



Office of the Investor Advocate

OFFICE OF THE INVESTOR ADVOCATE

REPORT ON ACTIVITIES

FISCAL YEAR 2018

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, 2017, the Office of the Investor Advocate (Office) filed a Report on Objectives for Fiscal Year 2018, which identified five 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 shall describe the activities of the Investor Advocate during the immediately preceding fiscal year. Among other things, the report must include information on steps the Investor Advocate has taken to improve the responsiveness of the 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

This Report on Activities for Fiscal Year 2018 describes our work in the five policy areas that we announced in our Report on Objectives for Fiscal Year 2018. In each of those areas, we have strived to understand the needs of American investors and the implications of policy choices. In a variety of ways, as more fully described below, we have identified proposed policy decisions that are likely to harm investors, have made recommendations for regulatory changes that will ease or resolve the problems encountered by investors, and have taken steps to improve the responsiveness of the Commission and SROs to investor concerns. The reporting period for this Report on Activities runs from October 1, 2017 to September 30, 2018 (Reporting Period).

This Report on Activities also discusses the efforts of the SEC Ombudsman to address the concerns expressed by investors during the course of Fiscal Year 2018. Exchange Act Section 4(g)(8)(D) requires the Ombudsman to submit a semi-annual report to the Investor Advocate for inclusion in reports to Congress and, accordingly, the Ombudsman Report is included herein.

In addition to the mandatory items in this Report, we include discussion of two other matters. As we have done in the past, we report on the recommendations made to the Commission by the Investor Advisory Committee, as well as the status of the Commission's responses to those recommendations. And, for the first time in this Report, we describe in more detail our activities related to investor testing.

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) any 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.

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MESSAGE FROM THE INVESTOR ADVOCATE

In our fourth full year of existence, the Office of the Investor Advocate at the U.S. Securities and Exchange Commission continued to break new ground. As the Investor Advocate, I am very proud of the high-quality work that my dedicated staff has carried out on behalf of American investors.

Of particular note, during the past fiscal year we continued to build up the research function of our Office. We have described our investor testing program, known as POSITIER, in previous reports to Congress, but for the first time we include in this Report on Activities a report from Dr. Brian Scholl, the leader of this initiative. His report provides more details about the work we have done so far, and more important, it provides a sense of our vision for this initiative and the ways we believe it can enhance the policymaking process at the Commission.

Our enabling statute, Section 4(g) of the Exchange Act, does not mention the term “investor testing,” but it makes clear that our Office is expected to engage in high-quality research in support of our advocacy role. For example, we are required to analyze the potential impact on investors of proposed changes to rules, identify areas in which investors would benefit from changes to existing rules, and identify problems that investors have with financial service providers and investment products. Our semi-annual reports to Congress, which describe our work in these areas, are to include “appropriate statistical information and full and substantive analysis.” Moreover, to conduct this type of work we are authorized (in consultation with the Chairman) to hire “research staff” with

technical skills—not just “independent counsel” with advocacy skills—to carry out the functions of the Office.

As discussed in the Report on Investor Testing below, we believe our investor research not only fulfills our statutory duties, but it can benefit the entire Commission by providing a new source of objective data to help the Commission make data-driven policy decisions. By utilizing tools such as surveys and focus groups, we can overcome the difficult challenge of motivating individual investors to provide meaningful comment on proposed rule changes involving highly technical matters. But, for this research to fulfill our Office’s purposes, it is important that we maintain a measure of independence so that we can guard against the all too natural temptation of policymakers to design testing so that it tends to justify a predetermined course of action. Ideally, we should seek input from Commissioners and rulemaking teams so that our research projects are useful for their purposes, but we should also retain control of the research design and implementation so that they meet our statutory objectives. This involves a delicate balance because, while Section 4(g) guards our independence of thought in our advocacy role, it does not give us independent funding for investor testing or staffing.



