While similar to mutual funds, variable annuities offer some investment features that mutual funds do not. First, variable annuities allow an investor to receive periodic payments for the rest of his or her life or for the life of the investor's spouse.[48] Second, variable annuities offer additional features, often for purchase, thereby allowing investors to personalize the product.[49] One such feature is a death benefit, whereby a named beneficiary receives an amount equal to at least the investor's purchase price if the investor dies before the insurer begins issuing payments.[50] In addition, investors pay no taxes on any income and investment gains generated from the investments held in the variable annuities until money is withdrawn.[51]

Variable annuities offer various features, some of which are quite complex, making it challenging for some investors to understand what is being recommended for them to buy.[52] For instance, there are fees associated with variable annuities that may not be readily apparent to many retail investors: surrender charges,[53] mortality and expense risk charges,[54] administrative fees,[55] underlying fund expenses,[56] and charges for special features.[57] Some financial professionals may attempt to attract investors by offering variable annuities with bonus credit features.[58] However, bonus credits are not usually free—insurers charge investors for bonus credits by imposing higher surrender charges or longer surrender periods compared to similar variable annuities with no bonus credits.[59]

During the Reporting Period, investors encountered a number of problems involving variable annuities. In many cases, the problems were not intrinsic to variable annuities *per se*, but rather to sales practices or certain collateral features of the products. For example, on July 31, 2014, a broker agreed to settle SEC charges alleging that he had orchestrated a variable annuities scheme designed to profit from the imminent deaths of the terminally ill.[60] Specifically, the broker had sold variable annuity contracts with death benefit and bonus credit features to wealthy investors and designated the terminally ill patients as annuitants whose death would trigger a benefit payout.[61] Anticipating that the patients would soon die, he marketed the annuities as opportunities for investors to reap short-term investment gains.[62] Among other admissions made by the broker in the settlement, he knew that if the "stranger annuitants" did not die within a matter of months, his customers would be locked into unsuitable, highly illiquid long-term investment vehicles that they would be able to exit only by paying substantial surrender charges.[63] He also submitted at least 14 trade tickets containing materially false statements concerning how long his clients intended to hold their annuities while knowing that his broker-dealer would not have approved his annuities sales if he had provided truthful information concerning his customers' intention to use the annuities as short-term investment vehicles.[64] The broker agreed to settle the SEC charges against him by paying more than $850,000, admitting wrongdoing, and being barred from the securities industry.[65]

Another area of concern involves the tax-free exchange of variable annuities. Section 1035 of the U.S. tax code[66] governs these tax-free exchanges, often known as "Section 1035 Exchanges." It allows an investor "to exchange an existing annuity contract for a new annuity contract without paying any tax on the income and investment gains in [his or her] current variable annuity contract."[67]

Section 1035 Exchanges can benefit some investors.[68] For instance, new developments in features now offered in variable annuities may provide investors an annuity that offers more preferable features than the one they already own, such as different annuity payout options, a larger death benefit, or a broader selection of investment choices.[69] However, some financial professionals try to generate sales by persuading investors to engage in these exchanges, even when the exchange is not advisable because of surrender charges or other features that offset the benefits.[70]

An additional area of concern involves deceptive or high-pressure sales tactics.[71] Some financial professionals have an incentive to recommend variable annuities because they may earn higher commissions for selling variable annuities than they would for selling other securities products.[72] This incentive may lead salespersons to engage in tactics such us "limited-time offers"[73] or "free lunch" seminars.[74]

Because the problems associated with variable annuities are related primarily to sales practices or certain collateral features of the products, the Investor Advocate has not made any recommendations for changes to rules or regulations governing their sale. Problems in this area can be addressed through continued enforcement of existing rules and ongoing investor education efforts.

Non-Traded Real Estate Investment Trusts

Congress established real estate investment trusts ("REITs") in 1960 to allow retail investors to invest in large-scale income producing real estate.[75] Investments in REITs make it possible for retail investors to earn a share of the income produced through commercial real estate ownership, without actually having to purchase the property directly.[76]

Generally, a REIT is a company that owns, and typically operates, income-producing real estate or real estate-related assets.[77] Most REITs specialize in a certain type of real estate, such as apartment

communities or office buildings.[78] REITs are unlike other types of real estate companies in that a REIT must acquire and develop its real estate properties mainly to operate them as part of its own investment portfolio, instead of reselling those properties once they have been developed.[79] To qualify as a REIT, a company must have most of its assets and income connected to real estate investment and must distribute at least 90 percent of its taxable income in the form of dividends to shareholders annually.[80]

There are two general types of REITs: traded and non-traded.[81] Traded REITs are registered with the Commission and are publicly traded on a securities exchange.[82] Non-traded REITs are registered with the Commission but are not publicly traded.[83] Non-traded REITs share similarities with traded REITs: both invest in real estate, are subject to the same qualification requirements, and are required to make regular SEC disclosures, which are made publicly available through the Commission's EDGAR database.[84]

Despite their similarities, non-traded REITs differ from traded REITs in important ways.[85] For example, investing in non-traded REITs can involve significant up-front costs, which can lower the value of the underlying investment substantially.[86] In addition, non-traded REITs typically have external managers who may be paid high fees by the REIT for conducting activities that are not necessarily aligned with the interests of shareholders.[87]

Non-traded REITs generally are illiquid because, by definition, they are not publicly traded on an exchange.[88] As a result, there is no trading market to establish pricing, and retail investors may encounter valuation complexities.[89] Unlike publicly-traded REITs, non-traded REITs often make distributions in excess of their taxable income using borrowed funds and offering proceeds.[90] This can deflate share value and reduce the cash available to purchase additional income-generating properties.[91] Nonetheless, the longstanding industry practice has been to value the shares of non-traded REITs at a constant dollar value per share—for example, $10 per share—on customer account statements, despite the use of significant capital for non-real estate purposes.[92]

