

The background of the cover features a complex, abstract pattern of dark red and black wavy lines that create a sense of depth and movement. Scattered throughout this pattern are numerous small, bright white dots, some of which appear to be part of a larger, faint constellation or star map. The overall effect is one of dynamic energy and modern design.

Office of the Investor Advocate

OFFICE OF THE INVESTOR ADVOCATE

REPORT ON ACTIVITIES

FISCAL YEAR 2019

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 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.² On June 29, 2018, the Office of the Investor Advocate (Office) filed a Report on Objectives for Fiscal Year 2019, which identified nine policy areas that the Office would focus on during the year.³ In addition to the Report on Objectives, a Report on Activities is due no later than December 31 of each year.⁴ The Report on Activities describes 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 Securities and Exchange Commission (Commission or SEC) 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 taken to address those problems, and recommendations for administrative and legislative actions to resolve problems encountered by investors.⁵

Functions of the Investor Advocate	Reporting Obligation
<p>According to Exchange Act Section 4(g)(4), 15 U.S.C. § 78d(g)(4), the Investor Advocate shall:</p> <ul style="list-style-type: none"> (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. 	<p>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:</p> <ul style="list-style-type: none"> (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— <ul style="list-style-type: none"> (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) other information, as determined appropriate by the Investor Advocate.

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

MESSAGE FROM THE INVESTOR ADVOCATE	1
REPORT ON ACTIVITIES RELATING TO THE FISCAL YEAR 2019 POLICY AGENDA	3
Public Company Disclosure	3
Equity Market Structure	6
Fixed Income Market Reform	7
Accounting and Auditing	8
Standards of Conduct for Broker-Dealers and Investment Advisers	10
Exchange-Traded Funds	12
Enhanced Disclosure for Funds and Variable Annuities	14
Transfer Agents	15
Impact of <i>Kokesh v. SEC</i> on Enforcement Actions	15
Protecting Senior Investors	16
PROBLEMATIC INVESTMENT PRODUCTS AND PRACTICES	17
Reverse Factoring's Rising Popularity and Hidden Risks	19
Dual-Class Share Structure	20
Transition from LIBOR	21
OMBUDSMAN'S REPORT	23
Service by the Numbers	23
Service Behind the Numbers	27
Streamlined Communications with Retail Investors	29
Standards of Practice	30
Areas of Interest and Importance to Retail Investors	32
Outreach Activities	39
Outlook for Fiscal Year 2020	39
REPORT ON INVESTOR TESTING	41
SUMMARY OF IAC RECOMMENDATIONS AND SEC RESPONSES	45
ENDNOTES	50



MESSAGE FROM THE INVESTOR ADVOCATE

On behalf of the Office of the Investor Advocate, I am pleased to provide this Report on Activities for Fiscal Year 2019. This report reflects the enormous efforts of our staff, for whom I am ever grateful. In the face of an ever-increasing workload, they continued to meet the challenges and provided a remarkable level of service to American investors.

Our biggest challenge has impacted the SEC's Ombudsman, Tracey McNeil. As shown in the Ombudsman's Report below, the number of matters brought by investors to the attention of the Ombudsman has tripled during the past year. Unfortunately, staffing has not kept pace with the increasing volume of work, as Tracey continues to receive assistance from one staff attorney and two non-permanent contractors. This very small team has worked as efficiently as possible to manage the large volume of inquiries, but we are in need of additional human capital in order to maintain a high level of service.

As we reflect on our policy work during Fiscal Year 2019, we continue to appreciate the opportunity to advocate for investors. Day in and day out, policy choices are being made in Washington and major financial centers, and those choices have real impacts on the ability of Americans to invest in order to purchase homes, send children to college, and enjoy a secure retirement. Most

investors, of course, have little awareness about the regulations that protect their investments, much less the proposed changes to those regulations, so they are unlikely to submit public comments or express their views about regulatory policy. We are pleased to provide a voice for investors so that their needs will be front-of-mind while important decisions are made at the SEC and self-regulatory organizations.

Naturally, we do not always agree with the decisions of policymakers, and sometimes we openly express our criticisms. We are equally transparent about our support for policy ideas that we believe will serve investors well. But, in reality, most of our work occurs behind the scenes, as staff from our Office review thousands of pages of rulemaking drafts and provide feedback to the rulemaking teams, or as I meet one-on-one with Commissioners and other leaders to advocate privately for investors on a multitude of issues. In this Report, we provide a glimpse of the work we have done, both formally and informally, to advocate zealously for investors during Fiscal Year 2019.



In addition to our policy work, we continue our efforts to conduct basic research into the demographics of investors, their financial capability, and the ways they process information to make financial decisions. This effort, led by Dr. Brian Scholl, is beginning to bear fruit as described further in this Report.

Finally, we report on the work of the SEC's Investor Advisory Committee. I have the privilege of serving on this body, and staff for the Office of the Investor

Advocate provide day-to-day support to the Committee. The recommendations of the Investor Advisory Committee, as well as the SEC's responses to those recommendations, are discussed below.

Again, it is a distinct honor to lead a hard-working and talented group of professionals who are so devoted to serving the needs of investors. I am proud of the work they have done during Fiscal Year 2019, and I would be pleased to answer any questions from Members of Congress.

Respectfully Submitted,

A handwritten signature in black ink, appearing to read "Rick Fleming". The signature is fluid and cursive, with a large initial "R" and a long, sweeping underline.

Rick A. Fleming
Investor Advocate

REPORT ON ACTIVITIES RELATING TO THE FISCAL YEAR 2019 POLICY AGENDA

Pursuant to Exchange Act Section 4(g)(4), the Office of the Investor Advocate is required to identify areas in which investors would benefit from changes in the regulations of the Commission or the rules of self-regulatory organizations. We also are expected to 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.⁶

On June 29, 2018, the Office of the Investor Advocate filed a Report on Objectives for Fiscal Year 2019.⁷ The Report identified nine key policy areas that would be the primary focus of the Office during Fiscal Year 2019:⁸ public company disclosure, equity market structure, fixed income market reform, accounting and auditing, standards of conduct for broker-dealers and investment advisers, exchange-traded funds, enhanced disclosure for funds and variable annuities, transfer agents, and the impact of *Kokesh v. SEC* on enforcement actions. This Report on Activities describes our activities and recommendations within each of those policy areas from October 1, 2018 to September 30, 2019 (the Reporting Period). It also describes some additional work we have done to advocate for the protection of senior investors.

PUBLIC COMPANY DISCLOSURE

As described in our prior reports, the Commission has undertaken a multi-year, comprehensive Disclosure Effectiveness Initiative to review and modernize public company reporting requirements in Regulation S-K and Regulation S-X. Over the course of Fiscal Year 2019, our Office closely followed developments in this area, reviewed and commented on draft rulemaking releases, and, in a couple of instances, added our views to the public record.

On August 8, 2019, the Commission proposed amendments to Regulation S-K to modernize the description of business, legal proceedings, and risk factor disclosures that registrants are required to provide.⁹ Among other features, the proposed amendments would revise Items 101(a) (description of the general development of the business), 101(c) (narrative description of the business), and 105 (risk factors) to emphasize a more principles-based approach on the rationale that some aspects of these disclosures may be material to a particular registrant while other aspects may not. Additional rule text revisions are designed to encourage registrants to enhance the salience of information by streamlining and avoiding duplication. Perhaps the most notable substantive development was a proposal to replace the current requirement for a registrant to disclose the number of employees with a broader requirement to disclose a description

of the registrant's human capital resources. This would include any human capital measures or objectives that management focuses on in managing the business, such as measures or objectives that address the attraction, development, and retention of personnel.¹⁰ We view the proposed amendments as sensible improvements to the disclosure framework.

In two other, related Disclosure Effectiveness work streams, the Commission sought to refresh industry-specific disclosure requirements. First, on October 31, 2018, the Commission adopted rules to update the disclosures provided by registrants that have material mining operations.¹¹ Second, on September 17, 2019, the Commission proposed rules to update the statistical disclosures provided by bank and savings and loan registrants.¹² The mining property disclosure requirements and the banking disclosure requirements are to be consolidated in new subparts of Regulation S-K and would replace obsolete industry guides. These rulemaking releases require considerable technical expertise to evaluate and, not surprisingly, have attracted few comment letters with direct bearing on the informational needs of investors. For our part, we advocated primarily for requiring the disclosures to be provided in a machine-readable format.¹³ For example, the Commission requires mining registrants to disclose for each material property the "location, accurate to within one mile, using an easily recognizable coordinate system."¹⁴ We believe that if the Commission were to specify the coordinate system and require that the location data be provided in a structured format, investors would more easily be able to run queries and retrieve the information that they want (such as a registrant's exposure to drought or geopolitical risk).¹⁵ Although we were disappointed when the

Commission opted not to prioritize structured disclosures in this rulemaking and in the banking disclosure rulemaking,¹⁶ we believe it is only a matter of time before machine-readability is viewed as imperative. In fact, the Open, Public, Electronic and Necessary (OPEN) Government Data Act, signed into law on January 14, 2019, provides a sweeping, government-wide mandate for all federal agencies to publish government information in a machine-readable format by default.¹⁷

There were other rulemakings that we reviewed that were not part of the Disclosure Effectiveness Initiative but were otherwise relevant to disclosure, capital raising, and corporate governance. On September 26, 2019, the Commission adopted a new rule to allow all issuers to gauge investor interest in a potential initial public offering or other registered securities offering through discussions with certain types of institutional investors prior to, or following, the filing of a registration statement.¹⁸ We considered the earlier objections of The Credit Roundtable, a group of fixed-income institutional asset managers focused principally on the primary market for investment-grade corporate bonds, concerning a 2018 bill before the U.S. House of Representatives and a 2009 rulemaking proposal that was similar but never finalized.¹⁹ The Credit Roundtable expressed concern that underwriters' pre-marketing of new bond issues could exacerbate the pressure that many Roundtable members say induces them to submit orders for book-building based on suboptimal information. In our outreach to the Roundtable, however, we determined that the present rulemaking likely would not impact the reported problem one way or the other. This is because there is no regulation of the book-building process, meaning that underwriters already may sell to whomever they want, need not extend the

offering to all investors equally, and need not hold open the offering for any prescribed period of time. Moreover, the practice of limited pre-marketing was already common in the fixed-income market. We value our involvement in helping gather and interpret input from these market participants,²⁰ and we believe the problem they have reported deserves further study.

In addition to reviewing the disclosure requirements for public offerings of securities, the Commission has begun a broad review of the regulatory framework for non-public offerings.²¹ On June 18, 2019, the Commission published a concept release seeking public comment on ways to simplify, harmonize and improve the exemptions from the Securities Act registration requirements.²² We agree that a fresh examination of these exemptions is warranted in light of the widely acknowledged complexity of the exemptive framework and the surge in capital-raising through exempt offerings. Nonetheless, we worry that the Commission may be inclined to implement recommendations that would further erode the protections of Securities Act registration for companies seeking to raise capital from retail investors, without a commensurate benefit to investors or a genuine improvement in capital formation. On July 11, 2019, we submitted a comment letter to the rulemaking file questioning some of the assumptions implicit in the recommendations put forward in the release.²³ Citing data from the Federal Reserve Board's Survey of Consumer Finances, we questioned whether it is reasonable to expect that retail investors who do not already meet the definition of accredited investor will have the wherewithal to invest in exempt offerings and earn higher risk-adjusted returns, as compared to investing in the public markets. Subsequently, the

U.S. House of Representatives held a hearing on this topic during which one of the witnesses—Duke University School of Law Professor Elisabeth de Fontenay—argued more forcefully that:

If Congress and the SEC are concerned about investment opportunities for retail investors, the solution lies not in throwing retail investors to the wolves in the private markets, but rather in ensuring a healthy pipeline of companies going and remaining public. This may require reversing course on Congress's approach of allowing companies to remain private indefinitely, despite multi-billion-dollar valuations and widely dispersed share ownership.²⁴

Lastly, the Commission is looking at the proxy process. On November 15, 2018, SEC staff held a public roundtable to discuss: (1) the proxy solicitation and voting process; (2) shareholder engagement through the shareholder proposal process; and (3) the role of proxy advisory firms.²⁵ The third item in the preceding list is the subject of considerable controversy. For instance, corporate executives sometimes disagree with the voting recommendations of proxy advisory firms that institutional investors have engaged to provide research and assistance with voting in annual and special meetings. Corporate lobbying groups calling for greater regulation of proxy advisory firms claim that those firms' voting recommendations contain errors and undisclosed conflicts of interest. In an April 8, 2019 speech, the Investor Advocate summarized the prevailing view of institutional investors, which is that the proxy advisory firms perform essential services relatively well, and that there is no market failure warranting further regulatory intervention.²⁶ Moreover, we reviewed

many of the alleged “errors” and determined that most would be more appropriately characterized as differences of opinion. Nevertheless, the Commission waded into the fray. On August 21, 2019, the Commission published guidance clarifying the fiduciary obligations of investment advisers in fulfilling their proxy-voting responsibilities.²⁷ The Commission also published an interpretation concluding that proxy-voting advice provided by proxy advisory firms generally constitutes a “solicitation” under the federal proxy rules, and providing related guidance about the application of the antifraud rule to voting advice.²⁸ We believe that these interpretive releases may have the effect of inhibiting investment advisers’ engagement in proxy voting and, arguably, should have been subject to a notice and comment process.

In a related action, the Commission on November 5, 2019, proposed a new rule that, among other things, would require proxy advisory firms to give a preview of their voting recommendations to the subject companies before communicating with the investor clients who purchased the advice.²⁹ On the same day, the Commission proposed rule changes that would make it easier for companies to exclude shareholder proposals from corporate proxy statements.³⁰ Because the proposals occurred after the conclusion of Fiscal Year 2019, we will discuss them in greater detail in our next Report on Activities.

EQUITY MARKET STRUCTURE

In November 2018, the Commission adopted rules that, for the first time, require broker-dealers to disclose the handling of institutional orders to customers under existing Rule 606 of Regulation NMS.³¹ This should provide customers with better information to evaluate the quality of execution for the orders they place.³² We evaluated the proposal, including questions surrounding the proposed definition of institutional order and its impact on the ability

of institutional customers to obtain information about all their orders, and we are pleased that the Commission finalized this proposal. We continue to monitor the implementation schedule for this rule, originally set for May 20, 2019, but partially and conditionally extended to provide additional time for broker-dealers to complete their preparation through the spring of 2020.³³

In December 2018, the Commission adopted a rule to conduct a transaction fee pilot for NMS stocks.³⁴ The rule will subject the stock exchanges to new temporary pricing restrictions across two test groups and thereby reduce or eliminate the use of so-called “maker-taker” fee-and-rebate pricing for transactions in those securities. We evaluated the proposed pilot and believe that it can potentially answer questions concerning broker-dealer conflicts of interest in order routing behavior. Accordingly, the Investor Advocate, as a voting member of the Investor Advisory Committee, supported a recommendation to the Commission to move forward with the pilot.³⁵ In March 2019, the Commission partially stayed the pilot pending judicial review after several national securities exchanges challenged the rule in court,³⁶ and we continue to monitor the ongoing litigation.

In addition to reviewing Commission rulemakings, the Office of the Investor Advocate is responsible for analyzing the potential impact on investors of proposed rules of SROs.³⁷ In furtherance of this objective, the Office has analyzed the potential impact of various SRO proposals related to equity market structure. For example, in June 2019, the Cboe EDGA Exchange, Inc. (EDGA) proposed to create a 4-millisecond speedbump for all executable orders submitted to the exchange, except for modification and cancel instructions for existing quotes.³⁸ In September 2019, the Commission instituted proceedings to determine whether to approve or disapprove this rule proposal, soliciting further comment as to whether the proposal was consistent

with the Exchange Act.³⁹ We reviewed the proposal and the comments submitted,⁴⁰ and we recently recommended that the Commission disapprove the proposed speedbump.⁴¹

There were numerous other SRO rule proposals that we monitored closely during the Reporting Period. As examples, we have reviewed proposed rules to give order book priority for equity orders submitted on behalf of retail investors,⁴² a request for comment from NASDAQ on initial listing requirements related to trading liquidity,⁴³ and the application to register a new equity exchange, the Long-Term Shareholders Exchange.⁴⁴ During the reporting period, the Division of Trading and Markets published guidance to assist the national securities exchanges and FINRA in preparing fee filings that meet their burden to demonstrate that proposed fees are consistent with the requirements of the Exchange Act,⁴⁵ which we hope will make our review of significant SRO fee filings more efficient and effective.

We continue to monitor progress on the implementation of the Commission's Consolidated Audit Trail, which is intended to enhance, centralize, and generally update the regulatory data infrastructure available to market regulators.⁴⁶

FIXED INCOME MARKET REFORM

As discussed in the Report on Activities for Fiscal Year 2018,⁴⁷ on September 17, 2018, the Office of the Investor Advocate filed a public comment letter in response to MSRB Regulatory Notice 2018-15, Request for Comment on Draft Amendments to MSRB Rules on Primary Offering Practices (Regulatory Notice 2018-15).⁴⁸ In pertinent part, Regulatory Notice 2018-15 sought comment on two issues of particular interest to the Office of the Investor Advocate: (1) whether to auto-populate into Form G-32 certain information that is submitted to Depository Trust Company's (DTC) New Issue

Information Dissemination Service (NIIDS) but is not currently required to be provided on Form G-32;⁴⁹ and (2) whether to require additional information on Form G-32 that is not currently provided to NIIDS.⁵⁰ During the Reporting Period, the MSRB proposed and received Commission approval to amend MSRB rules relating to primary offerings of municipal securities for brokers, dealers and municipal securities dealers.⁵¹ The Office reviewed the proposals and the comments submitted, and was encouraged to see that the proposed rules addressed many of the points raised in our September 2018 comment letter.⁵²

On June 11, 2019, the Commission's Fixed Income Market Structure Committee (FIMSAC)⁵³ adopted a recommendation to curb the practice known as "pennying" in the corporate and municipal bond auction process.⁵⁴ Typically, a bond dealer places a retail client's bid-wanted out to the market and compiles the bids received to determine the winning bid, but a broker engages in "pennying" when it nominally exceeds the high bid in order to purchase for its own account rather than execute the trade with the highest external bidder.⁵⁵ During the MSRB's first quarterly board meeting of Fiscal Year 2020, the MSRB Board approved acting on the FIMSAC's recommendation that the MSRB coordinate with FINRA on further analysis of the issue.⁵⁶ Our Office will continue to monitor what, if any, actions the MSRB and FINRA take to address the practice of pennyng.

Based on another recommendation from the FIMSAC,⁵⁷ FINRA requested public comment on a pilot program to study potential changes to the public dissemination of corporate bond block trades.⁵⁸ In the request, FINRA sought input from the public on increasing current dissemination caps for corporate bond trades and delaying the dissemination of any information about large trades above the proposed dissemination caps for 48 hours. Currently, FINRA's Trade Reporting

and Compliance Engine (TRACE) disseminates information to the marketplace about corporate bond trades, including trade price and size, immediately upon receipt. FINRA explained that, by delaying the reporting of large bond trades, the pilot program would provide data regarding the balance between trade transparency and bond liquidity. During the Reporting Period, we reviewed the public comments submitted to FINRA, many of which expressed concerns about the proposed pilot. We continue to monitor this issue for further developments, and we are likely to recommend disapproval if a similar proposal is submitted to the Commission for approval. We share commenters concerns that information asymmetry in the market could benefit a small subset of larger market participants at the expense of other participants, including small institutional investors.

ACCOUNTING AND AUDITING

On December 7, 2018, SEC Chairman Jay Clayton, then-SEC Chief Accountant Wes Bricker, and Public Company Accounting Oversight Board (PCAOB) Chairman William D. Duhnke III issued a joint statement that declared:

The bedrock of this [global] capital market system is high quality, reliable financial statements. This is indisputable. Without high quality and reliable financial information, capital markets do not function well.

In turn, confidence in the quality and reliability of financial statements is driven by a combination of quality audit services and regulatory oversight. Effective audits and regulatory oversight require timely access to comprehensive information.⁵⁹

While their public statement addressed certain international issues, these words have special resonance for the U.S. market. Investor confidence

in the audited financial statements of public companies listed in the U.S. helps to make our capital markets the deepest and most liquid in the world.

Hence the critical role of the PCAOB, which was established by the Sarbanes Oxley Act (SOX) to oversee the audits of public companies and SEC-registered brokers and dealers. The PCAOB's mission is to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports. During the Reporting Period, we monitored developments at the PCAOB, and we will continue to do so. In particular, we find it troubling that the PCAOB has not convened a meeting of its Investor Advisory Group since November 2018.⁶⁰

In addition, we monitored activity at the Financial Accounting Standards Board (FASB) as well as developments related to auditing and accounting policies at the Commission. During the Reporting Period, this has included a significant SEC rulemaking proposal to expand the exemption from the requirement, under Section 404(b) of the Sarbanes-Oxley Act, for issuers to obtain independent auditor attestation of management's assessment of the effectiveness of the company's internal control over financial reporting (ICFR).