On October 10, 2014, the Commission approved a proposed rule change by FINRA relating to the valuations for certain securities, including unlisted REIT securities, on customer account statements.[93] Generally, the proposed rule change would require broker-dealers to include in customer account statements a per share estimated value for an unlisted REIT "developed in a manner reasonably designed to ensure that the per share estimated value is reliable."[94]

In approving FINRA's proposed rule change, the Commission found, among other things, that the rule was "designed to address longstanding concerns with the current industry practice of displaying a REIT security's immutable offering price as its per share estimated value on customer account statements throughout the offering period" (which could span several years), notwithstanding the fluctuation in value of the REIT security during that period.[95] The Commission stated that it believed that FINRA's proposed rule change would "greatly improve the accuracy and transparency of the value of . . . REIT securities and, in turn, better protect the investing public."[96]

Binary Options

A binary option is a type of options contract in which the payout depends entirely on whether the underlying asset—for instance, a company's stock—rises above or falls below a specified amount.[97] Investors betting on a company's stock movement face an all-or-nothing outcome when the option expires.[98] Binary options are significantly different from more conventional options[99] in that binary options have different payouts, fees, risks, and an entirely different liquidity structure and investment process.[100]

A substantial portion of the binary options market takes place through internet-based trading platforms that are not necessarily complying with applicable U.S. regulatory requirements.[101] In fact, only a fraction of the binary options market is subject to oversight by United States regulators, such as the SEC and the Commodity Futures Trading Commission.[102] The number of internet-based binary options trading platforms has risen sharply in recent years.[103] This proliferation has led to an increase in the number of investor complaints regarding fraudulent promotion schemes involving binary options trading platforms.[104] There are at least three categories of complaints: refusal to credit customer accounts or reimburse funds to customers; identity theft; and manipulation of software to generate losing trades.[105]

Many binary options trading platforms may be operating in violation of other applicable laws and regulations.[106] Binary options that are considered securities may not be offered or sold unless the offer and sale have been registered with the SEC or qualify for an exemption from the registration requirement.[107] If an unregistered offering is not exempt, then the offer or sale of the binary option would be illegal.[108] Moreover, some trading platforms may be operating as unregistered broker-dealers.[109]

The Investor Advocate has not yet determined that changes in rules or regulations are needed to combat the growing problems associated with

binary options. At present, it appears that problems in this area can be addressed through aggressive enforcement of existing rules.

Reverse Churning—Migration of Commission-Based Brokerage Accounts to Fee-Based Wrap Accounts

Since the 1990s, there has been a trend among broker-dealers to migrate customers from commission-based accounts—in which broker-dealers generally earn commissions only when they execute trades—into accounts with fees that are based upon a percentage of assets in the account.[110] Some broker-dealers, perhaps experiencing pressure from decreasing trade volumes and declining commission rates, have decided to transform their choppy, transaction-based compensation into a steadier, more predictable revenue stream by switching brokerage accounts to fee-based wrap accounts that offer advice and no-commission trading for one bundled asset fee.[111] By making this switch, they no longer have to execute a trade to earn a fee.[112]

A commission-based fee system may create an incentive for "churning"—a practice in which an unscrupulous registered representative makes excessive transactions in an account in order to generate more commissions.[113] Asset-based fees, in contrast to commission-based fees, remove this incentive to generate trading commissions.[114]

An asset-based system, however, can present the risk that a broker-dealer will ignore the client's account because the firm will earn a fee regardless

of whether a transaction occurs.[115] This practice sometimes develops when a broker-dealer (usually dually registered as an investment adviser) transfers the account of a client who trades infrequently from a commission-based account into an account with asset-based fees.[116] This "reverse churning" can result in neglected clients who receive limited service and who seldom trade even if certain transactions may be advisable for them.[117]

Recently, the Commission has been "looking for undisclosed and unmitigated conflicts [of interest involving] the trend among dually registered firms to move their clients' assets from commission-based brokerage accounts to fee-based wrap accounts."[118] While there may be compelling and legitimate reasons for such a move, there also have been instances where the benefits to the client are not so clear.[119] Examples of questionable switches from commission-based fee systems to asset fee-based wrap accounts include the following:[120]

- Securities are purchased, and portfolios are constructed or reconstructed, in commission-paying brokerage accounts at significant expense to the client, and then promptly transferred to a fee-based wrap account in which the client could have executed the same trades without paying commissions.[121]
- Accounts that consist mainly or entirely of cash or cash equivalents earning a few basis points are transferred into a fee-based wrap account charging up to nearly three percent of assets under management and continue to remain invested in cash.[122]
- Assets sit in a fee-based account for years without a single transaction occurring, or sales are effected only to generate proceeds to pay the asset-based fee.[123]

The migration of commission-based fee accounts to asset-based systems is a widespread practice that may not always withstand scrutiny as being in the best interests of a client.[124] Indeed, "dual registrants [in particular must] consider whether the recommendation to move from a brokerage account to an advisory account is consistent with fiduciary obligations and whether the move is in the client's best interests."[125]

The Investor Advocate does not believe that changes in rules or regulations are required to address the problem of reverse churning. Rather, aggressive enforcement action, particularly with respect to enforcing the fiduciary duty of an investment adviser who accepts and oversees a fee-based account, should be sufficient to deter this type of unethical practice.

INVENTORY OF PROBLEMS IDENTIFIED, RECOMMENDATIONS MADE BY THE INVESTOR ADVOCATE, AND ACTIONS TAKEN BY THE COMMISSION OR SROS

Exchange Act Section 4(g)(6)(B)(ii)(IV) requires the Report on Activities to include an "inventory" of the most serious problems encountered by investors during the reporting period. The inventory will identify the recommendations made by the Investor Advocate to resolve those problems.[126] The statute mandates that any such recommendations include a description of the following items:

- any action taken by the Commission or an SRO, and the result of such action;
- the length of time that each item has remained on such inventory; and
- for items on which no action has been taken, the reasons for inaction and an identification of any official who is responsible for such action.