On May 9, 2019, the Commission proposed amendments that would exclude companies with annual revenue of less than \$100 million from the auditor attestation requirement.⁶¹ Commenters representing investors and investor interests consistently have opposed this proposal to lift the auditor attestation requirement for the specified companies.⁶²

The economic analysis in the proposing release, in particular, triggered criticisms from commenters representing investors and various academics.

These criticisms included assertions that the proposing release contained statements or analytic interpretations that were misleading, misrepresentative, had omitted critical information, or had relied on outdated information. These are very serious charges that raise the specter of regulatory hypocrisy, given that the SEC often takes enforcement action against market participants who misrepresent the facts or cherry-pick data to present misleading half-truths.

For example, accounting professors Weili Ge, Allison Koester, and Sarah McVay jointly filed a comment letter (the Ge Letter) objecting to the way in which the proposal characterized a study they had conducted.⁶³ Their study,⁶⁴ which quantified measurable costs and benefits of exempting non-accelerated filers from ICFR auditor attestation requirement, was cited widely in the proposing release (as the “Ge et al. 2017 Study”). Yet the Ge Letter takes issue with how their Study is characterized, because “our inference is *precisely the opposite of how the release characterizes our findings*” [emphasis added].⁶⁵ According to the professors, “We believe that 404(b) attestation would materially reduce internal control misreporting.”

Another group of professors, in their comment letter, called the proposal’s economic analysis “misleading” in one important respect. The comment letter, co-authored by Mary Barth and three other business school professors (the Barth Letter), noted that the economic analysis focused on the rate, but not the magnitude, of restatements among companies that would be affected by the proposed rollback of the 404(b) requirement. In their own preliminary analysis of companies that would be affected by the proposed rule, the commenters found 11 companies that had restated

their financial statements in 2018. These companies restated a total of approximately \$65 million in net income and lost more than \$294 million in stock market value. Those costs dwarf the projected average annual cost savings of \$210,000 per affected company, or a total of \$75 million in annual savings across all affected companies.⁶⁶

Commenters also criticized the proposal’s economic analysis of a phenomenon called “bunching.” Bunching refers to an attempt by companies to avoid auditor attestation by staying just below the \$75 million public float threshold that would trigger the current requirement. The proposing release interprets bunching as evidence that managers consider the costs of auditor attestation to be significant: “[S]tudies have demonstrated that smaller reporting issuers find the total compliance costs associated with the ICFR auditor attestation requirement to be significant by providing evidence that non-accelerated filers may seek to avoid crossing the \$75 million public float threshold and becoming accelerated filers.”⁶⁷

But that conclusion is unfounded, the Barth Letter asserts, because it fails to consider another plausible explanation of bunching: company managers might seek to avoid an audit, not simply to save the company money, but “because they are engaging in opportunistic behavior, and the audit would increase the probability such behavior would be detected.”⁶⁸ Indeed, as the Barth Letter notes, one academic study on bunching found higher levels of earnings management among companies whose public float fell just below the \$75 million threshold.⁶⁹ Although the proposing release’s economic analysis cited this study, it omitted any mention of the study’s discussion of earnings management.

Commissioner Robert Jackson, meanwhile, criticized the proposing release’s economic analysis of bunching from a different perspective. He stated:

[T]he proposal’s analysis of the costs of Section 404(b) relies heavily on a study using data from 2004 to show that companies with a public float under \$75 million—the level under which auditor attestation is not required—seemed to “bunch” under that threshold. . . . If that were still true in today’s markets, that would offer some basis for this proposal. But it’s not. The proposal makes no effort to update these studies, simply claiming that old data is enough basis for new rules.⁷⁰

Commissioner Jackson also asserted that the economic analysis made “no serious attempt to evaluate the benefits of attestation.”⁷¹ To fill that gap, his Office produced its own analysis of investor reactions to news of an internal control failure in two groups of companies: those that would receive a rollback of 404(b) under the proposal and those that would not. “The evidence is striking,” Commissioner Jackson concludes, because “[t]he data show we are proposing today to roll back 404(b) for exactly the group of companies where investors care about the benefits of auditor attestation *most*” [Emphasis in original].⁷²

Finally, the economic analysis drew criticism for not subjecting the proposal to a rigorous analysis of the risk of fraud among affected companies. The economic analysis does cite academic studies on the risk of fraud. Nonetheless, the Barth Letter argues that the Commission itself is in the best position to quantify the extent of fraud and suspicious or misstated filings for affected companies. Specifically, the letter argued, the Commission should have—but failed to—analyze four data sources at its disposal: the historical rate of

fraud; the incidence of SEC Accounting and Auditing Enforcement Releases; the incidence of Wells Notices; and the incidence of formal SEC investigations.⁷³

In our view, the proposed rule has profound implications for investor protection. Thus, we find the depth and range of criticisms from investor groups and scholars to be concerning. Should this proposal advance toward adoption, we urge that the economic analysis be amplified to address these criticisms.

STANDARDS OF CONDUCT FOR BROKER-DEALERS AND INVESTMENT ADVISERS

On June 5, 2019, the Commission adopted a package of rulemakings and interpretations that, according to the Commission, would enhance the quality and transparency of retail investors’ relationships with investment advisers and broker-dealers, bring the legal requirements and mandated disclosures in line with reasonable investor expectations, and preserve access (in terms of choice and cost) to a variety of investment services and products.⁷⁴ These actions followed an April 18, 2018 Commission proposal that was discussed in our Report on Objectives for Fiscal Year 2019.⁷⁵ Specifically, these actions included new Regulation Best Interest,⁷⁶ a new Form CRS Relationship Summary,⁷⁷ and two separate new interpretations under the Investment Advisers Act of 1940.⁷⁸

Regulation Best Interest

Regulation Best Interest imposes a new standard of conduct specifically for broker-dealers, intended to enhance the broker-dealer standard of conduct beyond existing suitability obligations. According to the adopting release, the new standard of conduct draws from key fiduciary principles and cannot be satisfied through disclosure alone. It provides specific requirements to address certain aspects of the relationships between broker-dealers

and their retail customers, including certain conflicts related to compensation.⁷⁹ In short, when making a recommendation of a securities transaction or an investment strategy involving securities, a broker-dealer must act in the retail customer's best interest and cannot place its own interests ahead of the customer's interests.

More specifically, Regulation Best Interest includes the following components:

- *Disclosure Obligation:* Broker-dealers must disclose material facts about the relationship and recommendations, including specific disclosures about the capacity in which the broker is acting, fees, the type and scope of services provided, conflicts, limitations on services and products, and whether the broker-dealer provides monitoring services.⁸⁰
- *Care Obligation:* A broker-dealer must exercise reasonable diligence, care and skill when making a recommendation to a retail customer. The broker-dealer must understand potential risks, rewards, and costs associated with the recommendation. The broker-dealer must then consider these factors in light of the retail customer's investment profile and make a recommendation that is in the retail customer's best interest. The final regulation, in a change from its originally proposed iteration, explicitly requires the broker-dealer to consider the costs of the recommendation.⁸¹
- *Conflict of Interest Obligation:* The broker-dealer must establish, maintain, and enforce written policies and procedures reasonably designed to identify and at a minimum disclose or eliminate conflicts of interest. This obligation specifically requires policies and procedures to:
 - » Mitigate conflicts that create an incentive for the firm's financial professionals to place

their interest or the interests of the firm ahead of the retail customer's interest;

- » Prevent material limitations on offerings, such as a limited product menu or offering only proprietary products, from causing the firm or its financial professional to place his or her interest or the interests of the firm ahead of the retail customer's interest; and
 - » Eliminate sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sale of specific securities or specific types of securities within a limited period of time.⁸²
- *Compliance Obligation:* In a change from the proposed version of Regulation Best Interest, the final version requires broker-dealers to establish, maintain and enforce policies and procedures reasonably designed to achieve compliance with Regulation Best Interest as a whole.⁸³

Regulation Best Interest, in a change from its originally proposed iteration, applies to account recommendations, including recommendations to roll over or transfer assets in a workplace retirement plan account to an individual retirement account (IRA), and recommendations to take a plan distribution. It also applies to implicit "recommendations to hold" that result from agreed-upon account monitoring.⁸⁴

Form CRS Relationship Summary

The Form CRS Relationship Summary requires investment advisers and broker-dealers to deliver certain information to retail investors at the beginning of their relationship. Firms must summarize information about services, fees and costs, conflicts of interest, the legal standard of conduct, and whether or not the firm and its financial professionals have disciplinary history. This relationship summary utilizes a standardized question-and-answer format to serve as a guide for disclosure and prompt additional conversation

between investors and financial professionals. The form also directs investors to the Commission’s investor education website, www.Investor.gov, which offers the investing public educational information, including a series of educational videos designed to provide ordinary investors with some basic information about broker-dealers and investment advisers.⁸⁵

Commission Interpretation—Standard of Conduct for Investment Advisers

An investment adviser owes a fiduciary duty to its clients under the Investment Advisers Act. This duty is principles-based and applies to the entire relationship between an investment adviser and its client. According to the Commission, its new “Commission Interpretation—Standard of Conduct for Investment Advisers” serves to reaffirm, and in some cases clarify, certain aspects of the federal fiduciary duty that an investment adviser owes to its clients.⁸⁶

Commission Interpretation—Broker-Dealer Exclusion

A broker-dealer exclusion under the Investment Advisers Act excludes from the definition of investment adviser—and thus from the application of the Investment Advisers Act—a broker or dealer whose performance of advisory services is solely incidental to the conduct of its business as a broker or dealer and receives no special compensation for those services. The “Commission Interpretation—Broker-Dealer Exclusion” confirms and clarifies the Commission’s interpretation of the “solely incidental” prong of the broker-dealer exclusion of the Advisers Act. Specifically, the final interpretation states that a broker-dealer’s advice as to the value and characteristics of securities or as to the advisability of transacting in securities falls within the “solely incidental” prong of this exclusion if the advice is provided in connection with and is reasonably related to the broker-dealer’s primary business of effecting securities transactions.⁸⁷

Public Statement of the Investor Advocate Regarding the Commission’s Standard of Conduct Rulemaking Package

On June 5, 2019, following the Commission vote to adopt the aforementioned rulemakings and interpretations, the Investor Advocate issued a public statement that included the following assessment:

Regulation Best Interest, while not as strong as it could be, is a step in the right direction because it is an improvement over the existing suitability standard for broker-dealers. However, what investors have gained in [Regulation Best Interest] has been undermined by what investors have lost in the Commission’s interpretation of the fiduciary duty that applies to investment advisers. And while the new Form CRS Relationship Summary will provide useful information to investors about their particular financial professional and account, it likely will not achieve its original goal of preventing the financial harm that results from investor confusion about the differences between investment advisers and broker-dealers. Finally, while the interpretation of “solely incidental” presented an opportunity to sharpen the distinctions between broker-dealers and investment advisers, the interpretation merely serves to formalize the Commission’s longstanding deference to broker-dealers who engage in conduct that is advisory in nature.⁸⁸

EXCHANGE-TRADED FUNDS

In our Report on Objectives for Fiscal Year 2019, we indicated that we supported Commission efforts to permit exchange-traded funds (ETFs) that satisfy certain conditions to operate without the expense and delay of obtaining an exemptive order insofar as such efforts do not sacrifice investor protection.⁸⁹ On September 25, 2019, the Commission adopted a new rule and form amendments designed to

modernize the regulation of ETFs by establishing a clear and consistent framework for the vast majority of ETFs operating today.⁹⁰ We believe the ETF Rule will facilitate greater competition and innovation in the ETF marketplace—increasing the number of ETF options available to investors—without sacrificing investor protection. It also will allow ETFs to come to market more quickly without the expense and delay of applying for individual exemptive relief.

ETFs are hybrid investment products not originally allowed under the U.S. securities laws. Their shares trade on an exchange like a stock or closed-end fund, but they also allow identified large institutions to transact directly with the fund. Since 1992, the Commission has issued more than 300 exemptive orders allowing ETFs to operate under the Investment Company Act.⁹¹ ETFs have grown substantially in that period, and today there are approximately 2,000 ETFs with over \$3.3 trillion in total net assets.⁹² Investors use ETFs for a variety of purposes, including core components of long-term investment portfolios, investment of temporary cash holdings, and for hedging portfolios.

ETFs relying on the ETF Rule will need to comply with standardized conditions.⁹³ First, an ETF will be required to provide daily portfolio transparency on its website. Second, an ETF will only be permitted to use “custom baskets” (baskets of securities that do not reflect a pro-rata representation of the fund’s portfolio or that differ from the initial basket used in transactions on the same business day) if the ETF adopts written policies and procedures regarding the construction and acceptance of custom baskets that are in the best interests of the ETF and its shareholders. Additionally, the rule requires an ETF to disclose certain information on its website, including historical information regarding premiums and discounts and bid-ask spread information. These website disclosures should help inform investors

about the costs of investing in an ETF and the efficiency of an ETF’s arbitrage process. Finally, the rule also will require an ETF to comply with certain recordkeeping requirements.

The ETF rule will be available to ETFs organized as open-end funds, the structure for the vast majority of ETFs today.⁹⁴ ETFs organized as unit investment trusts (UITs), leveraged or inverse ETFs, ETFs structured as a share class of a multi-class fund, and non-transparent ETFs will not be able to rely on the rule. To help create a consistent ETF regulatory framework, one year after the effective date of the ETF Rule (December 23, 2019), the Commission will rescind exemptive relief previously granted to ETFs that will be permitted to operate in reliance on the rule.⁹⁵ The Commission also adopted, as part of the ETF Rule, several ETF registration form amendments intended to provide more useful, ETF-specific information to investors who purchase ETF shares on an exchange.⁹⁶

We stated in our Report on Objectives for Fiscal Year 2019 that, while we supported the Commission’s rulemaking efforts with respect to traditional, “plain vanilla” ETFs, we believed the treatment of leveraged and inverse ETFs and non-transparent ETFs necessitated special consideration.⁹⁷ We are encouraged that these products will not be able to rely on the ETF Rule.⁹⁸ The Commission acknowledged the special investor protection concerns presented by leveraged and inverse ETFs, indicated that it should complete a broader consideration of the use of derivatives by registered funds before considering allowing leveraged and inverse ETFs to rely on the rule, and explicitly included a condition that excludes leveraged and inverse ETFs from the rule’s scope.⁹⁹ These ETFs must instead continue to rely on individualized exemptive relief. Additionally, as noted above, an ETF relying on the rule must provide daily portfolio transparency on its website, necessitating that non-transparent products also continue to rely on individualized exemptive relief.¹⁰⁰

The exclusion of these non-traditional ETFs from the ETF Rule, as well as the rule's important investor protection safeguards, helped earn the rule accolades from many market commentators as a "win" for both investors and the ETF industry.¹⁰¹ We will continue to work with Commission staff on rulemaking efforts that similarly protect the interests of investors while modernizing outdated regulatory frameworks.

ENHANCED DISCLOSURE FOR FUNDS AND VARIABLE ANNUITIES

In our Report on Objectives for Fiscal Year 2019, we discussed the importance of fund disclosures, noting that millions of individuals invest in funds as a means of achieving their financial goals, such as saving for retirement and funding their children's educations.¹⁰² We stated that, given this level of investor participation in funds, it makes sense for the Commission to seek the input of Main Street investors on how they use, and how to improve, fund disclosures.¹⁰³ We also stated that we continue to support the development of a summary prospectus for variable annuities that would disclose the key facts that investors need to know about the risks and costs, as well as the benefits, of their investment.¹⁰⁴

In June 2018, the Commission issued a request for comment to elicit the views of retail investors with respect to mutual funds, ETFs, and other pooled investment vehicles.¹⁰⁵ The purpose of the request for comment was to help the Commission learn how individual investors and other interested parties use disclosures by funds and how investors believe those disclosures could be improved to help investors make investment decisions.

On October 30, 2018, informed in part by responses to this request for comment, the SEC proposed rule and form amendments intended to help investors make informed investment

decisions regarding variable annuity and variable life insurance contracts.¹⁰⁶ Among other things, these proposed changes would permit a person to satisfy its prospectus delivery obligations under the Securities Act for a variable annuity or variable life insurance contract by sending or giving a summary prospectus to investors and making the statutory prospectus available online.

More specifically, the Commission proposed new rule 498A under the Securities Act, which would permit the use of two distinct types of contract summary prospectuses: initial summary prospectuses covering variable contracts offered to new investors, and updating summary prospectuses for existing investors. The initial summary prospectus would include an overview of the contract, a table summarizing certain key information about the contract's fees, risks, and other important considerations, and more detailed disclosures relating to fees, purchases, withdrawals, and other contract benefits. The updating summary prospectus would include a brief description of certain changes to the contract that occurred during the previous year, as well as the key information table from the initial summary prospectus.

In certain types of variable contracts, investors allocate their investment to one or more underlying investment options (typically, mutual funds). Key information about these funds would be provided in both the initial summary prospectus and updating summary prospectus.¹⁰⁷

The Commission also proposed related amendments to Forms N-3, N-4, and N-6—the registration forms for variable contracts—designed to update and enhance the disclosure regime for these investment products. These amendments are intended to improve the content, format, and presentation of information to investors, including by updating the required disclosures to reflect

industry developments (e.g., the prevalence of optional insurance benefits in today's variable contracts). In addition, the Commission proposed amendments to require the use of the machine-readable Inline eXtensible Business Reporting Language (Inline XBRL) format for the submission of certain required disclosures in the variable contract statutory prospectus. This would provide a mechanism for allowing investors, their investment professionals, data aggregators, and other data users to efficiently analyze and compare the available information about variable contracts.¹⁰⁸

As we stated in our Report on Objectives for Fiscal Year 2019, we have consistently advocated for enhanced disclosure concerning separate accounts that offer variable annuities, including the development of a summary prospectus for variable annuities,¹⁰⁹ and we are encouraged by the Commission's proposed rule and form amendments in this area. We look forward to working with Commission staff as they evaluate comments on the proposal and as they consider recommending additional action.

TRANSFER AGENTS

Transfer agents are critical gatekeepers who perform an important role in investor protection, but they have received relatively little regulatory attention over the years. Thus, our Office was encouraged to see transfer agents highlighted on a variety of occasions by the Commission during Fiscal Year 2019. For example, in March 2019, Chairman Clayton and Trading and Markets Director Brett Redfearn presented joint remarks wherein Director Redfearn acknowledged the potential gap in current protection for retail investors.¹¹⁰ Director Redfearn highlighted the role transfer agents play in removing restrictive legends, and the potential harm improper removal of such legends could pose for investors.¹¹¹

Director Redfearn concluded his remarks on transfer agents by stating, "I anticipate that the Division of Trading and Markets staff will present a recommendation to the Commission to update the transfer agent rules, including considering a rule that would specify transfer agent obligations with respect to the tracking and removal of restrictive legends."¹¹²

In an April 2019 speech, the Investor Advocate echoed the concern surrounding the improper removal of restrictive legends, stating ". . . a refresh of the antiquated transfer agent rules could curb abuses such as the improper removal of restrictive legends, a practice that facilitates the illegal public distribution of securities."¹¹³ Then in May 2019, Peter Driscoll, Director of the SEC's Office of Compliance Inspections and Examinations (OCIE), noted that "OCIE plans to examine the role of transfer agents in the issuance of microcap securities and the removal of legends from restricted stocks."¹¹⁴

According to the Commission's agenda that was publicized in accordance with the Regulatory Flexibility Act, Commission staff is considering updates and refinements to the Commission's transfer agent regulatory regime.¹¹⁵ We welcome a staff recommendation to modernize transfer agent regulations, and we will continue to monitor developments in this area.

IMPACT OF *KOKESH V. SEC* ON ENFORCEMENT ACTIONS

In our Report on Objectives for Fiscal Year 2019, we discussed the U.S. Supreme Court's June 2017 decision in *Kokesh v. SEC*¹¹⁶ and the limits it placed on the Commission's ability to recover funds on behalf of harmed investors.¹¹⁷ The Division of Enforcement's 2019 Annual Report indicates that the *Kokesh* decision continues to impact the

Commission's ability to disgorge and return funds to investors injured by long-running frauds, such as Ponzi schemes, that often directly impact retail investors.¹¹⁸ The Division of Enforcement estimates that the Commission has had to forgo approximately \$1.1 billion dollars in disgorgement in filed cases because of the *Kokesh* decision.¹¹⁹

We are pleased that legislation has recently passed the House of Representatives, which would allow the Commission to seek to recover illegal profits from defendants for 14 years after an alleged securities violation.¹²⁰ To prevent further harm to investors, we are hopeful that the legislation or a reasonable alternative will soon pass the Senate and be signed into law.

PROTECTING SENIOR INVESTORS

During the Reporting Period, our Office continued its efforts to raise public awareness on the issues of elder financial exploitation and protecting seniors. In June 2019, we published a white paper titled, "How the SEC Works to Protect Senior Investors."¹²¹ This followed an earlier paper entitled "Elder Financial Exploitation: Why it is a concern, what regulators are doing about it, and looking ahead," which was published in June 2018.¹²² The recent paper has been distributed at three events, two of them at SEC Headquarters in Washington, D.C. and a third at a conference for investment professionals in Rockville, Maryland. In addition, the paper's author, staff member Stephen

Deane, delivered two presentations on protecting seniors before audiences comprising legal and investment advice professionals.

In August 2019, FINRA announced that it was conducting a retrospective review to assess its rules and processes aimed at protecting senior investors from financial exploitation.¹²³ FINRA requested public comment on a number of questions related to this issue. Among other things, FINRA asks whether it should extend the safe harbor in Rule 2165, which permits broker-dealers to place a temporary hold on a disbursement of funds or securities from the account of a "specified adult" customer—including persons age 65 and older—when the firm reasonably suspects financial exploitation.

We commend FINRA for launching this holistic review. We were also pleased to see a number of substantive comments submitted in response. The comments came from a variety of entities and expressed a range of views, reflecting the challenges of protecting seniors while respecting their rights, autonomy and dignity. We hope that the initiative also will produce data on how firms are using the new tools they have received in recent years as a result of FINRA rule changes and new state laws aimed at protecting senior investors from financial exploitation. We will continue to monitor FINRA's initiative.

PROBLEMATIC INVESTMENT PRODUCTS AND PRACTICES

Among other statutory duties, 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.¹²⁴

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

- Investor Alerts, Tips, and Bulletins issued by the SEC, FINRA, and the North American Securities Administrators Association, Inc. (NASAA) during Fiscal Year 2019;
- SEC enforcement actions and FINRA disciplinary actions during the Reporting Period;
- NASAA's Activity Report,¹²⁵ 2019 Enforcement Report,¹²⁶ and Top Investor Threats;¹²⁷

- The SEC's Office of Compliance Inspections and Examinations' Examination Priorities for 2019;¹²⁸
- SEC and SRO staff reports providing guidance and interpretations relating to investment products;
- Discussions and correspondence with SRO staff, including a November 12, 2019, letter from Nanette D. Lawson, Interim Chief Executive Officer and Chief Financial Officer, MSRB, highlighting municipal market practices that may have an adverse impact on retail investors;¹²⁹ and
- Discussions with the SEC Retail Strategy Task Force.¹³⁰

The table below lists certain potentially problematic products or practices during Fiscal Year 2019 as reported by these sources. Although not exhaustive, the lists reflect some of the concerns of these organizations. Details regarding these products and practices are available on these organizations' websites.

SEC ¹³¹	NASAA ¹³²
<ul style="list-style-type: none"> • Initial Coin Offerings, Cryptocurrency, and Blockchain • Impersonation of a “Regulator” or SEC Employee, or False Claims of SEC or CFTC Approval • Scams Related to Natural Disasters • Investment Fees and Expenses • Affinity Fraud • Social Sentiment Investing Tools (trading based on social media) • Fraudsters Offering “Charitable” Investments 	<ul style="list-style-type: none"> • Real Estate Related Investments • Oil/Gas Investments • Ponzi/Pyramid Schemes • Promissory Notes • Affinity Fraud • Variable Annuities Sales Practices • Robo-Advisors • Cross-Selling of Unsuitable Products and Services • Opportunity Zone Investments • Initial Loan Procurements (crowdfunding for blockchain companies) • Marijuana-Related Investments • Contracts for Difference (speculative derivative contracts)

FINRA ¹³³	MSRB ¹³⁴
<ul style="list-style-type: none"> • Stock Fraud in the Wake of Hurricanes • Social Sentiment Investing Tools • Broker Imposter Scams (confirming broker registration) • Fake Check Scams • High-Yield CD Offers as Bait for High-Commission Investments • Fraudulent Binary Options 	<ul style="list-style-type: none"> • Pennyning¹³⁵ • Potential Impact of the SEC’s October 2019 Proposed Exemptive Order¹³⁶ • Potential Impact of Regulation Best Interest • London Interbank Offered Rate (LIBOR) • Sustained Historically Low Interest Rates • Cyberattacks • Climate Factors • Municipal Market Disclosure Practices

Each of the products and practices listed above were areas of concern for investors during the Reporting Period. Based on our review of the resources described above and consultations with knowledgeable professionals, however, we will highlight three areas of concern: reverse factoring’s rising popularity and hidden risks; dual-class share structures; and the transition from the London

Interbank Offered Rate (LIBOR). Previous reports have highlighted other issues, including initial coin offerings,¹³⁷ binary options,¹³⁸ public non-traded REITS,¹³⁹ municipal market disclosure practices,¹⁴⁰ below minimum denomination positions in municipal securities,¹⁴¹ and Simple Agreements for Future Equity in crowdfunding investments.¹⁴²

REVERSE FACTORING'S RISING POPULARITY AND HIDDEN RISKS

In recent years, there has been an increase in the number of companies working with intermediaries to arrange trade payable programs as well as an evolution in the types of programs used. To illustrate how such a program typically works, consider a company that purchases goods and services from multiple suppliers. The purchaser arranges for an intermediary to pay the suppliers on its behalf. The purchaser then settles its obligations with the intermediary and pays the intermediary a fee. Newer fintech intermediaries have developed software platforms that enable these types of purchasers to manage supplier relationships much more efficiently. A purchaser also may use such a program to stretch out its payment obligations by paying the intermediary on a delayed basis. Doing so enables the purchaser to hold cash on hand for longer, improving working capital.¹⁴³ A supplier may benefit as well, to the extent that the intermediary pays the supplier earlier than the supplier has requested (although an early payment is typically at a discount).

While these programs are referred to by a number of names (e.g., reverse factoring, supply-chain financing, structured trade payables, and vendor payable programs), some analysts and rating agencies are inclined to see the purchaser's liability to the intermediary as a form of borrowing. However, it is not a standard accounting practice to account for it as such.¹⁴⁴ Moreover, because there are no specific disclosure requirements in U.S. GAAP concerning these types of programs, there has been limited disclosure even about their existence. Earlier this year, UBS reported that only 34 out of 1,354 companies in its coverage universe—less than three percent—disclosed the use of reverse factoring in published documents despite evidence indicating that a much greater percentage—perhaps as much as 40 percent—were

using reverse factoring.¹⁴⁵ Similarly, Moody's reported that fewer than 5% of the non-financial companies that it rated globally disclosed such a program in their financial statements, whereas a contemporaneous PwC survey indicated a greater prevalence in reality.¹⁴⁶ PwC had surveyed 80 companies and found 49% reporting using reverse factoring with suppliers and a further 37% actively considering it.¹⁴⁷

As we have learned in our outreach to investors, a company could use reverse factoring to stretch out its payables in order to improve its working capital and claim to the analyst community that it is deleveraging. The company may not disclose its use of reverse factoring at all in its annual report, even though an analyst or other investor would want to know what the company's program terms were, what portion of the supplier base was utilizing the program, who the capital providers were (*i.e.*, a global, regulated bank versus a less well-capitalized fintech company), and the level of risk on the supplier side. Reverse factoring as a business is not cycle-tested, which means that it is unclear what might happen in an economic downturn (*i.e.*, there may be a snap-back in working capital). The worry is that curtailment of reverse factoring availability represents a liquidity risk which could lead to an immediate and material working capital outflow.¹⁴⁸ Unfortunately, without greater disclosure, many investors are left wondering how sustainable reverse factoring is as a source of capital.

On October 2, 2019, the Big Four accounting firms submitted a rare joint letter to the Financial Accounting Standards Board to request formal guidance regarding the financial statement disclosures and presentation of cash flows that an entity entering into such a program should provide.¹⁴⁹ Citing the SEC Division of Corporation Finance's renewed attention to such programs in recent comment letters, the signatories

acknowledged the lack of disclosure provided in practice and suggested that the FASB's Emerging Issues Task Force address the issue so that "users of the financial statements will have a better basis for making informed decisions with respect to the entity's financial position, liquidity, and cash flows."¹⁵⁰ We agree and look forward to monitoring the FASB's action in this area.

DUAL-CLASS SHARE STRUCTURE

Recent events involving so-called "unicorn" companies with weak corporate governance should have us revisiting a troubling trend involving dual-class shares. Companies have increasingly utilized capitalization structures that contain two or more classes of shares—one of which has significantly more voting power than the other.¹⁵¹ This is distinct from the more common single-class structure, which gives shareholders equal equity and voting power.¹⁵² In a dual-class structure, public shareholders receive shares with one vote per share, while insiders receive shares that empower them with multiple votes.¹⁵³ Recently, some firms have issued shares that give ordinary public investors no vote at all.¹⁵⁴

Dual-class shares are common in founder-led companies where the founders are perceived to be instrumental in the success of the company.¹⁵⁵ Proponents of dual-class shares argue that company founders and insiders are given more votes per share than public shareholders because the founders are so visionary and charismatic that the companies could not be as successful—or not be successful at all—without them. By going public with multiple classes of shares, a company allows the public an opportunity to participate in the company's growth, and the lack of voting rights for the public shareholders is advantageous because it allows the founders to guard against activists

who demand short-term profits at the expense of long-term growth. Dual-class share structures are also common in founder-led companies where the company has had to raise a significant amount of funding before an initial public offering to fund rapid growth, and when founders are averse to a change in control and therefore use the dual-class share structure as a defense mechanism.¹⁵⁶

In our view, the use of dual-class shares by companies is troubling. Without an appropriate level of accountability to shareholders, investors may suffer significant financial harm.¹⁵⁷ Unchecked corporate control can lead to many poor behaviors, such as self-dealing, poor accounting controls, outsized optimism, group-think, discriminatory practices, and a tendency to burn cash by investing in ancillary businesses to satisfy personal whims. Dual class shares can also make it difficult to remove control persons who begin to suffer from declining physical or mental health. And, as Commissioner Jackson has observed, when dual-class shares are perpetual, long-term public shareholders must place their faith not only in a founder, but also the founder's children and grandchildren.¹⁵⁸ Long after the original visionary is gone, there will still be no disciplining governance mechanism.

A growing body of research suggests that over the long term, entrenchment of founders produces lower returns for investors. Specifically, companies with dual-class structures tend to underperform companies with dispersed voting power.¹⁵⁹

There is a great deal the Commission and stock exchanges can do to address this issue. For example, we have encouraged the exchanges to consider reforms suggested by the investor community.¹⁶⁰ These suggested reforms include the

sun-setting of super-voting rights, which would protect a visionary founder from activist investors for a reasonable length of time while preventing the harms that may occur over the long term due to poor corporate governance.¹⁶¹ We also urge the Commission to require public companies to provide more fulsome disclosure of the risks associated with dual class shares, as recommended by the Investor Advisory Committee.¹⁶²

TRANSITION FROM LIBOR

The London Interbank Offered Rate (LIBOR), an indicative measure of the average interest rate at which banks could borrow from one another, has been used extensively as a benchmark for commercial and financial contracts, including interest rate swaps and other derivatives, as well as mortgages and debt. Many institutional investors, such as pension funds, use derivatives referencing LIBOR to hedge risk and execute investment strategies. Some municipal bonds, such as floating rate notes, may reset their interest rate periodically based on LIBOR.

However, the banks currently reporting information used to set LIBOR will likely stop after 2021. This is largely due to questions about manipulation, as some banks falsely inflated or deflated their rates to profit from trades or give the impression that they were more creditworthy than they were. These concerns led market participants to look elsewhere for a reference rate.

The Alternative Reference Rate Committee—a group convened by the Federal Reserve that includes major market participants, and on which SEC staff and other regulators participate—has proposed an alternative rate to replace LIBOR. This new rate, known as the Secured Overnight Financing Rate, or “SOFR,” is based on transac-

tions in the liquid market for overnight Treasury repurchase agreement transactions. Daily volumes in that market can exceed \$700 billion, which is a level of trading activity that is expected to provide a stable and reasonably accurate reference rate for short-term lending. But, it is important to note that SOFR will not perfectly match LIBOR, and the impact of the transition from LIBOR to SOFR is highly dependent upon the specific contracts that utilize the reference rates.

The Commission has noted that a significant risk for many market participants—whether public companies or municipalities that have floating-rate obligations tied to LIBOR, or broker-dealers, investment companies or investment advisers that have exposure to LIBOR—is how to manage the transition from LIBOR to a new rate such as SOFR, particularly with respect to contracts that will still be outstanding at the end of 2021.¹⁶³ The Federal Reserve estimates that there are approximately \$200 trillion in notional transactions referencing LIBOR, more than \$35 trillion of which would mature after 2021.¹⁶⁴ Many legacy contracts have interest rate provisions referencing LIBOR that did not contemplate the permanent discontinuation of LIBOR and, as a result, there may be uncertainty over how to interpret the contracts.

The Commission has recognized that there are also risks related to the differences in the structure of SOFR and LIBOR that could impact how products perform in periods of stress.¹⁶⁵ The existing LIBOR benchmark reflects both a risk free rate and an additional bank lending spread. SOFR is, however, an overnight rate that does not reflect a fluctuating bank funding spread. More work needs to be done to develop a SOFR term structure that will facilitate the transition from term-based LIBOR rates. Simply adding an additional fixed spread to SOFR

would not fully incorporate the floating bank funding spread captured by LIBOR.

Accordingly, although these are risks that the Commission must monitor with the Federal Reserve, Treasury Department and other financial regulators, ultimately market participants must plan and act.¹⁶⁶ Issuers should consider the risks presented by LIBOR's expected discontinuation and keep investors informed about the progress towards risk identification and mitigation, and the

anticipated impact on the company, if material. Funds that invest in instruments referencing LIBOR should consider how the discontinuation of LIBOR may impact the functioning, liquidity and value of these investments, whether any provisions need to be renegotiated, and whether any risks associated with LIBOR need to be disclosed to their investors. And brokers and central counterparties should consider how their customer business and their internal risk management could be impacted by the changes.

OMBUDSMAN'S REPORT

As set forth in Exchange Act Section 4(g)(8), 15 U.S.C. § 78d(g)(8), the Ombudsman is required to: (i) act as a liaison between the Commission and any retail investor in resolving problems that retail investors may have with the Commission or with self-regulatory organizations; (ii) review and make recommendations regarding policies and procedures to encourage persons to present questions to the Investor Advocate regarding compliance with the securities laws; and (iii) establish safeguards to maintain the confidentiality of communications between investors and the Ombudsman.¹⁶⁷

The Ombudsman is also required 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” (Ombudsman’s Report).¹⁶⁸ The Ombudsman’s Report must be included in the semi-annual reports submitted by the Investor Advocate to Congress. To maintain reporting continuity, the Ombudsman’s Report included in the Investor Advocate’s June 30 Report on Objectives will describe the Ombudsman’s activities during the first six months of the current fiscal year and provide the Ombudsman objectives and outlook for the following full fiscal year. The Ombudsman’s Report included in the Investor Advocate’s December 31 Report on Activities will provide a look back on the Ombudsman’s activities during the full preceding fiscal year.

Accordingly, this Ombudsman’s Report provides a look back on the Ombudsman’s activities for the full fiscal year period from October 1, 2018 through September 30, 2019 (Reporting Period) and discusses the Ombudsman’s outlook for Fiscal Year 2020.

SERVICE BY THE NUMBERS

The Ombudsman¹⁶⁹ assists retail investors—sometimes referred to as individual investors or Main Street investors—and other persons with concerns or complaints about the SEC or SROs the SEC oversees. The assistance the Ombudsman provides includes, but is not limited to:

- listening to inquiries, concerns, complaints, and related issues;
- helping persons explore available SEC options and resources;
- clarifying certain SEC decisions, policies, and practices;
- taking objective measures to informally resolve matters that fall outside of the established resolution channels and procedures at the SEC; and,
- acting as an alternate channel of communication between retail investors and the SEC.



In practice, individuals often seek the Ombudsman’s assistance as an initial point of contact to resolve their inquiries or as a subsequent or ongoing point of contact when they are dissatisfied with the outcome, rate of progress, or resolution. At times, individuals request the Ombudsman’s assistance with things the Ombudsman does not do. For example, individuals may ask us to provide financial or legal advice, participate in a formal

investigation, make binding decisions or legal determinations for the SEC, or overturn decisions of existing dispute resolution or appellate bodies.

The following graphic illustrates the standard lifecycle of what happens when investors or other interested persons contact the Ombudsman for assistance:

Figure 1: What Happens When You Contact the Ombudsman



To respond to inquiries effectively and efficiently, the Ombudsman monitors the volume of inquiries and the staff resources devoted to addressing the particular concerns raised. The Ombudsman tracks all inquiries received by, or referred to, the Ombudsman, as well as all related correspondence and communications to and from Ombudsman staff. We track the status of the inquiry from its receipt to its ultimate resolution or referral, and we monitor the amount of staff engagement and resources that were utilized to respond to the inquiry. We maintain these types of records in order to identify and respond to problems raised, analyze inquiry volume and trends, and provide data-driven support for recommendations presented by the Ombudsman to the Investor Advocate for review and consideration.

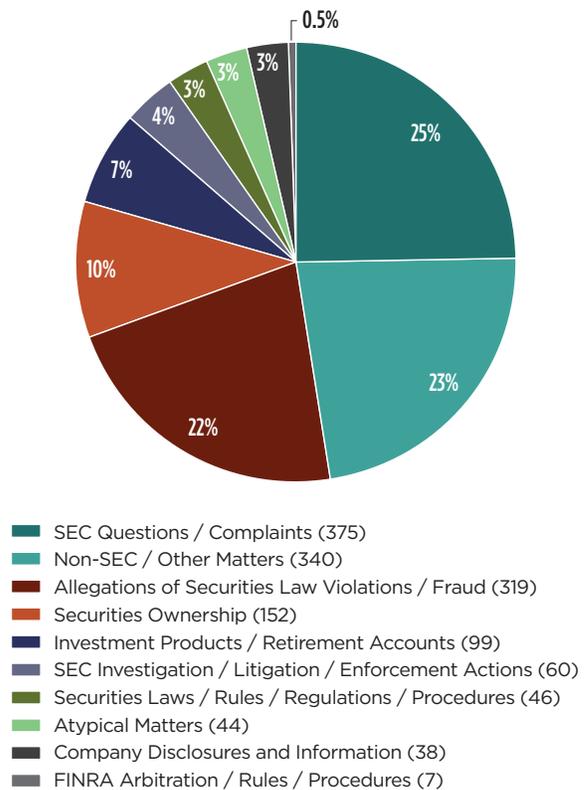
Inquiry volume is counted in terms of matters and contacts. The initial contact—a new, discrete inquiry received by or referred to the Ombudsman—is the contact that creates a matter. When a matter is created, the Ombudsman reviews the facts, circumstances, and concerns, and assesses the staff engagement and resources that may be required to respond to, refer, or resolve the matter.

Once a matter is created, it may generate subsequent contacts—related inquiries and communications to or from the Ombudsman staff deriving from the matter. These contacts often require further attention to answer additional investor questions, explain or clarify proposed resolution options, discuss issues with appropriate SEC or SRO staff, or respond to challenging or persistent communications from an investor. This system of counting matters and contacts helps the Ombudsman quickly assess volume and resource issues related to each matter.

Data Across Primary Issue Categories

During the Reporting Period, retail investors, industry professionals, concerned citizens, and other interested persons contacted the Ombudsman for assistance on 1,480 matters covering 10 primary issue categories:

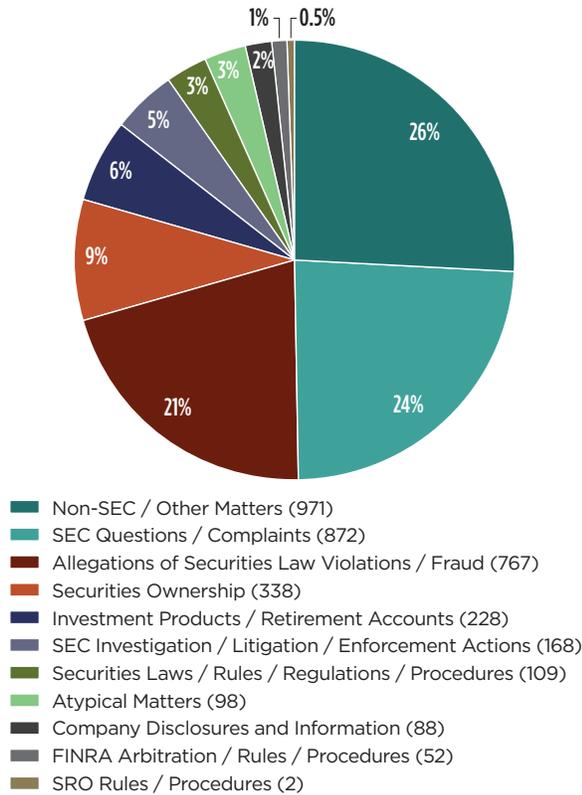
Figure 2: Matters by Primary Issue Category
October 1, 2018–September 30, 2019



In addition to the 1,480 matters received, we fielded 2,213 contacts covering 11 primary issue categories during the Reporting Period, for a total of 3,693 contacts. The chart that follows displays

the distribution of the 3,693 total contacts by primary issue category:

Figure 3: **Contacts by Primary Issue Category**
October 1, 2018–September 30, 2019

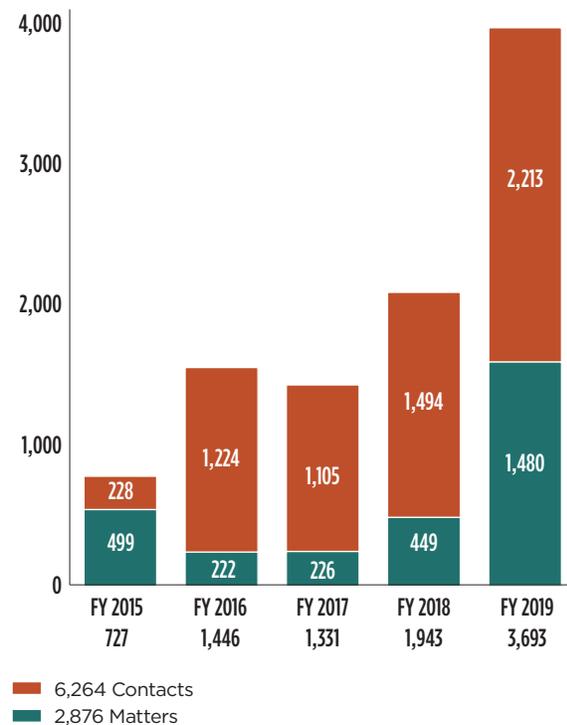


How the Numbers Inform Our Efforts

The Ombudsman tracks matter and contact data to maintain a comprehensive view of the allocation of staff resources and to identify matters and contacts that significantly alter workflow volumes, call for the realignment of Ombudsman staff assignments, or require added staff support to manage effectively. The data also informs staff resource allocation considerations related to proposed program development, training, and outreach efforts. By tracking the distribution of matters and contacts across primary issue categories, the data helps the Ombudsman identify potential areas of concern or interest and enables the Ombudsman to act as an early warning system, as necessary, to alert agency leaders about the number and potential impact of particular issues and concerns raised by retail investors and others.