The Office of the Investor Advocate was created on February 24, 2014, nearly midway through FY 2014. Because the instant report is the first Report on Activities to be submitted to Congress, there are no preexisting items to include in an inventory.


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SUMMARY OF IAC RECOMMENDATIONS AND SEC RESPONSES

Investor Advisory Committee. Front row from left to right: Hester Peirce; Joseph V. Carcello; Ann Yerger; Jean Setzfand; Darcy Bradbury; Craig Goettsch; Adam Kanzer. Back row from left to right: Rick Fleming; Alan Schnitzer; Kurt Schacht; Barbara Roper; Roger Ganser; Stephen Holmes; Steven Wallman; Damon Silvers. (Not pictured: J. Robert Brown, Jr.; Eugene Duffy; James Glassman; Joseph Grundfest; Roy Katzovicz; and Anne Sheehan).

Congress established the Investor Advisory Committee to advise and consult with the Commission on regulatory priorities, initiatives to protect investor interests, initiatives to promote investor confidence and the integrity of the securities marketplace, and other issues.[127] The Committee is composed of the Investor Advocate, a representative of state securities commissions, a representative of the interests of senior citizens, and not fewer than 10 or more than 20 members appointed by the Commission to represent the interests of various types of individual and institutional investors.[128]

Exchange Act Section 39 authorizes the Committee to submit findings and recommendations for review and consideration by the Commission.[129] The statute also requires the SEC "promptly" to issue a public statement assessing each finding or recommendation of the Committee and disclosing the action, if any, the Commission intends to take with respect to the finding or recommendation.[130] While the Commission must respond to the IAC's recommendations, it is under no obligation to agree with or act upon the recommendations.[131]

In its reports to Congress, including this one, the Office of the Investor Advocate summarizes the IAC recommendations and the SEC's responses to them.[132] This report covers the eight sets of recommendations that the IAC has made from its inception to the end of FY 2014.[133] Two additional recommendations that the IAC adopted in October 2014 fall beyond the scope of this report.[134]

The Commission and its staff have taken interim or final action on four of the IAC's eight recommendations; namely, those regarding tick sizes, Title II of the JOBS Act, target date retirement funds, and structured data. In addition, SEC Chair Mary Jo White has informed the IAC that Commission staff is working on the remaining IAC recommendations.[135]

SEC responses to IAC recommendations may take various forms. If an IAC recommendation pertains to a current rulemaking, the Commission's proposing release or the adopting release may constitute the Commission's response. If an IAC recommendation involves no current rulemaking, Chair White has indicated that the Commission would respond with a written statement.[136]

The Commission may be pursuing initiatives that are responsive to IAC recommendations but have not yet been made public. Commission staff—including staff of the Office of the Investor Advocate—are prohibited from disclosing nonpublic information.[137] Therefore, any such initiatives are not reflected in this Report on Activities.

CROWDFUNDING

At its meeting on April 10, 2014, the IAC adopted a package of six recommendations for the SEC to strengthen its proposed rules to implement the crowdfunding provisions of the JOBS Act.[138] The Committee stated that its recommendations would better ensure that investors understand the risks of crowdfunding and avoid unaffordable financial losses. Among other things, the Committee recommended that the SEC:

- Adopt tighter limits on the amount of money that investors could invest in crowdfunding;
- Strengthen the mechanisms for the enforcement of the investment limits in order to better prevent errors and evasion;
- Clarify and strengthen the obligations of crowdfunding intermediaries to ensure that issuers comply with their legal obligations; clarify the requirements for background checks; clearly affirm the right of portals to "curate" offerings; and consider a tiered regulatory structure based upon factors such as the size of offering, investment limits, and participation by individuals with a record of securities law violations;
- Enhance the effectiveness of educational materials for investors;
- Replace the proposed definition of electronic delivery with a stronger definition that, at a minimum, requires disclosure of a specific URL where required disclosures can be found; and
- Replace its proposal to eliminate application of the integration doctrine with a narrower approach.

These recommendations relate to proposed rules that are still under consideration.[139] Chair White informed the Committee at its meeting on July 10, 2014 that Commission staff was reviewing comments received during the comment period and developing recommendations for final rules. She added that the Commission's response to the Committee's recommendations would be reflected in the adopting release for the final rules.

DECIMALIZATION AND TICK SIZES

On January 31, 2014, the IAC adopted a resolution opposing any test or pilot programs to increase the minimum quoting and trading increments ("tick sizes") in the securities markets.[140] The resolution argued that larger tick sizes would harm retail investors by raising prices and would not improve the research coverage or liquidity of small-cap companies. The resolution urged the SEC to maintain its current policy on decimalization and to focus on other ways to enhance liquidity and capital formation without sacrificing investor protections. However, should the SEC decide to pursue a pilot program of increasing tick sizes, the IAC recommended a short "sunset" on the pilot unless benefits are proven to outweigh the costs; a careful evaluation of costs and benefits to investors, with a particular focus on retail investors;

From left to right: Investor Advocate Rick Fleming, Commissioner Kara M. Stein, Commissioner Luis A. Aguilar, Chair Mary Jo White, Commissioner David M. Gallagher, and Commissioner Michael S. Piwowar

and the piloting of other competition-based measures designed to encourage trading and capital formation.

On June 24, 2014, the Commission directed the national securities exchanges and FINRA to submit a plan for a pilot program to test a tick size of 5 cents per share in three groups of securities.[141] On August 25, 2014, the SROs submitted a plan for a 12-month pilot program that would widen the tick sizes for certain stocks. The pilot program would consist of stocks with a market capitalization of $5 billion or less, an average daily trading volume of one million shares or less, and a closing share price of at least $2 per share. The pilot would include one control group and three test groups, with 400 securities in each test group.[142]

At the IAC meeting on October 9, 2014, Chair White encouraged the Committee's further feedback on both the broader policy considerations and the particulars of the pilot design.[143] On November 7, 2014, the Commission opened a public comment period on the tick size plan and pilot program, with comments due by December 22, 2014.[144]

LEGISLATION TO FUND INVESTMENT ADVISER EXAMINATIONS

On November 22, 2013, the IAC recommended that the SEC request legislation from Congress that would authorize the Commission to impose user fees on SEC-registered investment advisers to provide a scalable source of funding for more frequent compliance examinations of advisers.[145] The IAC asserted that the examination cycle for SEC-registered investment advisers was "simply inadequate to detect or credibly deter fraud."