To bring this into perspective, all of the activities and initiatives covered in this Ombudsman’s Report, including the review, responses, and recordkeeping for the 3,693 contacts fielded during this Reporting Period, were led and completed by the Ombudsman and one attorney-adviser on detail from another SEC division, along with support from one contract law clerk for six months and one contract paralegal for four months. From FY 2015 through the end of FY 2019, at peak staffing levels, the Ombudsman team was comprised of the Ombudsman, one full-time attorney-adviser, one contract attorney, and one contract paralegal—and these staffing levels have fluctuated from time to time. The total number of matters and contacts received and responded to by the Ombudsman since FY 2015, the first full fiscal year of Ombudsman operations, grew from 727 in FY 2015 to 3,693 matters and contacts in FY 2019, an increase of 407.9 percent.

Figure 4: **9,140 Total Contacts**
Fiscal Year 2015–Fiscal Year 2019



SERVICE BEHIND THE NUMBERS

While the matter and contact data quantify the volume and categories of inquiries the Ombudsman receives, the data does not capture the full value of the service the Ombudsman provides to the investing public. Among the most common problems and concerns investors bring to the Ombudsman are those where the investors are unfamiliar with the existing channels established to resolve the particular concerns they raise, unsure which resolution channel to use, or unable to get the specific outcome they want through the resolution channels available. Typically, investors who are unfamiliar with or unsure of the available resolution channels will thoughtfully consider the advantages and disadvantages of the resolution options the Ombudsman presents, and establish their expectations based upon the potential outcome each option offers. For these investors, the Ombudsman serves a valuable resource function, but the investor retains responsibility for choosing how to proceed based on the resources the Ombudsman presents.

Investors who want a particular outcome or believe that the Ombudsman is permitted to do whatever they request can be more challenging to assist. The Ombudsman routinely receives requests from investors who want the Ombudsman to, for example, automatically grant them SEC whistleblower status and provide monetary awards, reveal confidential information relating to SEC investigations, stop a publicly traded company from taking certain corporate actions, prosecute a particular broker or investment adviser, overturn an arbitration decision, or terminate specific SEC or SRO personnel. At times, they resist the Ombudsman's efforts to engage in a productive dialogue and conclude that the only acceptable outcome is the particular outcome they want.

The vignettes that follow give a sense of the variety of issues addressed by the Ombudsman from FY 2015 through FY 2019. Collectively, they offer a closer look at the how the Ombudsman's time, effort, and commitment provide a meaningful service to investors and other interested persons, and demonstrate the value of the one-on-one interactions with Main Street investors work more effectively than the numbers alone.

Numerous investors contacted the Ombudsman from late December 2018 through late January 2019 while the SEC was closed due to the partial federal government shutdown. Although the Ombudsman was unable to respond to routine investor matters during that time, the Ombudsman monitored all investor inquiries on a regular basis. Many investors submitted questions and concerns relating to potential advance fee fraud schemes during the shutdown. Advance fee fraud generally involves a request for personal information and a fee to be paid up front—in advance of receiving any proceeds, money, stocks, or warrants—to complete a transaction. After the investor pays the advance fee, the soliciting person or entity may break off contact. In the end, the proposed transaction or settlement does not take place, and the investor is never paid and never recovers the fees paid in advance. Given the limited SEC staff available during the shutdown and the time sensitive nature of this type of fraud, the Ombudsman personally responded to each of these investors and provided information and resources to help these investors avoid becoming victims of advance fee fraud scams.

After a breakout session at the SEC Town Hall in Atlanta, Georgia, an investor asked the Ombudsman about a matter he submitted to the SEC many months prior. After discussing the matter with the investor, the Ombudsman also took a few moments to personally introduce the investor to the SEC Chairman and other senior staff in attendance. Back at SEC headquarters, the Ombudsman liaised with colleagues in several SEC divisions and offices to coordinate a conference call with the investor to discuss his matter in detail. The investor was extremely satisfied with the time and attention he received from senior SEC staff and with the resolution of his concerns.

An elderly investor was referred to the Ombudsman for assistance in replacing lost physical stock certificates. The investor spoke with the Ombudsman for more than 30 minutes about his investments over the years and his age-related mobility issues. At the end of the call, the investor stated that he truly appreciated having someone to talk to about his concerns.

A number of retail investors repeatedly contacted the Ombudsman to complain about how the SEC handled social media posts relating to a publicly traded company's business and financial outlook. The investors alleged that, by not shutting down the social media accounts or preventing specific persons from posting statements, the SEC was harming, rather than protecting, the investors. Furthermore, the investors feared that the SEC's pending enforcement actions, coupled with the ongoing social media posts, would negatively affect the value of their shares. The investors demanded that the Ombudsman either stop the social media posts or stop the SEC's pending enforcement actions.

A small business owner contacted the Ombudsman to complain about a request for proposal and related documents she received from the SEC Office of Acquisitions. Upon review, the Ombudsman realized that the business owner was contacted by someone impersonating SEC staff, and confirmed with the Office of Acquisitions that the request for proposal was a fraud. The Ombudsman subsequently contacted the business owner to advise her not to respond to the fraudulent proposal, and also provided her with additional resources relating to the SEC contracting process.

The Ombudsman was contacted by another SEC office to assist an investor entitled to receive funds obtained in an SEC enforcement action against a fraudster who preyed on unsophisticated investors. The Ombudsman recognized that the investor needed to act quickly to remain eligible to receive a portion of the distributed funds. The Ombudsman spoke with the investor, provided an overview of the distribution process, and connected the investor with SEC Division of Enforcement staff and the distribution agent in time to preserve his eligibility.

A concerned son-in-law sought the Ombudsman's help. His elderly mother-in-law lost her entire life's savings due to the unscrupulous practices of her investment adviser, and the family was waiting for funds to be returned to her and the other harmed investors through a fair fund distribution. The son-in-law felt that the money the adviser paid to satisfy the SEC disgorgement penalty was money that rightfully belonged to the harmed investors. Consequently, he felt that the SEC was exacerbating the harm by not returning the disgorged funds to the investors. The Ombudsman explained why, in this case, the disgorged funds were not returned to the investors. While disappointed with the outcome, he expressed appreciation that the Ombudsman took the time to personally return his call and discuss his concerns.

Our interactions with investors provide insight into the information investors rely upon and the assistance they want when making investment decisions. The tailored information and responses the Ombudsman provides to investors are unique and require a high degree of securities law analysis and expertise, conflict resolution skills, diplomacy, and judgment. Even when the information or response communicated to an investor appears simple, the threshold questions and considerations required to understand the inquiry and to identify next steps, SEC staff resources, and potential policy implications necessitate having staff with a level of securities law knowledge typically gained through several years of prior industry experience. When our interactions with investors highlight their lack of information or gaps in their understanding, we attempt to deliver personalized, straightforward service by communicating the information necessary to help investors better understand the solutions the SEC can provide, by liaising with the appropriate persons and entities, and by empowering and equipping investors to make well-informed decisions.

STREAMLINED COMMUNICATIONS WITH RETAIL INVESTORS

The Ombudsman Matter Management System (OMMS) is an electronic platform for receiving inquiries, as well as tracking and analyzing matter and contact information, while ensuring all necessary data management, confidentiality, and reporting requirements are met. The OMMS Form, a web-based, mobile friendly form permitting the submission of inquiries, complaints, and documents directly to the Ombudsman, guides the submitter through a series of questions specifically tailored to elicit information concerning matters within the scope of the Ombudsman's function. In addition, the OMMS Form allows submitters to easily upload and submit related documents for staff review. For any persons who do not wish, or are unable, to use the OMMS Form, they may still contact the Ombudsman by email, telephone, fax, and mail.

When an OMMS Form is submitted, OMMS automatically creates a matter record. The Ombudsman also manually creates an OMMS matter record for each inquiry received by telephone, email, or other means outside of the OMMS Form. Once an OMMS matter record is created, the Ombudsman and staff can review the matter details, track all related contacts and correspondence, update matter comments, and communicate with the investor via the OMMS platform. OMMS also allows the Ombudsman and staff to search and analyze matters and contacts by submitter, primary issue, fiscal year, and a number of other categories, and review data and customize specific reports when a deeper examination is required.

The Ombudsman worked with the SEC Office of Public Affairs (OPA) during the Reporting Period to create a stronger public presence on the SEC's www.sec.gov home page and on the SEC's social media channels to better inform the public about the role of the Ombudsman and the resources the Ombudsman provides. For example, a button linking to the www.sec.gov/Ombudsman web page and OMMS Form is available on the www.sec.gov homepage. Another web-based effort, "Q&A with the SEC Ombudsman," now available on the Ombudsman web page, was featured as an SEC Spotlight topic on the www.sec.gov home page for several weeks, and was posted on the SEC News Twitter account. The Ombudsman also worked with the technology contractor to make some back office improvements to OMMS to enable the Ombudsman staff to enter and update matter and contact data with enhanced efficiency. The technology contractor also created excellent custom solutions and report options for the Ombudsman's use in response to specific recordkeeping and reporting needs that arose during the Reporting Period. OMMS and the OMMS Form have proven so useful and well received that several SEC staff, and ombudsmen from other state and federal agencies and organizations, asked the Ombudsman to provide

overviews and demonstrations on the creation and functionality of OMMS and the OMMS Form.

As a result of our ongoing efforts to streamline and enhance communications with retail investors during FY 2019, we received 791 new matters submitted via the OMMS Form, representing 53.4 percent of the 1,480 new matters received during FY 2019. As a comparison, during FY 2018, the first full fiscal year the OMMS Form was available to the public, we received 164 new matters submitted via the OMMS Form, representing 36.5 percent of the 449 new matters received during FY 2018. The Ombudsman will continue to encourage persons to submit their inquiries via the OMMS Form, closely monitor questions and suggestions relating to the OMMS

Form, and work with OIT, the technology contractor, and OPA to enhance the OMMS user experience and the Ombudsman-related information and resources available to the public.

STANDARDS OF PRACTICE

Any retail investor with an issue or concern related to the SEC or an SRO subject to SEC oversight may contact the Ombudsman. The Ombudsman is available to identify existing SEC options and resources to address issues or concerns, and to explore informal, objective steps to address issues or concerns that may fall outside of the agency’s existing inquiry and complaint processes. Similar to ombudsmen at other federal agencies, the Ombudsman follows three core standards of practice:

CONFIDENTIALITY	IMPARTIALITY	INDEPENDENCE
<p>The Ombudsman has established safeguards to protect confidentiality, including the use of OMMS, a separate email address, dedicated telephone and fax lines, and secure file storage. The Ombudsman generally treats matters as confidential, and takes reasonable steps to maintain the confidentiality of communications. The Ombudsman also attempts to address matters without sharing information outside of the Ombudsman staff, unless given permission to do so. However, the Ombudsman may need to contact other SEC divisions or offices, SROs, entities, and/or individuals and share information without permission under certain circumstances including, but not limited to: a threat of imminent risk or serious harm; assertions, complaints, or information relating to violations of the securities laws; allegations of government fraud, waste, or abuse; or if otherwise required by law.</p>	<p>The Ombudsman does not represent or act as an advocate for any individual or entity, and does not take sides on any issues. The Ombudsman maintains a neutral position, considers the interests and concerns of all involved parties, and works to resolve questions and complaints by clarifying issues and procedures, facilitating discussions, and identifying options and resources.</p>	<p>By statute, the Ombudsman reports directly to the Investor Advocate, who reports directly to the Chairman of the SEC. However, the Office of the Investor Advocate and the Ombudsman are designed to remain somewhat independent from the rest of the SEC. Through the Congressional reports filed every six months by the Investor Advocate, the Ombudsman reports directly to Congress without any prior review or comment by the Commission or other Commission staff.</p>

The Ombudsman's Challenge

The mission statement of the SEC is to “protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.”¹⁷⁰ At the center of many complaints the Ombudsman receives is a misunderstanding about the SEC’s relationship and obligations to individual investors because of the “protect investors” language in the mission statement. In these situations, investors frequently assume the purpose for SEC investigations and enforcement actions is to address their specific allegations or protect their specific, individual interests. While the SEC’s enforcement actions may at times align with the personal interests of harmed investors, the SEC does not pursue investigations and enforcement actions solely to represent a specific investor’s particular legal interests or to recover money a particular investor may have lost.

Another frequent complaint from investors surrounds the “We are the Investor’s Advocate” language and similar messaging found on the www.sec.gov website and in other materials used across the agency. Investors regularly express confusion and disappointment when they are informed that the grammatically correct interpretation of “the investor’s”—as a singular possessive noun—is not what is meant by the language, and that the SEC is not the advocate for a particular investor or for an investor’s specific interests or needs. Rather, the SEC advocates for—or supports—the collective interests of all investors and the public by maintaining fair, orderly, and efficient capital markets through the enforcement of the federal securities laws.

A primary question we encounter is, then, what can the Ombudsman do for investors who have been harmed by violations of the federal securities laws? In appropriate circumstances, the Ombudsman may be able to present options to investors or foster communications between the investor and

SEC or SRO staff. However, the Ombudsman is not authorized to do many things that investors request, including:

- deciding the facts in a dispute that the investor has with the Commission or an SRO, or in a dispute before an SRO, such as an arbitration or mediation;
- intervening on behalf of, or representing the interest of, an investor in a formal dispute or investigation process;
- providing advice on how the federal securities laws may impact their particular investments or legal options; or
- changing formal outcomes, including decisions about whether to investigate an allegation of wrongdoing, settle an enforcement action, or create a Fair Fund.

With these limitations in mind, the Ombudsman routinely explains to investors that they have the ability to protect their interests and preserve their legal rights in ways that the Ombudsman cannot. For example, an investor can file an arbitration or mediation complaint with FINRA to address a broker dispute, or hire private legal counsel to advise the investor on the best ways to protect the investor’s rights or reach a particular outcome. Investors who do not have the means to hire legal counsel may want to request representation through no-cost legal clinics sponsored by various law schools.

While the Ombudsman staff cannot represent the interests of investors in private disputes, we do serve these investors by providing information that will assist them in making better informed choices for themselves.

Assisting Investors through Advocacy

Even when we cannot help investors achieve the specific results they desire, the concerns we hear from investors help to shape the policy agenda of

the Office of the Investor Advocate. We also engage with those who represent investors, including law school investor advocacy clinics, to gain a deeper understanding of potential legal and structural barriers encountered by investors.

To retail investors, FINRA is perhaps the most well-known SRO under SEC oversight. FINRA operates BrokerCheck¹⁷¹ and a dispute resolution forum,¹⁷² both of which are commonly used by retail investors. As discussed in prior reports, the Ombudsman closely follows FINRA's rulemaking and dispute resolution forum activities that may have a direct and significant impact on retail investors. We also look for ways to improve SEC or SROs processes and regulations for the collective benefit of investors, and we advocate for those types of reforms. Selected areas of interest and importance to retail investors are discussed below.

AREAS OF INTEREST AND IMPORTANCE TO RETAIL INVESTORS

Restricted Firms and Broker Migration

In our Report on Objectives for Fiscal Year 2020, we discussed FINRA Regulatory Notice 19-17¹⁷³ and Proposed Rule 4111—Restricted Firm Obligations, which would authorize FINRA to implement financial restrictions and other conditions on certain unsafe members.¹⁷⁴ The proposed rule focuses on firms that have histories of misconduct and those that employ a high concentration of brokers with such histories.¹⁷⁵ Under the proposed rule, FINRA would disincentivize these members from hiring or retaining bad brokers by imposing a soft cap on risk.¹⁷⁶

Specifically, Proposed Rule 4111 introduces a multi-step process by which firms exceeding a certain risk threshold for broker or member misconduct are subject to sanctions by FINRA. For purposes of the proposed rule, risk is calculated by assigning point values to various categories

of misconduct.¹⁷⁷ Firms that score higher than the allowable threshold would be provided an opportunity to explain why they should not be sanctioned.¹⁷⁸ Alternatively, firms may conduct a one-time reduction in staff in order to shed risk.¹⁷⁹

Firms that do not take these steps, or are unsuccessful in doing so, will be designated as “restricted firms” and may be required to make deposits of cash or qualified securities into a restricted deposit account.¹⁸⁰ These deposits may not be withdrawn without prior written consent by FINRA.¹⁸¹ In addition, restricted firms may be subject to unspecified additional conditions and restrictions at FINRA's discretion.¹⁸²

During the Reporting Period, we reviewed Regulatory Notice 19-17 and the public comment file.¹⁸³ In general, investors and their advocates noted four areas of concern relating to Proposed Rule 4111. First, the proposed rule suggests that it may help address the problem of unpaid arbitration awards.¹⁸⁴ However, the proposed rule does not explicitly state whether, and if so, how, restricted deposit amounts may be used to satisfy unpaid arbitration awards. As such, additional clarification on how the proposed rule may solve the unpaid arbitration award problem may be beneficial.

Second, the proposed rule grants FINRA discretion whether to impose sanctions on restricted firms. To the extent that sanctions are imposed, the proposed rule does not specify minimum or maximum deposit amounts, nor does it define the additional conditions and restrictions that may be levied by FINRA instead of, or in addition to, the deposit requirement. This unbounded regulatory discretion may have a deterrent effect that undermines the confidence of retail investors. Additional guidance on FINRA's discretion, including how restricted deposit amounts will be determined, may also be beneficial.

Third, several commenters argued that restricted firms should be publicly disclosed. The notion that investors might unwittingly invest with firms deemed the worst of the worst is an unacceptable, yet predictable outcome if these restricted firms are not publicly identified. Increased disclosure of broker risk data,¹⁸⁵ including publicly identifying firms with dangerous concentrations of risky brokers, is information that may prove beneficial to retail investors.

Fourth, some commenters expressed disappointment that the preliminary criteria for identification under the proposed rule were not specific, and that only a very small number of firms would satisfy the preliminary criteria.¹⁸⁶

As FINRA considers whether to submit a proposed rule to the Commission for approval, we trust that FINRA will consider the comments provided during the public comment process by investor advocacy groups. With some modifications, the rule could serve as a positive step to limit the ability of bad brokers to repeatedly find employment at new firms by dissuading, and sanctioning, if necessary, those firms most likely to take them in.

Unpaid Arbitration Awards

As discussed above and in prior Reports¹⁸⁷, FINRA has issued multiple regulatory notices for comment related to bad brokers and bad firms.¹⁸⁸ In this regard, commenters for and against Proposed Rule 4111¹⁸⁹ expressed support for the creation of a FINRA restitution fund to satisfy unpaid arbitration claims.¹⁹⁰ As discussed in our Report on Activities for Fiscal Year 2018,¹⁹¹ there are numerous other potential remedies available as well.¹⁹² We look forward to FINRA filing proposed rules that address the problem of unpaid arbitration awards and that provide viable solutions.