Although the Commission has not taken a formal position on user fees, its Fiscal Year 2015 budget request identified increased examinations of investment advisers as a top priority. The request called for sufficient appropriations to add 316 positions to the examination program in the SEC's Office of Compliance Inspections and Examinations.[146]

BROKER-DEALER FIDUCIARY DUTY

On November 22, 2013, the IAC adopted a set of recommendations encouraging the SEC to establish a fiduciary duty for broker-dealers when they provide personalized investment advice to retail investors.[147] The Committee preferred to accomplish this objective by narrowing the exclusion for broker-dealers within the definition of an "investment adviser" under the Investment Advisers Act of 1940. As an alternative, the Committee recommended the adoption of a rule under Section 913 of the Dodd-Frank Act to require broker-dealers to act in the best interests of their retail customers when providing personalized investment advice, with sufficient flexibility to permit certain sale-related conflicts of interest that are fully disclosed and appropriately

managed. In addition, the Committee recommended the adoption of a uniform, plain English disclosure document to be provided to customers and potential customers of broker-dealers and investment advisers. The document would disclose information about the nature of services offered, fees and compensation, conflicts of interest, and the disciplinary record of the broker-dealer or investment adviser.

The SEC's response to these recommendations is pending.

UNIVERSAL PROXY BALLOTS

On July 25, 2013, the IAC adopted a recommendation urging the SEC to explore the relaxation of the "*bona fide* nominee rule" (Rule 14a-4(d)(1)) to provide proxy contestants with the option, but not the obligation, to use Universal Ballots in connection with short slate director nominations.[148] The IAC also encouraged the Commission to hold one or more roundtable discussions on the topic.

At the IAC meeting on October 9, 2014, Chair White informed the Committee that the Commission would hold a roundtable early in 2015 on a number of proxy-related issues, including universal ballots.

DATA TAGGING

At its meeting on July 25, 2013, the IAC adopted a recommendation for the SEC to promote the collection, standardization, and retrieval of data filed with the SEC using machine-readable data tagging formats.[149] The Committee urged the SEC to take steps to reduce the costs of providing tagged data, particularly for smaller issuers and investors, by developing applications that allow users to enter information on forms that can be converted to machine-readable formats by the SEC. In addition, the IAC recommended that the SEC give priority to the data tagging of disclosures on corporate governance, including information about executive compensation and shareholder voting.

The Commission has incorporated the collection of structured data into several recently adopted and proposed rules. For example, the Commission adopted rules on September 4, 2014, to require loan-level disclosure for asset-backed securities in XML format so investors may more easily access and analyze data about the asset pool. Recently proposed new rules governing "crowdfunding"[150] and amendments to Regulation A[151] also include requirements for issuers to file certain key financial information in an XML format. In addition, Rule 30b1-7 under the Investment Company Act of 1940 requires money market funds to file Form N-MFP within five business after the end of each month—and the information required by the form must be data-tagged in XML format and filed through EDGAR.[152]

As Chair White has indicated, consistent with the IAC's recommendation to reduce the costs of providing structured data, Commission staff is considering a new filing method called "Inline-XBRL."[153] This new technology would effectively eliminate the need for companies to reconcile separate HTML and XBRL versions of the financial statement content, thus reducing the possibility of rekeying or similar errors. Instead, Inline-XBRL would allow companies to integrate (or embed) the XBRL tagging of the financial statements directly into their standard HTML formatted 10-K and 10-Q filings. In addition, Commission staff is working on a prototype viewer to allow users to display and search the integrated XBRL tagging while viewing the familiar HTML version of the financial statements.

The Commission's new Chief Economist and Director of the Division of Economic and Risk Analysis ("DERA"), Dr. Mark Flannery, dedicated his inaugural speech to the topic of structured data. On September 30, 2014, he spoke of the Commission's efforts to expand the public's access to the financial data submitted to the SEC by market participants, including work on utilizing Inline-XBRL. Dr. Flannery also referred to a recent DERA assessment of the usage of custom tags,[154] as well as an analysis of calculation errors in XBRL submissions. The latter analysis led the Division

of Corporation Finance to issue a "Dear CFO" letter to several companies that had failed to include all required calculation relationships in their XBRL data.[155]

TARGET DATE MUTUAL FUNDS

On April 11, 2013, the IAC adopted recommendations for the Commission to revise its proposed rule regarding target date retirement fund names and marketing.[156] The package of five IAC recommendations pertained to a 2010 SEC proposal that would, among other things, require marketing materials for target date retirement funds to include a table, chart, or graph depicting the fund's asset allocation over time (*i.e.*, an "asset allocation glide path").[157]

As either a replacement for or supplement to the SEC's proposed asset allocation glide path illustration, the IAC recommended that the Commission develop a glide path illustration that would be based on a measure of fund risk. To promote comparability between funds, the IAC recommended the adoption of standard methodologies to be used in glide path illustrations. In addition, the IAC urged the Commission to require clearer disclosure about the risk of loss, the cumulative impact of fees, and the assumptions used to design and manage the funds.

On April 3, 2014, the Commission reopened the comment period on the proposed rule in order to seek public comment on the IAC's recommendations to adopt a risk-based glide path illustration and the methodology to be used for measuring risk.[158] The comment period closed on June 9, 2014, and a final rule has not yet been adopted.

GENERAL SOLICITATION AND ADVERTISING

On October 12, 2012, the IAC adopted a set of seven recommendations concerning rulemaking to lift the ban on general solicitation and advertising in offerings conducted under Rule 506.[159] The IAC asserted that the recommendations would strengthen investor protections and enhance regulators' ability to police the private placement market.