Investor Advocacy Clinic Funding and Recent Clinic Closures

As previously discussed in our Report on Objectives for Fiscal Year 2019, the law school investor advocacy clinics¹⁹³ were started in 1997 to address concerns expressed in town halls by small retail investors.¹⁹⁴ In response to these concerns, then Chairman Arthur Levitt announced the creation of pilot arbitration clinics at two New York-area law schools.¹⁹⁵ A fifteen-year period of expansion followed during which investor advocacy clinics were launched at law schools across the country. These clinics were funded by a variety of sources including state securities fraud enforcement cases,¹⁹⁶ state securities commissions,¹⁹⁷ and FINRA's Investor Education Foundation (Foundation), the largest single source of clinic grant start-up funds.¹⁹⁸

At their peak, twenty-two investor advocacy clinics were in operation nationally.¹⁹⁹ However, since 2012, there have been no additional start-up grants from the Foundation to help launch new clinics. Similarly, securing other funding sources to sustain the operations of existing clinics has also been a challenge. As a result, the number of clinics has dwindled to critical levels. There are currently only fourteen active clinics remaining,²⁰⁰ as two clinics closed during this Reporting Period.²⁰¹

Main Street investors bear the brunt of each clinic closure. These clinics are often the only hope for retail investors who need to pursue small, but actionable, claims, those without the means to retain counsel, and those that cannot retain legal counsel due to the small dollar amount in dispute. For example, due to recent closures, there are no longer any investor advocacy law school clinics in Georgia or upstate New York to assist retail investors. When law school clinics close, many investors are left without affordable access to representation.²⁰² When clinics are unable to secure

adequate funding, they are forced to reduce the number of investor cases they take on, and in some cases, decline investor cases altogether. The scope of investor outreach and education they are able to provide to their local communities suffers as well.

In March 2018, the SEC Investor Advisory Committee (IAC) recommended several steps to address the funding crisis threatening investor advocacy clinics.²⁰³ The IAC recommendations included, among others, the creation of a matching grant program to fund the clinics through a combination of federal and clinic-sourced funds,²⁰⁴ appropriation of certain fines and monetary penalties levied by FINRA against its members,²⁰⁵ and legislative action authorizing the use of the SEC Investor Protection Fund to support law school clinics.

As the agency continues its focus on Main Street investors, immediate and creative problem solving is needed from regulators, legislators, and the industry to address the urgent funding needs of investor advocacy clinics. The Ombudsman continues to support the recommendations made by the IAC and welcomes the opportunity to work with the Commission and others to explore viable ideas to fund existing and proposed clinics to ensure that as many retail investors as possible have access to competent, affordable legal representation.

Law School Clinic Outreach Program

As discussed in prior Ombudsman's Reports, we launched the Law School Clinic Outreach Program (LSCOP) to complement our statutory mandate and core functions. One goal of LSCOP was, and remains, the exchange of information and ideas between the law school investor advocacy clinics and SEC staff. In their unique role as counsel to retail investors with small claims or limited incomes, clinics are privy to valuable information about the real world causes and consequences of bad market conduct and risky investment products.

In practice, clinics are uniquely poised to see issues that confront retail investors from a perspective unavailable to SEC staff.

Over the past five years, the hallmark of LSCOP has been its flexibility and dynamism. The program has joined clinic directors and their law students with SEC staff in a variety of settings to discuss the challenges facing retail investors. These interactions typically occur multiple times each year—during clinic visits to the SEC which are hosted by the Ombudsman and during site visits by the Ombudsman to the clinics or to clinic-sponsored events.²⁰⁶

These in-person exchanges supplement the more frequent and informal communications between the Ombudsman and the clinic directors. This ongoing dialogue ensures that when important information gathered by the clinics needs to be brought to the attention of SEC staff, it is not only received in a timely manner, but is also provided to the appropriate SEC staff for review.

During this fiscal year, the Ombudsman took significant steps to strengthen the Office's relationship with the clinics by hosting the first ever SEC Investor Advocacy Clinic Summit (the Summit), discussed below. The Summit marked an important LSCOP milestone and provided an exceptional opportunity to draw a greater depth and breadth of information from the various clinical practices during a single event.

SEC Investor Advocacy Clinic Summit

As briefly noted in the Report on Objectives for Fiscal Year 2020, the Ombudsman and staff devoted considerable time and resources to launch the inaugural SEC Investor Advocacy Clinic Summit, held on April 4, 2019 at SEC headquarters.²⁰⁷

Pre-Summit Planning

The Summit was designed as an opportunity for clinics from across the country to gather at SEC headquarters to participate in collaborative sessions with senior SEC staff and share ideas and perspectives on issues of importance to retail investors across the country. While several clinics have visited the SEC and met with staff members in the past, those hosted visits did not include structured working sessions with SEC staff. In contrast, the Summit was a first-of-its-kind opportunity for the students of the various clinics to work with each other and with SEC attorneys on behalf of Main Street investors. Despite a compressed planning schedule due to the weeks the agency was closed due to the partial government shutdown, the Ombudsman and staff contacted each clinic to preliminarily assess levels of interest and areas of expertise; coordinated participation by SEC Commissioners, senior SEC staff attorneys, and senior representatives from FINRA and NASAA;

and resolved myriad other substantive and logistical challenges.²⁰⁸ When the Summit convened, nearly 100 attendees, speakers, and participants, including 10 investor advocacy clinic directors and over 50 law students, were present.

The Summit—Morning Session

The Summit began with introductory remarks from several speakers, including SEC Commissioner Robert Jackson, the Investor Advocate, the Ombudsman, and Gerri Walsh, senior vice president of investor education at FINRA and president of the FINRA Foundation.²⁰⁹ The speakers discussed their unique roles and responsibilities relating to retail investors, and shared real world examples of the value and importance of the services provided by the clinics. The speakers also answered questions about careers in the securities industry, provided an overview of the day's events, and expressed appreciation for the clinics traveling to the SEC to participate in this first-ever Summit.



The Summit—Breakout Sessions

Following the morning remarks, the clinic participants moved to one of three breakout sessions focused on a substantive topic relevant to the Division of Corporation Finance, the Division of Investment Management, or the Division of Trading and Markets.²¹⁰ As breakout session

preferences were selected by the clinics in advance of the Summit, clinic participants were able to develop, research, and test ideas before arriving at the SEC, and then engage in enthusiastic and nuanced debates on the merits of various potential solutions to problems facing retail investors during the sessions.

Breakout Session	Summary
<p><i>Private Placements and the Accredited Investor Definition</i></p>	<p>The breakout session focused on the accredited investor definition and retail investor participation in private placement offerings. Clinics discussed, as a threshold policy question, how federal regulators should balance the desire by some Main Street investors for expanded access to private investment opportunities against the need to protect unsophisticated investors from risky private offerings. The group discussed the relative merits of various investor sophistication standards and the efficacy of an accredited investor definition based on comprehensive investor testing, such as actual knowledge versus imputed knowledge, and wealth tests. In a related inquiry, the clinics also examined the degree to which investor sophistication is fluid and subject to change over time, and the feasibility of enhanced third-party assistance for unsophisticated investors.</p>
<p><i>The Fund Retail Investor Experience and Variable Annuities</i></p>	<p>The breakout session focused on the experiences of retail investors who purchase funds and variable annuities. Clinic participants contemplated how and when regulators may best ensure that individual investors receive sufficient information to make informed investment decisions without being overwhelmed. The participants also explored the practical disparities relating to access to information and discussed alternative means of disclosure. For example, the law students expressed interest in a future regulatory model that incorporates multimedia alternatives to traditional text-based disclosures. Participants also discussed the prevalence of bad brokers selecting unsuitable investments—including risky funds and complex variable rate annuities—for investors of limited means.</p>
<p><i>Combating Retail Investor Fraud</i></p>	<p>The breakout session focused on retail investor fraud victims represented by the clinics and policy choices that might better protect victims in the future. Among the topics raised by the clinics were investor “speed bumps” to slow transaction times and add a buffer for additional deliberation and, if necessary, cancellation by investors, and the inclusion of additional legends on broker-dealer forms to identify investor-specific risks, such as instructions to provide a client with additional supervision, or cautionary red flags for high risk products. The clinics also examined ways in which the inability to assess levels of appropriate financial literacy may make many retail investors easy prey for fraudsters.</p>



The breakout sessions were designed to encourage open and direct dialogue between clinic participants and SEC staff. The sessions also encouraged clinic participants to grapple with pertinent topics on the regulatory horizon. Each breakout discussion was spirited and robust, in significant part because clinic participants were keenly aware that the matters at issue involved difficult real world policy considerations, and not abstract or theoretical practice exercises. For example, in the months following the Summit, the Division of Corporate Finance published a concept release on the harmonization of private exemptions,²¹¹ and the Commission adopted a proposal by the Division of Trading and Markets and the Division of Investment Management establishing new fiduciary standards for broker-dealers.²¹²

The Summit—Afternoon Session

During the afternoon session, Summit attendees heard from additional speakers from the SEC and other industry groups, including SEC Commissioner Elad Roisman, Charu Chandrasekhar, SEC Assistant Regional Director and chief of the SEC Retail Strategy Task Force, Rick Berry, FINRA's executive vice president and director of dispute resolution, and Joseph Brady, executive director of the North American Securities Administrators Association (NASAA).²¹³ In addition to their remarks, the speakers also welcomed questions and comments from the law students and clinic directors on topics ranging from SEC internship opportunities to targeted outreach specifically created for retail investors.

The remainder of the afternoon was reserved for student-led presentations on various topics relating to securities regulation and retail investor concerns.²¹⁴ The Ombudsman did not select or vet the presentation topics; instead, clinics were asked to present on areas in which they could provide unique or pertinent perspectives to SEC staff gained from their experiences representing their clients.²¹⁵ The presentation topics included the customer relationship summary form, referral arrangements, the fiduciary duty standard for broker-dealers, investor outreach education, the frequency of errors in customer account profiles, and investor empowerment. In each case, the clinics presented careful insights on the needs and concerns of retail investors and then responded to questions and comments from their clinic peers and SEC, FINRA, and NASAA staff in attendance.

The Summit—Feedback and Impact

In the days following the Summit, the Ombudsman received extensive positive feedback from attendees, including the excerpts below:

The opportunity to meet Commissioners, lead counsels and other high-ranking SEC officials was invaluable. I particularly enjoyed the breakout sessions, where we heard from agency counsel and learned about the SEC’s complex decision-making process. Sharing experiences with other clinics was very interesting as well. I was surprised to hear that immigrant communities are being targeted not only for affinity fraud, but for the sale of unsuitable and risky financial products.

— Student, St. John’s University School of Law Securities Arbitration Clinic

The event was truly unique and informative, while also allowing us, the students, to be heard by SEC staff who make a real difference.

— Student, Benjamin N. Cardozo School of Law Securities Arbitration Clinic

The SEC organized an impressive and extremely educational experience for its first ever clinic summit! I really enjoyed the opportunity to meet key leaders in the field, and discuss how pending regulations will affect our clients in the clinic and their ability to manage their own accounts. Additionally, the opportunity to converse with other clinics from across the country and compare experiences was extremely valuable as it validated the work that we are all doing, and gave insights for other potential avenues that our clinic could explore in managing its casework.

— Student, St. John’s University School of Law Securities Arbitration Clinic

We really enjoyed the event—it was very well done. The students thought it was the highlight of their law school careers and are still talking about how lucky they were to share their thoughts with policymakers. Thanks for all you do with the clinics!

— Professor Nicole Iannarone, Director, Investor Advocacy Clinic, Georgia State University College of Law

Thank you for setting up such an amazing opportunity for my students. They were overwhelmingly satisfied with the day, calling it ‘by far the most memorable law school experience,’ ‘a fantastic experience, both educationally and professionally,’ ‘invaluable,’ ‘one of the best experiences I have had so far in law school,’ and ‘impressive and extremely educational.’

— Professor Christine Lazaro, Director, Securities Arbitration Clinic, St. John’s University School of Law

My students could not stop talking about the wonderful experience they had at the SEC! In addition to providing the Investor Advocate and others at the SEC with feedback about what clinics are seeing on the street, it provided them with an opportunity to meet two of the Commissioners, others at the SEC, FINRA and, of course, each other. We hope that the office will do this again.

— Professor Teresa Verges, Director, University of Miami School of Law Investor Rights Clinic

Given the tremendous success of the Summit, we anticipate developing similar events and programming as part of the continued growth of the Law School Clinic Outreach Program.

OUTREACH ACTIVITIES

During the Reporting Period, in addition to the Summit, the Ombudsman continued to seek out opportunities to increase awareness and elevate the visibility of the services the SEC provides to retail investors. These opportunities included participation in the following ombudsman and securities industry events, professional conferences, and outreach activities.

- American Bar Association Section of Dispute Resolution—Ombuds Subcommittee monthly meetings
- Coalition of Federal Ombudsmen monthly meetings
- Federal Financial Ombudsmen Working Group quarterly meetings
- Northeast Ombudsmen Working Group quarterly meetings
- Coalition of Federal Ombudsmen Annual Conference
- American Bar Association Section of Dispute Resolution—Annual Spring Meeting
- International Ombudsman Association Annual Conference
- Securities Arbitration Clinics Annual Roundtable
- Corporate Counsel Women of Color Annual Conference
- International Network of Financial Services Ombudsmen Schemes Annual Conference
- SEC-hosted visit and panel discussions for the George Washington University School of Law Securities Seminar students
- On site visit, Legal Analytics Presentation on FINRA Research, Georgia State University College of Law, Investor Advocacy Clinic and Legal Analytics and Innovation Initiative

- Panelist, Women as Regulators in the Securities Industry, Women and Corporate Governance Conference, the George Washington University School of Law and *George Washington Law Review*
- Featured Presenter, Federal Chapter Session, United States Ombudsman Association Annual Conference

OUTLOOK FOR FISCAL YEAR 2020

As Ombudsman, I bridge a unique gap. Among my duties, I am required to both field complaints directly from retail investors about the SEC or the SROs we oversee, and serve as a liaison to help resolve those complaints. Analyzing those complaints and relaying pertinent, actionable information to SEC staff tasked with addressing regulatory concerns on a regular basis is an added value to both the SEC and the investing public, the importance of which grows more apparent with the increasing number and complexity of complaints received. However, staffing levels hinder my ability to provide this value on an ongoing basis while also fielding the rising volume of investor matters and contacts. Compared to the 3,693 investor contacts that I and one attorney-adviser on detail from another SEC division reviewed and responded to in Fiscal Year 2019—an average of 1,846 investor contacts each—other divisions and offices with similar external response duties average significantly lower numbers, peaking in the mid-hundreds per staff person per fiscal year. The additional staffing support proposed for Fiscal Year 2021 is much needed. It will help me address the volume and complexity of investor complaints and collaborate with my colleagues across the agency to ensure that the concerns of Main Street investors are considered throughout the regulatory process.

To appropriately focus my existing staff resources, I will continue to track detailed matter and contact information relating to investor complaints. In Fiscal Year 2020, I anticipate adding secondary

issue category reporting capability to OMMS to identify additional areas of concern within certain primary issue categories to allow for more targeted research, analysis, and reporting. I will also continue to identify areas where SEC messaging and processes that significantly impact Main Street investors may be refined and improved. Given some recent concerns and complaints raised by Main Street investors, areas of focus may include the messaging surrounding the Fair Fund process, including how and what the SEC communicates to retail investors awaiting Fair Fund distributions, messaging relating to advance fee fraud scams, and clarified messaging on how the SEC protects Main Street investors.

As discussed in this Ombudsman's Report, bringing the investor advocacy clinics together for an in-person summit in April 2019 was an extraordinary opportunity for SEC staff to hear directly from the clinics, and for the clinics to establish and strengthen their relationships with each other as they work to address retail investor concerns. Despite ongoing funding and operational challenges, investor advocacy clinics continue to

provide critical services to Main Street investors with small dollar amount claims who otherwise would have no practical options for legal representation. Investor advocacy clinic directors and law students are eager to identify areas in which retail investors may benefit from rulemaking and policy changes, and to offer feedback and practical solutions. I expect to convene another investor advocacy clinic summit or similar event in Fiscal Year 2020 to provide a forum for clinic directors and law students to share their perspectives on retail investor protection with each other and with SEC staff.

Finally, Fiscal Year 2020 should provide several opportunities to share my work and the work of the SEC with industry participants and the broader ombudsman and dispute resolution communities in ways that may directly benefit retail investors. I will also continue to explore ways to best use outreach opportunities, industry and investor events, and technology to better connect with investors and industry participants. I look forward to providing additional updates on Fiscal Year 2020 activities and progress in my next Ombudsman's Report.



Tracey L. McNeil
Ombudsman

REPORT ON INVESTOR TESTING

In 2017, the Office of the Investor Advocate formally launched the POSITIER investor testing initiative. POSITIER stands for Policy Oriented Stakeholder and Investor Testing for Innovative and Effective Regulation. POSITIER represents a flexible and sophisticated research and data collection architecture that is unique in government.

What makes POSITIER so unique? POSITIER provides rapidly deployable, cost-effective, and high quality data collection capacities with a high degree of flexibility. By the end of calendar year 2019, we will have completed 16 surveys, roughly 28 testing activities, 7 large qualitative studies and numerous research and policy studies. The result will be close to 35,000 completed survey questionnaires, hundreds of qualitative interview and focus group participants, and approximately 18.5 million unique quantitative data elements collected.

Benefits of Investor Testing

The traditional method by which agencies gather feedback from the public—the notice and comment process—has significant shortcomings. This is particularly true at the SEC, where it is unlikely that such feedback will come from a typical household or even a typical investor who has little awareness about securities regulation and policy developments at the SEC. More than likely, the comments will be provided by organizations with large stakes in the policy change—those with much to lose or gain from its enactment and that,

importantly, have the resources and expertise to understand the effect of the policy change on their organizations. Indeed, some organizations may encourage others with a similar interest to send in comments anonymously or under the guise of a typical investor to suggest that the preponderance of opinion and evidence points in their favor. At the same time, some consumer advocacy groups similarly may organize their own networks to send in commentary favorable to their point of view.

All of this information can play an important role in the policy process, but the policymaker receiving such information is often unable to assess how the information lines up with the policy's costs and benefits for society as a whole. Officials may form an inaccurate impression based on data resources that are shared with them rather than using data that has been independently developed for the purpose of understanding the issue. In essence, the information that is submitted through the comment process tends to be normatively biased and may also suffer from specific statistical biases. This makes it difficult or impossible—and often inappropriate—to use the information in cost-benefit analysis for a policy because it does not provide a complete, clear and unbiased picture of the implications of the proposed policy



for others that may either be adversely or beneficially affected.

Through POSITIER, we seek to supplement the comment process by obtaining information directly from investors that is objective and useful for decision-making at the SEC and elsewhere. Thus, in our efforts to build a flexible, responsive and rapidly deployable research initiative, we have placed the highest priority on high quality data collection. We can deploy a survey or a test to collect data using the best statistical and social science methods available. Our surveys are all nationally representative probability-based surveys similar to those conducted by the Census for various agencies. Our research endeavors are sequential and cumulative, meaning that we often analyze some results from a prior study before developing a new test.

Importantly, POSITIER is not simply a survey program—in fact, we intend to reduce reliance on surveys as alternative data sources become available. The crux of POSITIER is testing, and we focus on getting to measurable outcomes rather than opinions. This might include, for example, a test in which some households receive one type of disclosure document while other households receive a different version. With testing, we can collect evidence that helps to illuminate how proposals may work in the real world with real people.

Primary Research vs. Rulemaking

POSITIER is designed to accommodate research in support of a rule proposal and research that is more fundamental in nature. In the fall of 2018, for example, we published a study on the “Retail Market for Investment Advice” with support from the RAND Corporation. Although we did not directly work on the rulemaking, our research work was conducted to provide insights for the rulemaking process that ultimately led to Regulation Best Interest.

In designing POSITIER, we made a conscious effort to compress timeframes for research projects in order to accommodate the needs of agency leaders with respect to their rulemaking agendas. In order for our research to be decision-useful, it must be timely. We accomplished this objective in our research study on the Retail Market for Investment Advice when, in under six months, the project moved from the point of inception to completion of a full research report. This includes all time required for procurement, design, fielding of a survey instrument, data cleaning and report writing. By comparison, prior to POSITIER, a previous similar research project at the Commission took about three years from start to finish.

To date, most of the POSITIER effort has been devoted to primary research rather than research related to specific rulemakings. This type of fundamental research, done apart from the demands of a particular rule proposal, helps us to understand investors more generally and either provide a foundation for future policy or simply enrich the SEC’s understanding of investors. For example, what do households know about investing and investing products? How do they invest? What prevents them from investing? How do they interact with and process disclosure information? How do they evaluate investment options? Are they overloaded in terms of choice or information? Do households interact with financial markets in the way that economic and regulatory theory assume that they do? In our view, for the SEC to become an even more effective regulatory institution, it must pursue basic questions like these.

Supporting a New Way of Doing Business

In some regulatory agencies, rule proposals originate with rule writers and only undergo economic analysis at the back-end after most or all key decisions have been locked in. In fact, those conducting the economic analysis may have no influence on the proposal and in some

circumstances are only informed about the details of the proposal after it has been drafted and submitted to them. Pressure inevitably mounts to obtain economic analysis that is supportive of the rule, rather than analysis that provides a critical assessment of the rule. In effect, such analysis becomes more of a justification for decisions that have already been made. The lack of concrete data often means that the economic analysis itself is qualitative and speculative as to the impacts of the proposal.

With POSITIER, we can support a different way of conducting research, whereby intended outcomes are set forth up front and the rulemaking is designed to find the best way to achieve those outcomes. Instead of economic analysis being conducted on the back end, social science and other inputs can be used to gather available evidence in order to develop potential policy interventions, with a well-articulated “theory of change” describing how those interventions can produce the desired outcomes. POSITIER could then be utilized to design and implement a set of tests that could determine how the ideas work in practice, and in particular, to determine if the assumptions underlying the rule (e.g. that a new disclosure will be read by investors) are borne out in reality.