On July 10, 2013, the SEC took three related actions.[160] First, the Commission adopted a final rule permitting general solicitation and advertising in Rule 506 offerings.[161] Second, it adopted a final rule disqualifying offerings involving felons and other bad actors.[162] Third, it proposed an additional rule to enhance the Commission's ability to evaluate the development of market practices in Rule 506 offerings and to address concerns that may arise because the ban on general solicitation was lifted.[163]

Taken together, the two final rules and the proposed rule generally reflect consideration of the IAC recommendations. However, the majority of the IAC recommendations relate to the proposed rule, which has not yet been adopted.

End Notes

1 Exchange Act § 4(g)(2)(A)(ii), 15 U.S.C. § 78d(g)(2)(A)(ii) (2012).

2 Exchange Act § 4(g)(6), 15 U.S.C. § 78d(g)(6).

3 Exchange Act § 4(g)(6)(A)(i), 15 U.S.C. § 78d(g)(6)(A)(i).

4 The 2014 Report on Objectives is incorporated herein by reference. SEC, Office of the Investor Advocate, *Report on Objectives, Fiscal Year 2015,* (June 30, 2014), *available at* http://www.sec.gov/reportspubs/annual-reports/sec-office-investor-advocate-report-on-objectives-fy2015.pdf.

5 Exchange Act § 4(g)(6)(B)(i), 15 U.S.C. § 78d(g)(6)(B)(i).

6 *Id.*

7 SEC, Agency Financial Report Fiscal Year 2014, at 54 (2014), *available at* http://www.sec.gov/about/secpar/secafr2014.pdf.

8 On October 31, 2014, the Investor Advocate filed a comment letter with the Municipal Securities Rulemaking Board (the "MSRB"). In the letter, the Investor Advocate recommended that the MSRB assign a higher long-term priority to price transparency in the municipal securities market. This letter was submitted after the Reporting Period—a copy is available at http://www.sec.gov/advocate/msrb-letter-103114.pdf.

9 SEC, *Press Release: Tracey L. McNeil Named as SEC's First Ombudsman* (Sept. 5, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542869949.

10 Exchange Act § 39(b)(1)(A), 15 U.S.C. § 78pp(b)(1)(A).

11 Exchange Act § 4(g)(6)(B)(ii)(V), 15 U.S.C. § 78d(g)(6)(B)(ii)(V).

12 NASAA, *NASAA Enforcement Report: 2014 Report on 2013 Data* (Oct. 2014), http://www.nasaa.org/wp-content/uploads/2011/08/2014-Enforcement-Report-on-2013-Data_110414.pdf. *See also* NASAA, *Top Investor* Threats (Nov. 12, 2014), http://www.nasaa.org/3752/top-investor-threats/.

13 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 during FY 2014.

14 *See* NASAA, *Top Investor Threats*, *supra* note 12.

15 This list of problematic products is based on staff analysis of the alerts and bulletins issued by FINRA for investors during FY 2014.

16 Securities Act of 1933, Pub. L. 73-22, c. 38, Title I, § 5, 48 Stat. 77 (May 27, 1933), *codified as amended at* 15 U.S.C. § 77e.

17 NASAA, *Issue Brief: Private Placement Offerings* (2013), http://www.nasaa.org/issues-and-advocacy/private-placement-offerings/.

18 *Id.*

19 SEC, *Investor Bulletin: Private Placements Under Regulation D* (Sept. 2014), http://investor.gov/news-alerts/investor-bulletins/investor-bulletin-private-placements-under-regulation-d#.VEgQIzYpCUl (explaining that generally, private placements are not subject to some of the laws and regulations that are designed to protect investors, such as the comprehensive disclosure requirements that apply to registered offerings). See also SEC, *Investor Alert: 10 Red Flags That an Unregistered Offering May Be a Scam* (Aug. 2014), http://investor.gov/news-alerts/investor-alerts/investor-alert-10-red-flags-unregistered-offering-may-be-scam#.VEVZ7TYpCUl.

20 *See* NASAA, *Top Investor Threats*, *supra* note 12.

21 SEC, *Investor Bulletin: Private Placements Under Regulation D, supra* note 19.

22 *Id.*

23 *Id.*

24 FINRA, *Private Placements—Evaluate the Risks Before Placing Them in Your Portfolio* (Sept. 17, 2013), http://www.finra.org/Investors/ProtectYourself/InvestorAlerts/PrivateOfferings/P339650.

25 SEC, *Investor Bulletin: Private Placements Under Regulation D, supra* note 19.

26 *SEC v. AIC, Inc. et al.*, No. 3:11-CV-176-TAV-HBG, 2014 WL 3810667 (E.D. Tenn. Oct. 22, 2013).

27 SEC, *SEC Obtains Nearly $70 Million Judgment Against Richmond, VA.-Based Firms and CEO Found Liable for Defrauding Investors,* (Aug. 1, 2014), http://investor.gov/news-alerts/press-releases/sec-obtains-nearly-70-million-judgment-against-richmond-va-based-firms-ce#.VG-WgjZOmUk.

28 *Id.*

29 *Id.*

30 Comment Letter, A. Heath Abshure, NASAA, *RE: NASAA Comments in Response to Release Nos. 33-9416, 34-69960, IC-30595 (File No. S7-06-13), "Amendments to Regulation D, Form D and Rule 156 under the Securities Act"* (Sept. 27, 2013), http://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Comment-Letter-re-Form-D.pdf.

31 *See* NASAA, *Issue Brief: Private Placement Offerings, supra* note 17.

32 *Id.*

33 SEC, *Investor Bulletin: Private Placements Under Regulation D, supra* note 19.

34 *Id.*

35 SEC, *Recommendation of the IAC Regarding SEC Rulemaking to Lift the Ban on General Solicitation and Advertising in Rule 506 Offerings: Efficiently Balancing Investor Protection, Capital Formation and Market Integrity* (Oct. 12, 2012), http://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-general-solicitation-advertising-recommendations.pdf.

36 *Id.*

37 SEC, *Recommendation of the IAC: Accredited Investor Definition* (Oct. 9, 2014), http://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-advisor-accredited-definition.pdf.

38 *Id.*

39 *Id.*

40 *Id.*

41 Amendments to Regulation D, Form D and Rule 156, Securities Act Release No. 9416 (July 10, 2013) [78 FR 44806 (July 24, 2013)].

42 *Id.* at 44808.

43 Amendments to Regulation D, Form D and Rule 156, Re-Opening of Comment Period, Securities Act Release No. 9458 (Sept. 27, 2013) [78 FR 61222 (Oct. 3, 2013)].

44 SEC, *Variable Annuities: What You Should Know*, at 3 (Sept. 2007), http://www.sec.gov/investor/pubs/sec-guide-to-variable-annuities.pdf*; See also,* FINRA, *Investor Alert: Variable Annuities: Beyond the Hard Sell,* at 1 (Aug. 2009), http://www.finra.org/web/groups/investors/@inv/documents/investors/p125846.pdf (explaining that "[i]f the payments are delayed to the future, [it is a] deferred annuity. If the payments start immediately, [it is an] immediate annuity." Of concern here are deferred variable annuities).

45 SEC, *Variable Annuities: What You Should Know, supra* note 44, at 3.

46 *Id.*

47 FINRA, *Investor Alert—Variable Annuities: Beyond the Hard Sell, supra* note 44. *See also* NASAA, *Informed Investor Alert: Annuities* (Nov. 2010), http://www.nasaa.org/2692/informed-investor-alert-annuities/ (noting that "variable annuities are considered to be securities under federal law and the laws of some states. Certain states consider variable annuities to be strictly insurance products, while other states consider them to be both insurance and securities. In states where variable annuities are regulated by both the state's insurance and securities regulator, variable annuities must be registered with both state regulators.").

48 SEC, *Investor Bulletin: Variable Annuities—An Introduction,* at 2 (Feb. 2014), http://investor.gov/sites/default/files/ib_var_annuities_0.pdf.

49 *Id.*

50 *Id.* This is considered a benefit if, at the time of death, the account value is less than the guaranteed amount. *Id.*

51 *Id.* When money is withdrawn, investors are taxed on the earnings at ordinary income tax rates, rather than at lower capital gains tax rates associated with other investments, i.e. mutual funds. *Id.* There also is a 10% federal income tax penalty if money is withdrawn before an investor turns 59 ½ years old. *Id.*

52 FINRA, *Investor Alert—Variable Annuities: Beyond the Hard Sell, supra* note 44, at 2.

53 *See* SEC, *Variable Annuities: What You Should Know*, *supra* note 44, at 10. Surrender charges are a type of sales charge that an insurance company assesses if an investor withdraws money from a variable annuity within a certain period after a purchase payment (known as the "surrender period," which is typically within 6 to 8 years, but sometimes as long as 10 years). *Id.* Typically, the surrender charge is a percentage of the amount withdrawn, and declines gradually until the surrender period no longer applies. *Id.*

54 *Id.* at 11. Mortality and expense risk charges are equal to a certain percentage of an investor's account value, usually about 1.25 percent per year. *Id.* They are used to compensate the insurance company for the insurance risks it assumes under the annuity contract. *Id.* Profit from these charges is sometimes used to pay the insurer's costs of selling the variable annuity, such as a commission paid to the financial professional for selling the variable annuity to an investor. *Id.*

55 *Id.* Administrative fees may be deducted from an investor's account to cover record-keeping and other administrative expenses. *Id.* Administrative fees may be charged as a flat account maintenance fee or as a percentage of the total account value. *Id.*

56 *Id.* at 12. Investors indirectly pay underlying fund expenses, which are fees and expenses imposed by the mutual funds that underlie the investment choices for a variable annuity. *Id.*

57 *Id.* Some variable annuities offer special features for additional fees or charges, such as a guaranteed minimum income benefit, long-term care insurance or principal protection. *Id.*

58 *Id.* at 14.

59 *Id.* ("Variable annuities with bonus credits may carry a downside, however—higher expenses that can outweigh the benefit of the bonus credit offered."). *See also* SEC, *Investor Bulletin: Variable Annuities—An Introduction, supra* note 48, at 4 (stating that "some products take back the bonus under certain conditions, for example if a death benefit is paid, or if [an investor] make[s] a withdrawal").

60 Press Release, SEC, Architect of Variable Annuities Scheme Agrees to Pay $850,000, Admit Wrongdoing, and Be Barred From Securities Industry, (July 31, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542573818. *Michael A. Horowitz*, Exchange Act Release No. 72729, 2014 WL 3749703 (SEC July 31, 2014).

61 Press Release, *supra* note 60.

62 *Id.*

63 *Id.*

64 *Id.*

65 *Id.*

66 26 U.S.C. § 1035.

67 SEC, *Variable Annuities: What You Should Know*, *supra* note 44, at 13.

68 FINRA, *Investor Alert: Should You Exchange Your Variable Annuity?*, at 2 (March 2006), http://www.finra.org/web/groups/investors/@inv/@protect/@ia/documents/investors/p125849.pdf.

69 SEC, *Variable Annuities: What You Should Know, supra* note 44, at 13.

70 FINRA, *Investor Alert: Should You Exchange Your Variable Annuity?, supra* note 68, at 2.

71 NAIC, *Consumer Alert: Annuities and Senior Citizens*, http://www.naic.org/documents/consumer_alert_annuities_senior_citizens.htm.

72 FINRA, *Investor Alert: Should You Exchange Your Variable Annuity?, supra* note 68, at 2.

73 NAIC, *Consumer Alert: Annuities and Senior Citizens, supra* note 71.

74 NASAA, *Informed Investor Alert: Annuities, supra* note 47.

75 SEC, *Investor Bulletin: Real Estate Investment Trusts (REITs),* at 1 (Dec. 2011), http://investor.gov/sites/default/files/REITs.pdf.