Challenges Facing POSITIER

Since its beginning, POSITIER has received strong support from SEC leadership. Nonetheless, we continue to face challenges that make it difficult to realize the full potential of POSITIER. In particular, we suffer from resource constraints, most acutely in terms of human capital.

During Fiscal Year 2019, POSITIER was staffed with one full-time senior economist and one contract research assistant to conduct seven new data collection projects and much analysis of data. In contrast, similar research programs at other financial regulatory agencies typically devote multiple economists as well as other staff to each project because testing efforts require careful planning, enormous attention to detail, and a variety of highly specialized skills. We look forward to the addition of a decision scientist and a part-time academic fellow to the POSITIER team in early 2020, but we will still lack the resources that are needed to have a full-fledged investor testing program.

As with many government agencies, our work was negatively impacted by the lapse in government appropriations in December and January of 2018-2019. The resulting government shutdown disrupted our workplan and required a considerable amount of effort to reprogram our activities. Moreover, because of the uncertain budget environment we had no choice but to compress a 12-month workplan into six months.

Looking ahead to the next year, we will continue to make progress on our current topical research streams and stand ready to support the Commission in other efforts where they deem that evidence could help to guide their work. We have made great strides in developing survey instruments and understanding some key cognitive and conceptual barriers for investors, and we look forward to sharing the results of our work.



Brian Scholl, Ph.D.
Principal Economic Advisor and Senior Economist
Office of the Investor Advocate



SUMMARY OF IAC RECOMMENDATIONS AND SEC RESPONSES

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.²¹⁶ 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.²¹⁷

Exchange Act Section 39 authorizes the Committee to submit findings and recommendations for review and consideration by the Commission.²¹⁸ 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.²¹⁹ While the Commission must respond to the IAC’s recommendations, it is under no obligation to agree with or act upon the recommendations.²²⁰

In each of its reports to Congress, including this one, the Office of the Investor Advocate summarizes the IAC recommendations and the SEC’s responses to them.²²¹

In the past, the Commission has taken action that was responsive to a number of IAC recommendations, such as those related to Regulation Best Interest, Form CRS, and IA Fiduciary Guidance.²²² This Report covers recommendations of the IAC to which the Commission responded in the latest reporting period or those to which the Commission response is pending. For more detailed summaries of previous Commission responses, please see our earlier reports to Congress.

The Commission may be pursuing initiatives that are responsive to IAC recommendations but have not yet been made public. Commission staff—including the staff of this Office—are prohibited from disclosing nonpublic information.²²³ Therefore, any such initiatives are not reflected in this Report.

Topic	Date	IAC Recommendation	SEC Response
Proxy Plumbing ²²⁴	Sept. 5, 2019	Require end-to-end confirmation of votes; enforce a duty to cooperate in more routine, off-cycle reconciliations; study share lending and investor preferences regarding anonymity; and relax current regulations that inhibit use of universal proxies.	Pending.
Investment Research in a Post-MiFID II World ²²⁵	July 25, 2019	Provide consumers of research a choice whether to purchase research bundled or unbundled from trading fees, and enhance transparency of costs.	On Nov. 4, 2019, the SEC staff issued an extension of an earlier no-action letter until July 3, 2023. The original letter had been set to expire on July 3, 2020. Under the extension, the staff said it would not recommend enforcement action to the Commission under the Investment Advisers Act of 1940 against broker-dealers receiving payments in hard dollars or through research payment accounts from clients subject to MiFID II. ²²⁶
Human Capital Management (HCM) Disclosure ²²⁷	March 28, 2019	Incorporate HCM as a part of the Commission's effort to modernize corporate reporting and disclosure, including disclosure requirements regarding the number of people employed, competitive conditions, and how human capital within a firm is being incentivized and managed.	On Aug. 8, 2019, the Commission proposed rule amendments to modernize the description of business, legal proceedings, and risk factor disclosures that registrants are required to make pursuant to Regulation S-K. One amendment (of Item 101(c)) would include, as a disclosure topic, human capital resources, including any human capital measures or objectives that management focuses on in managing the business, to the extent such disclosures would be material to an understanding of the registrant's business. Depending on the nature of the registrant's business and workforce, disclosure items could include measures or objectives that address the attraction, development, and retention of personnel. ²²⁸ The comment period ended on Oct. 22, 2019.

Topic	Date	IAC Recommendation	SEC Response
Transaction Fee Pilot for NMS Stocks ²²⁹	Sept. 13, 2018	Adopt a proposed Transaction Fee Pilot with the following conditions: (1) include a “no rebate” bucket; (2) permit companies to opt out of the pilot; and (3) consider consolidating Test Groups 1 and 2.	On Dec. 19, 2018, the SEC announced that it had voted to adopt new Rule 610T of Regulation NMS to conduct a Transaction Fee Pilot in NMS stocks. ²³⁰ On March 28, 2019, following a lawsuit filed by several exchanges, the SEC issued an order staying the rule and pilot program pending final resolution of the petitions. ²³¹ Litigation continued in the reporting period.
Financial Support for Law School Clinics that Support Investors ²³²	March 8, 2018	Explore ways to improve external funding sources to the law school investor advocacy clinics. Work with FINRA and other potential partners, and request legislation from Congress to consider permanent funding.	Pending. On April 4, 2019, the Ombudsman’s office hosted an Investor Advocacy Clinic Summit.
Dual Class and Other Entrenching Governance Structures in Public Companies ²³³	March 8, 2018	The SEC Division of Corporation Finance should encourage companies to improve the disclosure of risks related to such structures and commence a pilot program to monitor shareholder disputes and to determine if enhanced disclosure requirements are necessary.	Pending. This topic was discussed on Nov. 15, 2018, at an SEC public roundtable on the proxy process.

Topic	Date	IAC Recommendation	SEC Response
Mutual Fund Cost Disclosure ²³⁴	April 14, 2016	Enhance investors' understanding of mutual fund costs and the impact of those costs on total accumulations over time. Provide standardized disclosure of actual dollar costs on customer account statements.	<p>On June 4, 2018, the SEC issued a request for comment on ways to enhance the delivery, design, and content of fund disclosures, including shareholder reports and prospectuses. The request for comment solicited investor feedback on fund fees and expenses, and it included other questions related to the IAC recommendation (e.g., dollar vs. percentage disclosure, disclosure within account statements, etc.).²³⁵</p> <p>On Oct. 30, 2018, the SEC proposed amendments to help investors make informed investment decisions regarding variable annuity and variable life insurance contracts.²³⁶ The release cited responses to the June 2018 request for comment to support the notion that investors prefer shorter summary disclosures, with additional information available online or upon request.²³⁷ The comment period closed on March 15, 2019.</p>
Accredited Investor Definition ²³⁸	Oct. 9, 2014	Consider enabling individuals to qualify as accredited investors based on their financial sophistication.	<p>On June 18, 2019, the SEC issued a Concept Release on Harmonization of Securities Offering Exemptions.²³⁹ The release sought comment regarding the "accredited investor" definition and whether it should include investors with demonstrable financial sophistication.</p> <p>Previously, in Dec. 2015, the SEC issued a staff report that discussed, among other alternatives, using sophistication as an element of the accredited investor definition.²⁴⁰</p>

Topic	Date	IAC Recommendation	SEC Response
Impartiality in the Disclosure of Preliminary Voting Results ²⁴¹	Oct. 9, 2014	Ensure impartiality in the disclosure of preliminary voting results.	Pending.
Universal Proxy Ballots ²⁴²	July 25, 2013	Allow universal ballots in connection with short slate director nominations.	On October 26, 2016, the SEC proposed amendments to the proxy rules to require parties in a contested election to use universal proxy cards that would include the names of all board of director nominees. The comment period closed on January 9, 2017. ²⁴³ This topic was discussed on Nov. 15, 2018, at an SEC public roundtable on the proxy process.

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 See SEC, Office of the Investor Advocate, *Report on Objectives, Fiscal Year 2019* (June 29, 2018) [hereinafter *Report on Objectives, Fiscal Year 2019*], <https://www.sec.gov/advocate/reportspubs/annual-reports/sec-office-investor-advocate-report-on-objectives-fy2019.pdf>.
- 4 Exchange Act § 4(g)(6)(B)(i), 15 U.S.C. § 78d(g)(6)(B)(i).
- 5 *Id.* Exchange Act Section 4(g)(6)(B) requires the Report on Activities to include an “inventory” of the most serious problems encountered by investors during the Reporting Period. The inventory must identify any action taken by the Commission or an SRO to resolve each problem, the length of time that each item has remained on our 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.
- 6 Exchange Act § 4(g)(4), 15 U.S.C. § 78d(g)(4).
- 7 *Report on Objectives, Fiscal Year 2019*, *supra* note 3.
- 8 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 (Dodd-Frank Act). On February 24, 2014, SEC Chair Mary Jo White appointed Rick A. Fleming as the Commission’s first Investor Advocate.
- 9 See Modernization of Regulation S-K Items 101, 103, and 105, Securities Act Rel. No. 10668, 84 Fed. Reg. 44358 (Aug. 23, 2019).
- 10 The disclosure would be required only “to the extent material to an understanding of the registrant’s business taken as a whole.” See *id.* at 44365.
- 11 See Modernization of Property Disclosures for Mining Registrants, Securities Act Rel. No. 10570, 83 Fed. Reg. 66344 (Dec. 26, 2018) [hereinafter *Mining Registrants Adopting Release*].
- 12 See Update of Statistical Disclosures for Bank and Savings and Loan Registrants, Securities Exchange Act Rel. No. 86984, 84 Fed. Reg. 52936 (Oct. 3, 2019) [hereinafter *Banking Disclosure Proposing Release*].
- 13 For an example of our public advocacy on this topic, see Rick A. Fleming, Investor Advocate, SEC, *Improving Disclosure with Smart Data* (Oct. 24, 2016), <https://www.sec.gov/news/speech/improving-disclosure-with-smart-data.html>.
- 14 See Item 1304(b)(1)(i) of Regulation S-K.
- 15 See Modernization of Property Disclosures for Mining Registrants, Securities Act Release No. 10098, 81 Fed. Reg. 41651, 41709 (June 27, 2016) (contemplating structured disclosures as an option in the proposal). “When registrants provide disclosure items in a structured data format, investors and other data users (e.g., analysts) can more easily retrieve and use the information reported by registrants and perform comparisons of common disclosures across registrants and reporting periods.” *Id.* See also “A Primer on Machine Readability for Online Documents and Data,” Data.gov Developers Blog, <https://www.data.gov/developers/blog/primer-machine-readability-online-documents-and-data> (last accessed Nov. 4, 2019).
- 16 See Mining Registrants Adopting Release, *supra* note 11, at 66408 (stating that “presentation in a structured format, such as XBRL, would impose additional burdens on registrants without providing substantial additional benefits for users of the information”); Banking Disclosure Proposing Release, *supra* note 12, at 52958 (citing “limited feedback on this point”).
- 17 See Foundations for Evidence-Based Policymaking Act of 2018, Pub. L. No. 115-435, § 201, 132 Stat. 5529, 5534-5544 (2019) (with the OPEN Government Data Act beginning at Section 202).
- 18 See Solicitations of Interest Prior to a Registered Public Offering, Securities Act Rel. No. 10699, 84 Fed. Reg. 53011 (Oct. 4, 2019).
- 19 See Letter from The Credit Roundtable to Elizabeth M. Murphy, Secretary, SEC (Feb. 4, 2010), SEC File No. S7-30-09, <https://www.sec.gov/comments/s7-30-09/s73009-14.pdf>; Letter from The Credit Roundtable to Hon. Jeb Hensarling and Hon. Maxine Waters, H. Comm. on Financial Servs. (June 12, 2019), https://www.iimemberships.com/sites/iic/files/Credit%20Roundtable%20Comment%20on%20Bill%20H.R.%206035_2.pdf.
- 20 The group followed up with a submission to the rulemaking proposal’s comment file. See Letter from The Credit Roundtable to Brent J. Fields, Secretary, SEC (Apr. 29, 2019), SEC File No. S7-01-19, <https://www.sec.gov/comments/s7-01-19/s70119-5422921-184609.pdf>.
- 21 See Jay Clayton, Chairman, SEC, *SEC Rulemaking Over the Past Year, the Road Ahead and Challenges Posed by Brexit, LIBOR Transition and Cybersecurity Risks* (Dec. 6, 2018), <https://www.sec.gov/news/speech/speech-clayton-120618>.
- 22 See Concept Release on Harmonization of Securities Offering Exemptions, Securities Act Rel. No. 10649, 84 Fed. Reg. 30460 (June 26, 2019).
- 23 See Letter from Rick A. Fleming, Investor Advocate, SEC to Vanessa Countryman, Secretary, SEC (July 11, 2019), SEC File No. S7-08-19, <https://www.sec.gov/comments/s7-08-19/s70819-5800855-187067.pdf>.

- 24 See Testimony Before the Subcomm. on Investor Protection, Entrepreneurship, and Capital Markets of the H. Comm. on Financial Servs., 116th Cong. (Sept. 11, 2019) (testimony of Elisabeth de Fontenay, Professor of Law, Duke University), available at <https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=404232>.
- 25 See November 15, 2018: Roundtable on the Proxy Process, available at <https://www.sec.gov/proxy-roundtable-2018>.
- 26 See Rick Fleming, Investor Advocate, SEC, *Important Issues for Investors in 2019* (Apr. 8, 2019), <https://www.sec.gov/news/speech/fleming-important-issues-investors-2019>.
- 27 See Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, Investment Advisers Act Release No. 5325, 84 Fed. Reg. 47420 (Sept. 10, 2019).
- 28 See Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice, Exchange Act Rel. No. 86721, 84 Fed. Reg. 47416 (Sept. 10, 2019).
- 29 See Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, Exchange Act Release No. 87457 (adopted Nov. 5, 2019), <https://www.sec.gov/rules/proposed/2019/34-87457.pdf>.
- 30 See Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8, Exchange Act Rel. No. 87458 (adopted Nov. 5, 2019), <https://www.sec.gov/rules/proposed/2019/34-87458.pdf>.
- 31 See Disclosure of Order Handling Information, Exchange Act Release No. 84528, 83 Fed. Reg. 58338 (adopted Nov. 2, 2018).
- 32 See *id.*
- 33 See, e.g., Order Granting Application by The Financial Information Forum and Security Traders Association for an Exemption Pursuant to Rule 606(c) of Regulation NMS Under the Exchange Act from Certain Requirements of Rule 606 of Regulation NMS Under the Exchange Act, Exchange Act Release No. 86874 (Sept. 4, 2019), 84 Fed. Reg. 47625 (Sept. 10, 2019), <https://www.federalregister.gov/d/2019-19469>.
- 34 See Transaction Fee Pilot for NMS Stocks, Exchange Act Release No. 84875, 84 Fed. Reg. 5,202 (adopted Dec. 19, 2018), <https://www.federalregister.gov/d/2018-27982>.
- 35 See SEC, *Recommendation of the Investor Advisory Committee: Crowdfunding Regulations* (Sept. 13, 2018), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-transaction-fee-pilot-for-nms-stocks.pdf>.
- 36 See SEC, *Order Issuing Stay*, In the Matter of Rule 610T of Regulation NMS, Exchange Act Release No. 85447 (March 28, 2019), <https://www.sec.gov/rules/other/2019/34-85447.pdf>.
- 37 See Exchange Act § 4(g)(4), 15 U.S.C. § 78d(g)(4).
- 38 See Cboe EDGA Exchange, Inc., Order Instituting Proceedings To Determine Whether To Approve or Disapprove a Proposed Rule Change To Introduce a Liquidity Provider Protection Delay Mechanism on EDGA, Exchange Act Release No. 87096, 84 Fed. Reg. 51657 (published Sept. 24, 2019), <https://www.federalregister.gov/d/2019-21096>.
- 39 See *id.*
- 40 See Comments on Cboe EDGA Rulemaking, <https://www.sec.gov/comments/sr-cboeedga-2019-012/srcboeedga2019012.htm>.
- 41 Memorandum from Rick A. Fleming, Investor Advocate, to the Securities and Exchange Commission (Dec. 13, 2019), <https://www.sec.gov/advocate/investor-advocate-comment-letters.html>.
- 42 See, e.g., Cboe EDGX Exchange, Inc.; Order Granting Approval of a Proposed Rule Change, as Modified by Amendment No. 1, To Introduce Retail Priority, Exchange Act Release No. 87200 (Oct. 2, 2019), 84 Fed. Reg. 53788 (Oct. 8, 2019)).
- 43 See Nasdaq Inc., Solicitation of Comments on Behalf of the NASDAQ Listing and Hearing Review Counsel, Potential Changes to the Initial Listing Requirements to Enhance Investor Protection and the Liquidity of Listed Securities (Oct. 5, 2018), https://listingcenter.nasdaq.com/assets/Liquidity_Measures_Comment_Solicitation.pdf. The Commission approved some of the contemplated changes in July 2019. See Exchange Act Release No. 86314 (July 5, 2019), 84 Fed. Reg. 33102 (July 11, 2019), <https://www.federalregister.gov/d/2019-14723>.
- 44 See, e.g., In the Matter of the Application of Long Term Stock Exchange, Inc.; for Registration as a National Securities Exchange; Findings, Opinion, and Order of the Commission, Securities Exchange Act Release No. 85828 (May 10, 2019), 84 Fed. Reg. 21841 (May 15, 2018), <https://www.federalregister.gov/d/2019-10037>.
- 45 See SEC, Staff Guidance on SRO Rule Filings Relating to Fees (May 21, 2019), <https://www.sec.gov/tm/staff-guidance-sro-rule-filings-fees>.
- 46 See Joint Industry Plan, Order Approving the National Market System Plan Governing the Consolidated Audit Trail, Exchange Act Release No. 79318 (Nov. 15, 2016), <https://www.sec.gov/rules/sro/nms/2016/34-79318.pdf>.
- 47 SEC, Office of the Investor Advocate, *Report on Activities, Fiscal Year 2018* (Dec. 20, 2018) at 10, <https://www.sec.gov/advocate/reportspubs/annual-reports/sec-investor-advocate-report-on-activities-2018.pdf>.