76 *Id.*

77 *Id.*

78 *Id.*

79 *Id.*

80 *Id.*

81 FINRA, *Investor Alert – Public Non-Traded REITs – Perform a Careful Review Before Investing* (Aug. 2012), http://www.finra.org/Investors/ProtectYourself/InvestorAlerts/REITS/P124232.

82 SEC, *Investor Bulletin: Real Estate Investment Trusts (REITs), supra* note 75, at 2.

83 *Id.*

84 FINRA, *Investor Alert – Public Non-Traded REITs – Perform a Careful Review Before Investing, supra* note 81.

85 For a comparison of traded REITs and non-traded REITs, *see* SEC, *Investor Bulletin: Real Estate Investment Trusts (REITs), supra* note 75, at 2-3.

86 *Id.* at 4.

87 *Id.*

88 *Id.* at 3. ("Although non-traded REITs usually offer share redemption programs, these are typically subject to significant limitations and may be discontinued at the discretion of the company. Investors may have to wait to receive a return of their capital until the company decides to engage in a transaction, such as the listing of the shares on an exchange or a liquidation of the company's assets.").

89 *Id.* at 3-4. ("Non-traded REITs typically do not provide an estimate of their value per share until 18 months after their offering closes, but this may be years after [an investor has] made [an] investment.").

90 *Id* at 4.

91 *Id.*

92 Notice of Filing of Proposed Rule Change Relating to per Share Estimated Valuations for Unlisted DPP and REIT Securities, Exchange Act Release No. 71545 (Feb. 12, 2014) [79 FR 9535, 9536 (Feb. 19, 2014)].

93 Order Approving FINRA Proposed Rule Change Relating to Per Share Estimated Valuations for Unlisted DPP and REIT Securities, Exchange Act Release No. 73339 (Oct. 10, 2014) [79 FR 62489 (Oct. 17, 2014)].

94 *Id.*

95 *Id.* at 62491.

96 *Id.*

97 SEC, *Investor Alert: Binary Options and Fraud*, at 1 (June 2013), http://investor.gov/sites/default/files/Binary-Options-and-Fraud_0.pdf.

98 Press Release, SEC, SEC Warns Investors About Binary Options and Charges Cyprus-Based Company with Selling Them Illegally in the U.S, (June 6, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171575220.

99 SEC, *Investor Alert: Binary Options and Fraud*, *supra* note 97.

100 *See generally, Id.*

101 *Id.*

102 *Id.*

103 *Id.*

104 *Id.*

105 *Id.* at 2-3.

106 *Id.* at 3.

107 *Id.*

108 *Id.*

109 *Id.*

110 *See* Arthur B. Laby, *Fiduciary Obligations of Broker-Dealers and Investment Advisers*, 55 Villanova L. Rev. 701, 739-40 (2010) (discussing, among other things, compensatory schemes of broker-dealers and investment advisers).

111 Andrew J. Bowden, Director, Office of Compliance Inspections & Examinations, SEC, *People Handling Other Peoples' Money*, Investment Adviser Association Compliance Conference (Mar. 6, 2014) (transcript available at http://www.sec.gov/News/Speech/Detail/Speech/1370541260300).

112 *Id.*

113 Laby, *supra* note 110.

114 *Id.* at 740.

115 *Id.*

116 *See, e.g.,* Mary Jo White, Chair, SEC, Remarks at National Society of Compliance Professionals National Membership Meeting (Oct. 22, 2013) (transcript available at http://www.sec.gov/News/Speech/Detail/Speech/1370539960588).

117 *See* Laby, *supra* note 110, at 740.

118 Bowden, *supra* note 111.

119 *Id.*

120 *Id.*

121 *Id.*

122 *Id.*

123 *Id.*

124 *Id.*

125 Norm Champ, Director, Div. of Inv. Mgmt., Remarks to the 2014 Mutual Funds and Investment Management Conference (Mar. 17, 2014) (transcript available at http://www.sec.gov/News/Speech/Detail/Speech/1370541168327).

126 Exchange Act § 4(g)(6)(B)(ii)(IV) does not explicitly require the Investor Advocate's recommendations to be included within this inventory, but § 4(g)(4)(E) requires the Investor Advocate, to the extent practicable, to recommend to the Commission and Congress any changes in regulations or statutes to address problems identified by the Investor Advocate. Furthermore, § 4(g)(4)(E) requires the Investor Advocate to analyze proposed rules and regulations of the Commission and SROs and to identify areas in which investor would benefit from changes in the rules and regulations.

127 Exchange Act § 39(a), 15 U.S.C. § 78pp(a).

128 *Id.*

129 Exchange Act § 39(a)(2)(B), 15 U.S.C. § 78pp(a)(2)(B).

130 Exchange Act § 39(g), 15 U.S.C. § 78pp(g).

131 Exchange Act § 39(h), 15 U.S.C. § 78pp(h).

132 According to Exchange Act Section 4(g)(6)(B)(ii), 15 U.S.C. § 78d(g)(6)(B)(ii), a Report on Activities must include several enumerated items, and it may include "any other information, as determined appropriate by the Investor Advocate."

133 All IAC Recommendations are available at http://www.sec.gov/spotlight/investor-advisory-committee-2012.shtml.

134 The recommendations concern the Accredited Investor Definition and Impartiality in the Disclosure of Preliminary Voting Results, both available at http://www.sec.gov/spotlight/investor-advisory-committee-2012.shtml.

135 Transcript of SEC IAC Meeting, at 12 (Apr. 10, 2014).

136 Mary Jo White, Chair, SEC, Remarks at the Meeting of the IAC (July 25, 2013).

137 17 C.F.R. §§ 200.735-3(b)(2)(i), 230.122 (2014); Exchange Act § 24(b), 15 U.S.C. § 78x; 5 U.S.C. § 552a(i)(1; SECR18-2, Section 8.5 (Nonpublic Information) (July 31, 2005).

138 SEC,*Recommendation of the IAC: Crowdfunding Regulations* (Apr. 10, 2014), http://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-adviser-crowdfunding-recommendation.pdf.

139 Crowdfunding, Securities Act Release No. 9470 (Oct. 23, 2013) [78 FR 66427 (Nov. 5, 2013)].

140 SEC,*Recommendation of IAC: Decimalization and Tick Sizes* (Jan. 31, 2014), http://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-adviser-decimilization-recommendation.pdf.

141 Order Directing the Exchanges and the Financial Industry Regulatory Authority To Submit a Tick Size Pilot Plan, Exchange Act Release No. 72460 (June 24, 2014) [79 FR 36840 (June 30, 2014)].

142 Letter from Brendon J. Weiss, Vice President, NYSE Group, Inc. et al, *Re: Plan to Implement a Tick Size Pilot Program* (Aug. 25, 2014), http://www.sec.gov/divisions/marketreg/tick-size-pilot-plan-transmittal-letter.pdf; BATS Exchange, Inc. et al, *Plan to Implement a Tick Size Pilot Program*, http://www.sec.gov/divisions/marketreg/tick-size-pilot-plan-final.pdf.

143 Mary Jo White, Chair, SEC, Opening Remarks at the IAC Meeting (Oct. 9, 2014) (transcript available at http://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1370543132802).

144 Notice of Filing Proposed National Market System Plan to Implement a Tick Size Pilot Program on a One-Year Pilot Basis, Exchange Act Release No. 73511 (Nov. 3, 2014) [79 FR 66423 (Nov. 7, 2014)].

145 SEC,*Recommendation of the IAC: Legislation to Fund Investment Adviser Examinations* (Nov. 22, 2013), http://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-adviser-examinations-recommendation-2013.pdf.

146 Testifying in support of the budget request, Chair White stated, "There is an immediate and pressing need for significant additional resources to permit the SEC to increase its examination coverage of registered investment advisers so as to better protect investors and our markets." Mary Jo White, Chair, SEC, Budget Hearing: Before H. Subcomm. on Fin. Service & Gen. Gov't of the H. Comm. on Appropriations, 113th Cong. (Apr. 1, 2014) (transcript available at http://docs.house.gov/meetings/AP/AP23/20140401/102004/HHRG-113-AP23-Wstate-WhiteM-20140401.pdf).

147 SEC, *Recommendation of the IAC: Broker-Dealer Fiduciary Duty* (Nov. 22, 2013), http://www.sec.gov/spotlight/investor-advisory-committee-2012/fiduciary-duty-recommendation-2013.pdf.

148 SEC, *Recommendations of the Investor Advisory Committee Regarding SEC Rulemaking to Explore Universal Proxy Ballots*, http://www.sec.gov/spotlight/investor-advisory-committee-2012/universal-proxy-recommendation-072613.pdf (adopted July 25, 2013).

149 SEC, *Recommendations of the Investor Advisory Committee Regarding the SEC and the Need for the Cost Effective Retrieval of Information by Investors*, http://www.sec.gov/spotlight/investor-advisory-committee-2012/data-tagging-resolution-72513.pdf (adopted July 25, 2013).

150 Crowdfunding, *supra* note 139.

151 Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act, Securities Act Release No. 9497 (Dec. 18, 2013) [79 FR 3926 (Jan. 23, 2014)].

152 Money Market Fund Reform; Amendments to Form PF, Securities Act Release No. 9616 (July 23, 2014) [79 FR 47736, 47944 (Aug. 14, 2014)].

153 Mary Jo White, Chair, SEC, Testimony on "Oversight of the SEC's Agenda, Operations and FY 2015 Budget Request," Before H. Subcomm. On Fin. Services & Gen. Gov't of the H. Comm. On Appropriations, 113 Cong. (Apr. 29, 2014) (transcript available at http://financialservices.house.gov/uploadedfiles/hhrg-113-ba00-wstate-mwhite-20140429.pdf).

154 Staff of the SEC, Div. of Risk & Economic Analysis, *Observations of Custom Tag Rates* (July 7, 2014), *available at* http://www.sec.gov/dera/reportspubs/assessment-custom-tag-rates-xbrl.html.

155 *See* SEC, Div. of Corp. Fin., *Sample Letter Sent to Public Companies Regarding XBRL Requirement to Include Calculation Relationships* (July 2014), http://www.sec.gov/divisions/corpfin/guidance/xbrl-calculation-0714.htm.

156 SEC, *Recommendation of the IAC: Target Date Mutual Funds* (Apr. 11, 2013), http://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-recommendation-target-date-fund.pdf.

157 Investment Company Advertising: Target Date Retirement Fund Names and Marketing, Exchange Act Release No. 9126 (June 16, 2010) [75 FR 35920 (June 23, 2010)].

158 Investment Company Advertising: Target Date Retirement Fund Names and Marketing, Securities Act Release No. 9570 (Apr. 3, 2014) [79 FR 19564 (Apr. 9, 2014)].

159 SEC, *Recommendation of the IAC Regarding SEC Rulemaking to Lift the Ban on General Solicitation and Advertising in Rule 506 Offerings: Efficiently Balancing Investor Protection, Capital Formation and Market Integrity*, *supra* note 35. Title II of the JOBS Act requires the SEC to lift the ban on general solicitation and advertising in Rule 506 securities offerings. Jumpstart Our Business Startups Act, Pub. L. No. 112-106, sec. 201(a), 126 Stat. 306, 313 (2012).

160 At the IAC meeting on July 25, 2013, Chair White provided the IAC with a chart mapping each of its recommendations to the corresponding text in the Commission's proposed and final rule releases.

161 Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Securities Act Release No. 9415 (July 10, 2013) [78 FR 44771 (July 24, 2013)].

162 Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings, Securities Act Release No. 9414 (July 10, 2013) [78 FR 44729 (July 24, 2013)].

163 Amendments to Regulation D, Form D and Rule 156, *supra* note 41.

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