- 48 Letter from Rick A. Fleming, Investor Advocate, SEC to Ronald W. Smith, Corp. Sec’y, Mun. Sec. Rulemaking Bd., RE: MSRB Regulatory Notice 2018-15, Request for Comment on Draft Amendments to MSRB Rules on Primary Offering Practices (Sept. 17, 2018), <https://www.msrb.org/RFC/2018-15/SEC.pdf> [hereinafter Comment Letter, Regulatory Notice 2018-15].
- 49 MSRB, Notice 2018-15, Request for Comment on Draft Amendments to MSRB Rules on Primary Offering Practices (July 19, 2018), <http://www.msrb.org/~media/Files/Regulatory-Notices/RFCs/2018-15.ashx?n=1> [hereinafter MSRB, Regulatory Notice 2018-15].
- 50 *Id.* at 9.
- 51 Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, Consisting of Proposed Amendments to MSRB Rule G-11 and MSRB Rule G-32 and Form G-32 Regarding a Collection of Data Elements Provided in Electronic Format to the EMMA Dataport System in Connection with Primary Offerings, Exchange Act Release No. 86219, 81 Fed. Reg. 31961 (July 3, 2019).
- 52 *See* Comment Letter, Regulatory Notice 2018-15, *supra* note 48.
- 53 *See* SEC, Notice of Federal Advisory Committee Establishment, Fixed Income Market Structure Advisory Committee, Exchange Act Release No. 81958 (Oct. 26, 2017), 82 Fed. Reg. 50460 (Oct. 31, 2017), <https://www.federalregister.gov/d/2017-23670>.
- 54 *See* SEC, Press Release, SEC Issues Agenda for April 15 Meeting of the Fixed Income of the Fixed Income Market Structure Advisory Committee, 2019-54 (Apr. 11, 2019), <https://www.sec.gov/news/press-release/2019-54>; *see also* SEC, Fixed Income Market Structure Advisory Committee, Transcript of Meeting, April 15, 2019, <https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-041519-transcript.txt>. Our Office also highlighted the issue of pennyng in our *Report on Objectives, Fiscal Year 2019* and our *Report on Activities, Fiscal Year 2018*. SEC, Office of the Investor Advocate, *Report on Objectives, Fiscal Year 2019* (June 29, 2018), at 9, <https://www.sec.gov/advocate/reportspubs/annual-reports/sec-office-investor-advocate-report-on-objectives-fy2019.pdf>; *see* SEC, Office of the Investor Advocate, *Report on Activities, Fiscal Year 2018* (Dec. 20, 2018), at 16, n. 105, <https://www.sec.gov/advocate/reportspubs/annual-reports/sec-investor-advocate-report-on-activities-2018.pdf>.
- 55 Letter from Lynnette Kelly, Exec. Dir., MSRB, to Rick A. Fleming, Investor Advocate, SEC, RE: Response to Investor Advocate Request Highlighting Municipal Market Practices (Oct. 19, 2018), <http://www.msrb.org/Market-Topics/~media/1BD671EB464F406282968143A8A65274.ashx>.
- 56 Press Release, Leah Szarek, Director of Communications, MSRB Holds First Quarterly Board Meeting of FY 2020 (Oct. 25, 2019), http://msrb.org/About-MSRB/Governance/MSRB-Board-of-Directors/~link.aspx?_id=CD2CA7D229484D27929524D3B4A54776&_z=z.
- 57 *See* SEC, FIMSAC, Recommendation for a Pilot Program to Study the Market Implications of Changing the Reporting Regime for Block-Size Trades in Corporate Bonds (April 9, 2018), <https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-block-trade-recommendation.pdf>.
- 58 *See* FINRA, Trade Reporting and Compliance Engine (TRACE), Regulatory Notice 19-12 (April 12, 2019), https://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-19-12.pdf.
- 59 Jay Clayton, Chairman, SEC, Wes Bricker, Chief Accountant, SEC and William D. Duhnke III, Chairman, PCAOB, Statement on the Vital Role of Audit Quality and Regulatory Access to Audit and Other Information Internationally—Discussion of Current Information Access Challenges with Respect to U.S.-listed Companies with Significant Operations in China, (Dec. 7, 2018), at <https://www.sec.gov/news/public-statement/statement-vital-role-audit-quality-and-regulatory-access-audit-and-other>.
- 60 Polina Marinova, *Why Investors Should Worry About the Regulator of U.S. Auditors*, *Fortune*, Nov. 26, 2019, <https://fortune.com/2019/11/26/why-investors-should-worry-about-the-regulator-of-u-s-auditors/>.
- 61 *See* Amendments to the Accelerated Filer and Large Accelerated Filer Definitions, Exchange Act Release No. 85814, 84 Fed. Reg. 36434 (May 9, 2019), <https://www.sec.gov/rules/proposed/2019/34-85814.pdf>.
- 62 *See, e.g.*, comment letters from Better Markets, the Council of Institutional Investors (CII), the CFA Institute, and the Consumer Federation of America. The Comment file is available at SEC, Comments on Proposed Rule: Amendments to the Accelerated Filer and Large Accelerated Filer Definitions, <https://www.sec.gov/comments/s7-06-19/s70619.htm>.
- 63 Letter from Weili Ge, Professor, University of Washington, Allison Koester, Associate Professor, Georgetown University, and Sarah McVay, Professor, University of Washington to SEC, *Comments on S7-06-19 “Amendments to the Accelerated Filer and Large Accelerated Filer Definitions”* (July 26, 2019), <https://www.sec.gov/comments/s7-06-19/s70619-5879065-188729.pdf> [hereinafter Comment Letter, Ge, et al.].
- 64 Weili Ge, Allison Koester, & Sarah McVay, Benefits and Costs of Sarbanes-Oxley Section 404(b) Exemption: Evidence from Small Firms’ Internal Control Disclosures, 63 J. OF ACCT. AND ECON. 358 (2017) (“Ge et al. 2017 Study”).

- 65 Comment Letter, Ge, et al., *supra* note 63.
- 66 Comment Letter, Mary Barth, Wayne Landsman, Joseph Schroeder, and Daniel Taylor to SEC, *Re: Amendments to the Accelerated Filer and Large Accelerated Filer Definitions - File No. S7-06-19* (July 11, 2019), <https://www.sec.gov/comments/s7-06-19/s70619-5802113-187069.pdf> [hereinafter Comment Letter, Barth, et al.]
- 67 *See* Amendments to the Accelerated Filer and Large Accelerated Filer Definitions, Exchange Act Release No. 85814 (May 9, 2019), at 70, <https://www.sec.gov/rules/proposed/2019/34-85814.pdf>.
- 68 Comment Letter, Barth, et al., *supra* note 66.
- 69 That includes both Section 404(a), requiring management’s assessment of the effectiveness of the company’s ICFR, and 404(b), requiring ICFR auditor attestation. *See* Peter Iliev, *The Effect of SOX Section 404: Costs, Earnings Quality, and Stock Prices*, 45 J. OF FIN. 1163 (2010), at 20-24.
- 70 Robert J. Jackson Jr., Commissioner, SEC, Public Statement: Statement on Proposed Amendments to Sarbanes Oxley 404(b) Accelerated Filer Definition (May 9, 2019), <https://www.sec.gov/news/public-statement/jackson-statement-proposed-amendments-accelerated-filer-definition>.
- 71 *Id.*
- 72 *Id.*
- 73 Comment Letter, Barth, et al., *supra* note 66.
- 74 SEC, Press Release and Fact Sheet, SEC Adopts Rules and Interpretations to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships With Financial Professionals, 2019-89 (June 5, 2019), <https://www.sec.gov/news/press-release/2019-89> [hereinafter Regulation Best Interest Press Release and Fact Sheet].
- 75 *See Report on Objectives, Fiscal Year 2019, supra* note 3, at 11.
- 76 *See* Regulation Best Interest: The Broker-Dealer Standard of Conduct, Exchange Act Release No. 86031, 84 Fed. Reg. 33318 (adopted June 5, 2019) [hereinafter Regulation Best Interest].
- 77 *See* Form CRS Relationship Summary; Amendments to Form ADV, Exchange Act Release No. 86032, Investment Advisers Act Release No. 5247, 84 Fed. Reg. 33492 (adopted June 5, 2019) [hereinafter Form CRS Relationship Summary].
- 78 *See* Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Investment Advisers Act Release No. 5248, 84 Fed. Reg. 33669 (adopted June 5, 2019) [hereinafter Commission Interpretation—Standard of Conduct for Investment Advisers]; Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser, Investment Advisers Act Release No. 5249, 84 Fed. Reg. 33681 (adopted June 5, 2019) [hereinafter Commission Interpretation—Broker-Dealer Exclusion].
- 79 *See* Regulation Best Interest Press Release and Fact Sheet, *supra* note 74.
- 80 *See* Regulation Best Interest, *supra* note 76, at section II.C.1.
- 81 *See id.* at section II.C.2.
- 82 *See id.* at section II.C.3.
- 83 *See id.* at section II.C.4.
- 84 *See id.*
- 85 *See* Regulation Best Interest Press Release and Fact Sheet, *supra* note 74.
- 86 *See id.*
- 87 *See id.*
- 88 *See* Rick A. Fleming, Investor Advocate, SEC, Statement Regarding the SEC’s Rulemaking Package for Investment Advisers and Broker-Dealers (June 5, 2019), <https://www.sec.gov/news/public-statement/statement-regarding-sec-rulemaking-package-investment-advisers-broker-dealers>.
- 89 *See Report on Objectives, Fiscal Year 2019, supra* note 3, at 13.
- 90 *See* Exchange-Traded Funds, Securities Act Release No. 10695, Investment Company Act Release No. 33646, 84 Fed. Reg. 57162 (adopted Sept. 25, 2019) [hereinafter ETF Rule].
- 91 *See id.* at nn. 6 and accompanying text.
- 92 *See id.* at nn. 2 and accompanying text.
- 93 *See id.* at section II.C.
- 94 *See id.* at section II.A.
- 95 *See id.* at section II.G.
- 96 *See id.* at sections II.H-I.
- 97 *Report on Objectives, Fiscal Year 2019, supra* note 3, at 13.
- 98 *See id.* at section II.A.3; *id.* at nn. 8.
- 99 *See id.* at section II.A.3.
- 100 *See id.* at nn. 8.

- 101 See, e.g., Kathleen Moriarty, *SEC's New ETF Rule Is A Win For Issuers, Investors*, Law 360 (Oct. 29, 2019), <https://www.law360.com/articles/1212866/sec-s-new-etf-rule-is-a-win-for-issuers-investors>; Sarah Max, *Will the SEC's New ETF Rule Benefit Investors?*, Barron's (Sept. 26, 2019), <https://www.barrons.com/articles/will-the-secs-new-etf-rule-benefit-investors-51569519577>.
- 102 See *Report on Objectives, Fiscal Year 2019*, *supra* note 3, at 13.
- 103 See *id.*
- 104 See *id.*
- 105 See *id.*; see also Request for Comment on Fund Retail Investor Experience and Disclosure, Securities Act Release No. 10503, Exchange Act Release No. 83376, Investment Company Act Release No. 33113 (June 5, 2018), <https://www.sec.gov/rules/other/2018/33-10503.pdf> [hereinafter Request for Comment on Fund Retail Investor Experience].
- 106 SEC, Press Release and Fact Sheet, SEC Proposes Disclosure Improvements for Variable Annuities and Variable Life Insurance Contracts, 2018-246 (Oct. 30, 2018), <https://www.sec.gov/news/press-release/2018-246> [hereinafter Disclosure Improvements Press Release and Fact Sheet]; see also Updated Disclosure Requirements and Summary Prospectus for Variable Annuity and Variable Life Insurance Contracts, Securities Act Release No. 10569, Exchange Act Release No. 84508, Investment Company Act Release No. 33286, 83 Fed. Reg. 61730 (proposed Oct. 18, 2018) at nn. 39 and accompanying text (“Multiple comment letters that the Commission has received to date on [the Request for Comment on Fund Retail Investor Experience] reflect a preference for shorter summary disclosures, with additional information available online or upon request.”).
- 107 See Disclosure Improvements Press Release and Fact Sheet, *supra* note 106.
- 108 See *id.*
- 109 See *Report on Objectives, Fiscal Year 2019*, *supra* note 3 at 13.
- 110 Jay Clayton, Chairman, SEC and Brett Redfearn, Director, Trading and Markets, SEC, Equity Market Structure 2019: Looking Back and Moving Forward: Remarks at Gabelli School of Business, Fordham University, New York, NY (Mar. 8, 2019), <https://www.sec.gov/news/speech/clayton-redfearn-equity-market-structure-2019>.
- 111 Jay Clayton, Chairman, SEC and Brett Redfearn, Director, Trading and Markets, SEC, Equity Market Structure 2019: Looking Back and Moving Forward: Remarks at Gabelli School of Business, Fordham University, New York, NY (Mar. 8, 2019), <https://www.sec.gov/news/speech/clayton-redfearn-equity-market-structure-2019> (“Transfer agents who provide services to issuers of restricted and control securities generally are responsible for processing requests from selling shareholders to remove restrictive legends in connection with the intended resale of these securities by their owners. If a transfer agent improperly or inappropriately removes a legend, it could facilitate an illegal public distribution of securities that could harm investors.”).
- 112 Jay Clayton, Chairman, SEC and Brett Redfearn, Director, Trading and Markets, SEC, Equity Market Structure 2019: Looking Back and Moving Forward: Remarks at Gabelli School of Business, Fordham University, New York, NY (Mar. 8, 2019), <https://www.sec.gov/news/speech/clayton-redfearn-equity-market-structure-2019>.
- 113 Rick Fleming, Investor Advocate, SEC, Important Issues for Investors in 2019: The SEC Speaks in 2019, Washington, D.C. (Apr. 8, 2019), <https://www.sec.gov/news/speech/fleming-important-issues-investors-2019>.
- 114 Peter Driscoll, Director, Office of Compliance Inspections and Examinations, SEC, Remarks at the SIFMA Operations Conference & Exhibition: Staying Vigilant to Protect Investors (May 8, 2019), <https://www.sec.gov/news/speech/driscoll-remarks-sifma-operations-conference-050819>.
- 115 Office of Info. And Regulatory Affairs, Office of Mgmt. and Budget, Agency Rule List – Fall 2019, SEC, *available at* https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST¤tPub=true&agencyCode=&showStage=active&agencyCd=3235&Image58.x=45&Image58.y=16&csrf_token=143DD8654FCB5A263E8BF3E26CEEC90D54A278A41BF77433B1F1EE467F80FA06020990AB0A7A5647FEFF3C9A2567BCBE76F7 (last visited Nov. 21, 2019).
- 116 *Kokesh v. SEC*, 137 S. Ct. 1635, 1645 (2017).
- 117 *Report on Objectives, Fiscal Year 2019*, *supra* note 3, at 15-16.
- 118 SEC, Division of Enforcement, *2019 Annual Report*, at 21 (Nov. 6, 2019), <https://www.sec.gov/files/enforcement-annual-report-2019.pdf>.
- 119 *Id.*
- 120 Investor Protection and Capital Markets Fairness Act, H.R. 4344, 116th Cong. (2019).
- 121 Stephen Deane, SEC, Office of the Investor Advocate, *How the SEC Works to Protect Senior Investors* (May 2019), <https://www.sec.gov/about/offices/investorad/how-the-sec-works-to-protect-senior-investors.pdf>.
- 122 Stephen Deane, SEC, Office of the Investor Advocate, *Elder Financial Exploitation: Why it is a concern, what regulators are doing about it, and looking ahead* (June 2018), <https://www.sec.gov/files/elder-financial-exploitation.pdf>.

- 123 See FINRA, Regulatory Notice 19-27, Retrospective Rule Review, FINRA Requests Comment on Rules and Issues Relating to Senior Investors, (Aug. 9, 2019), <https://www.finra.org/sites/default/files/2019-09/Regulatory-Notice-19-27.pdf>.
- 124 Exchange Act § 4(g)(6)(B)(ii)(V), 15 U.S.C. § 78d(g)(6)(B)(ii)(V).
- 125 NASAA, *NASAA 2017-2018 Activity Report, Working Together to Protect Investors*, <https://www.nasaa.org/wp-content/uploads/2019/06/NASAA-2017-2018-Activity-Report.pdf> [hereinafter NASAA, *Activity Report*].
- 126 NASAA, *NASAA Enforcement Report: 2019 Report Based on 2018 Data* (Sept. 2019), <https://www.nasaa.org/52518/nasaa-releases-annual-enforcement-report-5/> [hereinafter NASAA *Enforcement Report*].
- 127 NASAA, *Top Investor Threats*, <https://www.nasaa.org/investor-education/fraud-center/top-investor-threats/> (last visited Nov. 19, 2019).
- 128 SEC, Office of Compliance Inspections and Examinations, *Examination Priorities for 2019* (Dec. 20, 2018), <https://www.sec.gov/files/OCIE%202019%20Priorities.pdf>.
- 129 Letter from Nanette D. Lawson, Interim Chief Exec. Officer and Chief Financial Officer, MSRB, to Rick A. Fleming, Investor Advocate, SEC, *RE: Response to Investor Advocate Request Highlighting Municipal Market Practices* (Nov. 12, 2019), <http://msrb.org/Market-Topics/~media/A917F7F313A1457D857A4B9EEB4C99FE.ashx?>.
- 130 Throughout FY 2019, OIAD staff has engaged in conversations with the Division of Enforcement's Retail Strategy Task Force. During FY 2019, the Division of Enforcement investigated and recommended numerous actions with an eye toward protecting the "Main Street" or retail investors including, but not limited to, offering frauds, pump-and-dump schemes, unscrupulous market participants, cyber threats, misconduct by issuers and auditors, and violations by financial institutions, investment advisers, broker-dealers, hedge funds, and other regulated market participants. Moreover, the Division of Enforcement remained focused on individual accountability.
- 131 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 Office of Compliance Inspections and Examinations during FY 2019. See SEC, Office of Investor Education and Advocacy, *Investor Alerts and Bulletins*, <https://www.sec.gov/investor/alerts> (last visited Nov. 13, 2019); see also SEC, Office of Compliance Inspections and Examinations, *Risk Alerts*, <https://www.sec.gov/ocie> (last visited Nov. 13, 2019).
- 132 See NASAA, *Investor Advisories*, <https://www.nasaa.org/category/investor-education/investor-advisories/> (last visited Nov. 18, 2019); see also NASAA *Activity Report*, *supra* note 125; see also NASAA *Enforcement Report*, *supra* note 126; see also NASAA, *Top Investor Threats*, *supra* note 127.
- 133 This list of problematic products is based on the alerts and bulletins issued by FINRA for investors during FY 2019.
- 134 *Lawson*, *supra* note 129.
- 135 Typically, a municipal bond dealer places a retail client's bid-wanted out to the market and compiles the bids received to determine the winning bid. In "pennying" or as it may also be called, "last look," the dealer rather than execute a trade with the highest bidder, will nominally exceed the high bid to the client and buy the bond for the dealer's own trading account. The MSRB has expressed concern that it can be harmful to investors over the long-term if the practice discourages broad market participation in the bidding process and renders the market less efficient. *Lawson*, *supra* note 130.
- 136 See Proposed Exemptive Order Granting a Conditional Exemption from the Broker Registration Requirements of Section 15(a) of the Securities Exchange Act of 1934 for Certain Activities of Registered Municipal Advisors, Exchange Act Release No. 87204, 84 Fed. Reg. 54062 (proposed Oct. 2, 2019), <https://www.sec.gov/rules/exorders/2019/34-87204.pdf>. The proposed Exemptive Order would provide municipal advisors registered with the SEC a conditional exemption from the requirement to register as a broker when engaging in certain limited activities in connection with the direct placement of municipal securities. The MSRB is considering whether this change would result in regulatory disparities and potential impact to market transparency.
- 137 SEC, Office of the Investor Advocate, *Report on Activities, Fiscal Year 2018* (Dec. 20, 2018), at 17 <https://www.sec.gov/advocate/reportspubs/annual-reports/sec-investor-advocate-report-on-activities-2018.pdf>.
- 138 SEC, Office of the Investor Advocate, *Report on Activities, Fiscal Year 2014* (Dec. 23, 2014), at 10, <https://www.sec.gov/advocate/reportspubs/sec-investor-advocate-report-on-activities-2014.pdf>.
- 139 *Id.* at 8-9.
- 140 SEC, Office of the Investor Advocate, *Report on Activities, Fiscal Year 2015* (Dec. 23, 2015), at 16-17, <https://www.sec.gov/advocate/reportspubs/annual-reports/sec-investor-advocate-report-on-activities-2015.pdf>.
- 141 SEC, Office of the Investor Advocate, *Report on Activities, Fiscal Year 2017* (Dec. 20, 2017) at 13-14, <https://www.sec.gov/advocate/reportspubs/annual-reports/sec-investor-advocate-report-on-activities-2017.pdf>.

- 142 SEC, Office of the Investor Advocate, *Report on Activities, Fiscal Year 2016* (Dec. 21, 2016), at 20 – 21, <https://www.sec.gov/advocate/reportspubs/annual-reports/sec-investor-advocate-report-on-activities-2016.pdf>.
- 143 See Robert Freedman, *Reverse factoring in cash management prompts alarm from Moody's*, CFO Dive (Sept. 22, 2019), <https://www.cfodive.com/news/moodys-alarm-reverse-factoring-cash-management/563415/> (describing the ability of a purchaser to stretch out its payments as the “main benefit”).
- 144 See, e.g., Chris Bryant, *SoftBank Invests in an Opaque \$100 Billion Industry*, Bloomberg Opinion (May 15, 2019), <https://www.bloomberg.com/opinion/articles/2019-05-15/a-100-billion-finance-industry-flies-under-radar> (agreeing with this view).
- 145 See Geoff Robinson, et al., *Reverse factoring: The good, the bad, and the unknown*, UBS (May 13, 2019) (global research report authored by UBS equities analysts), at 1.
- 146 See *Accounting spotlight: Audit Firms urge FASB to address reverse factoring blind spot*, Sector Comment, Moody's Investors Service (Oct. 21, 2019).
- 147 See *id.* (citing “SCF Barometer 2018/2019,” PwC & Supply Chain Finance Community, <https://www.pwc.com/vn/en/deals/assets/scf-barometer-2018-2019.pdf>).
- 148 See *supra* note 143 (quoting a Moody's report).
- 149 See Letter from Big Four Accounting Firms to Shayne Kuhaneck, Acting Technical Director, FASB (Oct. 2, 2019), https://www.fasb.org/jsp/FASB/CommentLetter_C/CommentLetterPage&cid=1218220137090&project_id=AR-2019.
- 150 *Id.* at 4.
- 151 Robert J. Jackson, Jr., Commissioner, SEC, *Perpetual Dual-Class Stock: The Case Against Corporate Royalty* (Feb. 15, 2018), <https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty> [hereinafter Jackson, *The Case Against Corporate Royalty*].
- 152 See *id.*
- 153 See *id.*
- 154 See *id.* (citing Snap Inc., Form S-1 (Feb. 2, 2017) (“Holders of our Class A common stock—the only class being sold in this offering—are entitled to no vote on matters submitted to our stockholders.”)).
- 155 See CFA Institute, “Dual-Class Shares: The Good, The Bad, and The Ugly: A Review of the Debate Surrounding Dual-Class Shares and their Emergence in Asia Pacific” (Aug. 2018), at 1, <https://www.cfainstitute.org/-/media/documents/survey/apac-dual-class-shares-survey-report.ashx> [hereinafter CFA Institute, *Dual-Class Shares*].
- 156 See *id.*
- 157 Law professor Renee Jones has chronicled shortcomings of this governance structure for investors, employees, consumers and society. See Written Testimony of Renee M. Jones, Associate Dean for Academic Affairs and Professor of Law, Boston College Law School, Before the U.S. House of Representatives, Committee on Financial Services, Subcommittee on Capital Markets, Securities, and Investments (Sept. 9, 2019), <https://financialservices.house.gov/uploadedfiles/hrg-116-ba16-wstate-jonesr-20190911.pdf>. See also Renee M. Jones, *The Unicorn Governance Trap*, 166 U. Pa. Law Rev. Online 165, 179-183 (2017).
- 158 Jackson, *The Case Against Corporate Royalty*, *supra* note 151.
- 159 See CFA Institute, *Dual-Class Shares*, *supra* note 155, at 16-20 (citing empirical research from SEC Commissioner Robert J. Jackson, Jr., among others).
- 160 Rick Fleming, Investor Advocate, SEC, *Dual-Class Shares: A Recipe for Disaster*, ICGN Miami Conference (Oct. 15, 2019), <https://www.sec.gov/news/speech/fleming-dual-class-shares-recipe-disaster> [hereinafter Fleming, *A Recipe for Disaster*] citing Connie Loizos, *In the Dual-Class Shares Debate, the Big Exchanges Should Get Off the Sidelines* (Sept. 30, 2019), <https://techcrunch.com/2019/09/30/in-the-dual-class-shares-debate-the-big-exchanges-should-get-off-the-sidelines>, and “CII letter to Nasdaq on sunset provisions” (Oct. 24, 2018), https://www.cii.org/files/issues_and_advocacy/correspondence/2018/20181024%20NASDAQ%20Petition%20on%20Multiclass%20Sunsets%20FINAL.pdf.
- 161 Fleming, *A Recipe for Disaster*, *supra* note 159.
- 162 SEC, *Recommendation of the Investor Advisory Committee: Dual Class and Other Entrenching Governance Structures in Public Companies* (Mar. 8, 2018), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-on-dual-class-shares.pdf>.
- 163 See Jay Clayton, Chairman, SEC, *SEC Rulemaking Over the Past Year, the Road Ahead and Challenges Posed by Brexit, LIBOR Transition and Cybersecurity Risks* (Dec. 6, 2018), <https://www.sec.gov/news/speech/speech-clayton-120618>.
- 164 See Second Report of the Alternative Reference Rates Committee (Mar. 5, 2018), available at <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2018/ARRC-Second-report.com>.
- 165 See Jay Clayton, Chairman, SEC, *Remarks to the SEC Fixed Income Market Structure Advisory Committee* (Nov. 4, 2019), <https://www.sec.gov/news/public-statement/statement-clayton-fimsac-110419>.

- 166 See *Division of Corporation Finance, Division of Investment Management, Division of Trading and Markets, and Office of the Chief Accountant, SEC*, Staff Statement on LIBOR Transition (July 12, 2019), <https://www.sec.gov/news/public-statement/libor-transition>.
- 167 Exchange Act § 4(g)(8)(B), 15 U.S.C. § 78d(g)(8)(B).
- 168 Exchange Act § 4(g)(8)(D), 15 U.S.C. § 78d(g)(8)(D).
- 169 As used in this report, the term “Ombudsman” may refer to the Ombudsman, or to the Ombudsman and Office of the Investor Advocate staff and contractors directly supporting the ombudsman function.
- 170 *What We Do*, SEC (June 10, 2013), <https://www.sec.gov/Article/whatwedo.html>.
- 171 BrokerCheck is a free tool that enables investors to research the professional backgrounds of brokers and brokerage firms. *About BrokerCheck*, <http://www.finra.org/investors/about-brokercheck> (last visited Nov. 1, 2018).
- 172 When an investor opens an account at a brokerage firm, the agreement almost always includes a mandatory pre-dispute arbitration clause that specifies that any legal dispute between the investor and the broker will be resolved via FINRA dispute resolution. As a result, investors have become aware of FINRA’s arbitration and mediation forum.
- 173 FINRA, Regulatory Notice 19-17, Protecting Investors from Misconduct (May 2, 2019), <https://www.finra.org/sites/default/files/2019-05/Regulatory-Notice-19-17.pdf> [hereinafter FINRA, Regulatory Notice 19-17].
- 174 See SEC, Office of the Investor Advocate, *Report on Objectives, Fiscal Year 2020*, at 12 (June 27, 2019), <https://www.sec.gov/files/sec-office-investor-advocate-report-on-objectives-fy2020.pdf> [hereinafter *Report on Objectives, Fiscal Year 2020*].
- 175 FINRA, Regulatory Notice 19-17, p.3 (“FINRA has identified certain firms that have a concentration of individuals with a history of misconduct, and some of these firms consistently hire such individuals and fail to reasonably supervise their activities.). The proposed rule also touts itself as a partial remedy to the long unresolved problem of unpaid arbitration awards.
- 176 We note that the new Rule 4111 would operate as a soft cap on risk because FINRA firms may exceed the acceptable risk thresholds specified in the rule. In other words, firms may still hire additional bad brokers once the risk limit is reached, provided that the firms satisfy a monetary deposit requirement levied by FINRA. A hard cap on risk would prevent firms from hiring additional bad brokers once the risk threshold is reached. *Id.* at 6.
- 177 *Id.* at 7-8.
- 178 FINRA evaluates firm risk by assessing six different categories of events or conditions: registered person adjudicated events, registered person pending events, registered person termination and internal review events, member firm adjudication events, member firm pending events, and registered persons associated with previously expelled firms. We note that five of the six categories measure the average number of risk events per registered broker at a firm; the sixth category of risk, association with previously expelled firms, measures, as a percentage, the concentration of registered persons at a firm who were associated, at any time in their career, with previously expelled firms.
- 179 *Id.* at 11-12.
- 180 *Id.* at 12. In addition to providing firms an opportunity to consult with FINRA at the initial identification stage, the proposed rule also provides firms an opportunity to appeal any final designation as a “restricted firm.”
- 181 *Id.*
- 182 *Id.*
- 183 Thirty-two comment letters were submitted through the public comment process. See “Comments” tab at <https://www.finra.org/rules-guidance/notices/19-17>. The majority of commenters (mostly industry participants) expressed opposition to the proposal’s purpose and procedural mechanisms. In contrast, certain commenters (primarily investor advocacy groups and state securities commissioners) offered cautious support for the proposal. These commenters were generally in favor of FINRA’s stated objective, but offered substantial criticism of the proposed methodology.
- 184 FINRA, Regulatory Notice 19-17, at 6 (stating “this proposal also aims to preserve funds for payment of arbitration awards against” member firms); see also, *id.* at 26 (stating “the proposal may also help address unpaid arbitration awards associated with firms identified as Restricted Firms under the proposal).
- 185 See SEC, Office of the Investor Advocate, *Report on Activities, Fiscal Year 2018* (Dec. 20, 2018), at 18-20, <https://www.sec.gov/advocate/reportspubs/annual-reports/sec-investor-advocate-report-on-activities-2018.pdf>, [hereinafter *Report on Activities, Fiscal Year 2018*].
- 186 Specifically, Appendix D to Regulatory Notice 19-17 shows that 1.6% to 2.4% of firms would have been met the preliminary criteria for identification by the proposed rule in 2013 to 2018. See https://www.finra.org/sites/default/files/2019-05/Regulatory_Note_19-17_Attachment_D.pdf.
- 187 See *Report on Activities, Fiscal Year 2018*, *supra* note 186, at 18; *Report on Objectives, Fiscal Year 2020*, *supra* note 174.

- 188 See FINRA, Regulatory Notice 18-06, Membership Application Program (Feb. 8, 2018), http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-18-06.pdf [hereinafter FINRA, Regulatory Notice 18-06] (limiting the ability of firms to transfer assets to avoid satisfaction of judgements and the ability of firms to expand by adding associated persons with certain pending arbitration claims or unpaid arbitration awards or settlements, subject to applicable materiality consultations); FINRA, Regulatory Notice 18-16, High Risk Brokers, (Apr. 30, 2018), <http://www.finra.org/sites/default/files/Regulatory-Notice-18-16.pdf> [hereinafter FINRA, Regulatory Notice 18-16] (requiring each member firm to seek a materiality consultation with FINRA if it intends to hire a broker with a history of certain “specified risk events” or the broker seeks to become an owner, control person or principal of the firm). See also FINRA, Regulatory Notice 18-23, Membership Application Proceedings, at 42 (July 26, 2018), http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-18-23.pdf (noting that FINRA has refrained from setting additional standards “pending further development” related to outstanding proposals in Regulatory Notice 18-06 and Regulatory Notice 18-16 “to strengthen controls on brokers with a history of past misconduct and to ensure greater accountability for firms that choose to employ high-risk brokers, and to incentivize payment of arbitration awards.”).
- 189 See Letter from John Jay Legal Services, Inc. to FINRA (July 1, 2019), at 2, https://www.finra.org/sites/default/files/2019-07/19-17_JohnJayLegal_comment.pdf; and Letter from Sichenzia Ross Ference LLP to FINRA (June 28, 2019) at 5, https://www.finra.org/sites/default/files/2019-06/19-17_SRF_comment.pdf.
- 190 Several states have created their own restitution funds in the absence of action at the federal level. However, state funds are typically limited in size and geographic availability. The resulting patchwork coverage is uneven and provides inadequate protection for investors. See Joseph Maglich, *Should States Compensate Ponzi Scheme Victims: Montana and New Hampshire Think So*, *Forbes.com* (Mar. 18, 2013), <https://www.forbes.com/sites/jordanmaglich/2013/03/18/should-states-compensate-ponzi-scheme-victims-montana-and-new-hampshire-think-so/#2bc942124374>.
- 191 See *Report on Activities, Fiscal Year 2018*, *supra* note 185, at 33.
- 192 *Id.* These remedies may include, for example, fees or penalties levied on FINRA members and increased insurance requirements. See also *id.* at 34.
- 193 As formal clinic names vary, for purposes of this Report, all the law school securities law, securities arbitration, and investor protection focused clinics referenced herein are referred to as investor advocacy clinics or clinics.
- 194 Press Release, SEC, SEC Announces Pilot Securities Arbitration Clinic to Help Small Investors—Levitt Responds to Concerns Voiced at Town Meetings, 97-101 (Nov. 12, 1997), available at <https://www.sec.gov/news/press/pressarchive/1997/97-101.txt>.
- 195 See *id.*
- 196 *Ex-Quest Chairman Settles IPO suit*, CNN Money (May 12, 2003), https://money.cnn.com/2003/05/13/news/spitzer_ipo/index.htm.
- 197 Press Release, Univ. of Pittsburgh, Pitt Law School to Open Securities Arbitration Clinic (May 2, 2011), <http://www.news.pitt.edu/news/pitt-law-school-open-securities-arbitration-clinic>.
- 198 See FINRA Investor Education Foundation, Press Release, FINRA Foundation Announces \$1 Million in Grants to Fund Securities Advocacy Clinics (Jan. 28, 2010), <https://www.finra.org/media-center/news-releases/2010/finra-foundation-announces-1-million-grants-fund-securities-advocacy>; see also Jill Gross, *The Improbable Birth and Conceivable Death of the Securities Arbitration Clinic*, 15 *CARDOZO J. CONFLICT RESOL.* 597, 604 (2014) (“As a result of these grants, clinics opened at other law schools such as Florida International University, Howard University, Suffolk University, and Pepperdine in 2009; at Seton Hall University and University of Miami in 2010; and at Georgia State and Michigan State University in 2012.”).
- 199 In 2012, 22 investor advocacy clinics were in operation: twelve located in New York (Pace University Law School, Fordham Law School, Brooklyn Law School, Buffalo Law School, Benjamin N. Cardozo School of Law, Cornell University School of Law, Hofstra School of Law, New York Law School, St. John’s University School of Law, Syracuse University College of Law, Touro Law Center); two each in California (University of San Francisco School of Law, Pepperdine University School of Law), and Florida (Florida International University School of Law and University of Miami School of Law); and one each in District of Columbia (Howard University School of Law), Georgia (Georgia State University College of Law), Illinois (Northwestern University School of Law), Massachusetts (Suffolk University School of Law), Michigan (Michigan State University School of Law), New Jersey (Seton Hall University School of Law), and Pennsylvania (University of Pittsburgh School of Law). During the fifteen year span from 1997 to 2012, investor advocacy clinics were also established, and subsequently closed, at Albany Law School (2004 – 2005) and Duquesne Law School (2001- 2011). See Gross, *supra* note 198, at 602-603.

- 200 As of the close of the Reporting Period, there were fourteen clinics in active operation: six located in New York (Benjamin N. Cardozo School of Law, Cornell Law School, Fordham University School of Law, New York Law School, Pace University School of Law, and St. John’s University School of Law); two in California (Pepperdine University School of Law, and University of San Francisco School of Law); and one each in the District of Columbia (Howard University School of Law), Florida (University of Miami School of Law), Illinois (Northwestern University School of Law), Nevada (University of Nevada Las Vegas School of Law), New Jersey (Seton Hall University School of Law), and Pennsylvania (University of Pittsburgh School of Law). In addition to these clinics, Brooklyn Law School maintains an investor advocacy clinic; however, it is unclear if the clinic is currently in operation or actively representing clients.
- 201 The Georgia State University College of Law Investor Advocacy Clinic and the Syracuse University School of Law Securities Arbitration Clinic have closed.
- 202 Clinic clients often include senior citizens as well as middle-class and working class Americans such as hairdressers, mail carriers, welders, schoolteachers, first-time investors, and millennials. See Letter from Nicole G. Iannarone Director, Investor Advocacy Clinic, Georgia State University College of Law, et al. to FINRA (June 19, 2017), at 2, https://www.finra.org/sites/default/files/notice_comment_file_ref/SN-32117_G.
- 203 SEC, *Recommendation of the Investor Advisory Committee: Financial Support for Law School Clinics that Support Investors* (Mar. 8, 2018), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/law-clinics-recommendation.pdf>.
- 204 *Id.*
- 205 *Id.*
- 206 During this fiscal year, LSCOP programming included a visit to the SEC by students enrolled in the George Washington University School of Law securities seminar; a visit by the Ombudsman to the Georgia State University College of Law Investor Advocacy Clinic, and the first SEC Investor Advocacy Clinic Summit. See *Report on Objectives, Fiscal Year 2020*, *supra* note 174, at 26.
- 207 *Id.* at 26. The Ombudsman acknowledges and appreciates the contributions of Daniel Morris, Attorney-Adviser, SEC Division of Corporation Finance, on detail to the Office during the Reporting Period, in making the Summit a success.
- 208 Due to the partial federal government shutdown, we lost several weeks of Summit planning, as only certain SEC staff were permitted to work on critical agency matters during the shutdown. See Meghan Morris, *The government shutdown hits the SEC starting Thursday—here’s how it’s impacted*, *Business Insider* (Dec. 26, 2018), <https://markets.businessinsider.com/news/stocks/how-sec-affected-by-partial-government-shutdown-2018-12-1027832560>.
- 209 The speakers discussed the importance of investor advocacy clinics to retail investors with small claim amounts or lower incomes, and the need for students to pursue meaningful work at the federal and state levels on behalf of retail investors.
- 210 Each breakout session was comprised of law students and directors from three or four clinics and was facilitated by a team of senior SEC attorneys.
- 211 SEC, Concept Release on Harmonization of Securities Offering Exemptions, Securities Act Release No. 10649, Exchange Act Release No. 86129, Investment Advisers Act Release No. 5256, Investment Company Act Release No. 33512, 84 Fed. Reg. 30460 (June 26, 2019), <https://www.sec.gov/rules/concept/2019/33-10649.pdf> [hereinafter Harmonization Concept Release].
- 212 Regulation Best Interest, *supra* note 76.
- 213 Each speaker presented a perspective on the importance of protecting retail investors, whether through rulemaking, federal and state enforcement actions, or the arbitration process.
- 214 Student presentations were scheduled to ensure that each clinic was given an equal amount of time to present to the staff.
- 215 The clinics were responsible for selecting and developing their presentation topics and content. SEC staff did not exercise any editorial control over the content of the clinic presentations.
- 216 Exchange Act § 39(a), 15 U.S.C. § 78pp(a).
- 217 *Id.*
- 218 Exchange Act § 39(a)(2)(B), 15 U.S.C. § 78pp(a)(2)(B).
- 219 Exchange Act § 39(g), 15 U.S.C. § 78pp(g).
- 220 Exchange Act § 39(h), 15 U.S.C. § 78pp(h).
- 221 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.”
- 222 SEC, *Recommendation of the Investor Advisory Committee Regarding Proposed Regulation Best Interest, Form CRS, and Investment Advisers Act Fiduciary Guidance* (Nov. 7, 2018), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-on-proposed-reg-bi.pdf>.
- 223 17 C.F.R. §§ 200.735-3(b)(2)(i), 230122 (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).

- 224 SEC, *Recommendation of the Investor Advisory Committee: Proxy Plumbing* (Sept. 5, 2019), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-recommendation-proxy-plumbing.pdf>.
- 225 SEC, *Recommendation of the Investor Advisory Committee: Structural Changes to the US Capital Markets Re Investment Research in a Post-MiFID II World* (July 25, 2019), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-research-post-mfid-ii-world.pdf>.
- 226 See SEC, *Press Release, SEC Announces Extension of Temporary Measure to Facilitate Cross-Border Implementation of the European Union’s MiFID II’s Research Provisions* (Nov. 4, 2019), at <https://www.sec.gov/news/press-release/2019-229>.
- 227 SEC, *Recommendation of the Investor Advisory Committee Regarding Human Capital Management Disclosure* (Mar. 28, 2019), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/human-capital-disclosure-recommendation.pdf>.
- 228 See Modernization of Regulation S-K Items 101, 103, and 105, Release Nos. 33–10668 and 34–86614, 84 Fed. Reg. 44358 (Aug. 23, 2019), at <https://www.govinfo.gov/content/pkg/FR-2019-08-23/pdf/2019-17410.pdf>. See also SEC, *Press Release, SEC Proposes to Modernize Disclosures of Business, Legal Proceedings, and Risk Factors Under Regulation S-K* (Aug. 8, 2019), <https://www.sec.gov/news/press-release/2019-148>.
- 229 SEC, *Recommendation of the Investor Advisory Committee in Support of the Transaction Fee Pilot for NMS Stocks* (Sept. 13, 2018), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-transaction-fee-pilot-for-nms-stocks.pdf>.
- 230 SEC, *Transaction Fee Pilot for NMS Stock, Release No. 34-84875* (Dec. 19, 2018), <https://www.sec.gov/rules/final/2018/34-84875.pdf>.
- 231 SEC, *Order Issuing Stay* (Mar. 28, 2019), <https://www.sec.gov/rules/other/2019/34-85447.pdf>.
- 232 SEC, *Recommendation of the Investor Advisory Committee: Financial Support for Law School Clinics that Support Investors* (Mar. 8, 2018), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/law-clinics-recommendation.pdf>.
- 233 SEC, *Recommendation of the Investor Advisory Committee: Dual Class and Other Entrenching Governance Structures in Public Companies* (Mar. 8, 2018), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-on-dual-class-shares.pdf>.
- 234 SEC, *Recommendation of the Investor Advisory Committee Regarding Mutual Fund Cost Disclosure* (Apr. 14, 2016), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-mf-fee-disclosure-041916.pdf>.
- 235 Request for Comment on Fund Retail Investor Experience and Disclosure, Securities Act Release No. 10503, Exchange Act Release No. 83376, Investment Company Act Release No. 33113, 83 Fed. Reg. 26891 (June 11, 2018), <https://www.sec.gov/rules/other/2018/33-10503.pdf>.
- 236 See Updated Disclosure Requirements and Summary Prospectus for Variable Annuity and Variable Life Insurance Contracts, Securities Act Release No. 10569, Exchange Act Release No. 84508, Investment Company Act Release No. 33286, 83 Fed. Reg. 61730 (Nov. 30, 2018), at <https://www.federalregister.gov/documents/2018/11/30/2018-24376/updated-disclosure-requirements-and-summary-prospectus-for-variable-annuity-and-variable-life>
- 237 *Id.* at 61735, n. 39.
- 238 SEC, *Recommendation of the Investor Advisory Committee: Accredited Investor Definition* (Oct. 9, 2014), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-advisor-accredited-definition.pdf>.
- 239 Harmonization Concept Release, *supra* note 211.
- 240 Staff of the SEC, *Report on the Review of the Definition of “Accredited Investor”* (Dec. 18, 2015), <https://www.sec.gov/corpfin/reportspubs/special-studies/review-definition-of-accredited-investor-12-18-2015.pdf>.
- 241 SEC, *Recommendations of the Investor Advisory Committee: Impartiality in the Disclosure of Preliminary Voting Results* (Oct. 9, 2014), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/impartiality-disclosure-prelim-voting-results.pdf>.
- 242 SEC, *Recommendations of the Investor Advisory Committee Regarding SEC Rulemaking to Explore Universal Proxy Ballots* (July 25, 2013), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/universal-proxy-recommendation-072613.pdf>.
- 243 Universal Proxy, Exchange Act Release No. 79164, Investment Company Act Release No. 32339, 81 Fed. Reg. 79122 (Nov. 10, 2016), <https://www.federalregister.gov/documents/2016/11/10/2016-26349/universal-proxy>.



OFFICE OF THE
INVESTOR ADVOCATE

U.S. Securities and
Exchange Commission
100 F Street NE
Washington, DC 20549
202.551.3302