With a hiring freeze in place at the SEC, Fiscal Year 2018 proved to be a very challenging year for our Office to continue on a steady path of obtaining the resources we need to accomplish all the parts of our mission. When the Office of the Investor Advocate was established in 2014, we began by building a legal and policy team to track the numerous rulemakings at the Commission and self-regulatory organizations (SROs) and to advocate for investors in the rulemaking process. This elite team, while small, is comparable to the staff in a Commissioner's office, which is the staffing level I envisioned for this function. The Ombudsman, on the other hand, has only one full-time employee, along with two contractors, to support her work of assisting investors who have complaints about the SEC or an SRO. While this had been adequate to address the initial workload, as the Office has become more widely known and the volume of inquiries has multiplied, the staffing level has not kept pace. Even more challenging, though, is our critical shortage of staffing in our investor testing program, where Dr. Scholl has done the extraordinary work discussed in this Report with very little assistance. Due to the hiring freeze during all of Fiscal Year 2018, our efforts to devote additional resources to the Ombudsman and research functions were hindered, which has delayed our ability to build out these critical programs as Congress intended when it created the Office of the Investor Advocate.

Fortunately, Chairman Jay Clayton continues to demonstrate support for our efforts to build up our Office. Despite the budgetary challenges in Fiscal Year 2018, we expect to receive approval for modest growth in 2019, and we hope to obtain additional resources in the future. We

believe these are worthwhile investments because our work has the potential to transform the way the Commission evaluates how its decisions will help or harm investors.

In our advocacy role, we have enjoyed considerable success during Fiscal Year 2018. Often, our job requires us to oppose aspects of rulemakings that may negatively impact investors, but we also try to support reforms that will benefit investors, knowing that those changes are likely to be opposed by other stakeholders. As described in more detail in the section entitled "Report on Activities and Recommendations Relating to the Fiscal Year 2018 Policy Agenda," we saw a number of these types of positive developments for investors during Fiscal Year 2018. For example, the Commission adopted rules to require greater disclosure by alternative trading systems (known as "dark pools") and approved the PCAOB's proposed enhancements to the auditor's report. More recently, this trend has continued with the adoption of changes to Rule 606 to enhance the disclosures that broker-dealers must make to institutional investors.

As we have done in the past, we ventured beyond our nation's capital during Fiscal Year 2018 to meet with Main Street investors in person and listen to their concerns. In addition to fifteen speaking engagements at a variety of events around the country, we conducted three-day "investor outreach tours" in Boston and Denver. During these tours, we engaged with numerous investors to get a better sense of how SEC rulemakings may affect them. In particular, we explored the ways investors use SEC-mandated disclosures to make investment decisions.

Finally, we decided to take our investor outreach efforts a step further this year by encouraging the SEC Commissioners to participate in an outreach event outside of Washington, D.C. We envisioned an event in which Commissioners and staff would spend time speaking with investors and hearing *from* them, as opposed to speaking *to* them. To our delight, the Chairman and Commissioners all supported the idea, and the Office of the Investor Advocate worked in tandem with the SEC's Atlanta Regional Office to organize the event. In particular, Stephen Deane, Investor Engagement Advisor in the Office of the Investor Advocate, and Richard Best, the Director of the Atlanta Regional Office, spent numerous hours tending to all the details for the event. Their efforts, along with the contributions of many other staff, came to fruition on June 13, 2018 when the full Commission conducted a first-of-its-

kind Investor Town Hall in Atlanta, Georgia. In addition, the SEC's Investor Advisory Committee convened a meeting at the same location the following day, marking the first time the Committee has met outside of Washington, D.C.

It is a great privilege to serve American investors as their advocate, and I am deeply indebted to the men and women in my Office who assist me in this task. Their tireless efforts are reflected in the pages that follow, and I am pleased to provide this glimpse into the work they perform day by day. As always, I would welcome the opportunity to answer questions or provide additional information to Members of Congress.


Sincerely,

A handwritten signature in black ink, appearing to read "Rick Fleming", written in a cursive style.

Rick A. Fleming
Investor Advocate



REPORT ON ACTIVITIES AND RECOMMENDATIONS RELATING TO THE FISCAL YEAR 2018 POLICY AGENDA

 In June 29, 2017, the Office of the Investor Advocate filed a Report on Objectives for Fiscal Year 2018.⁶ The Report identified five key policy areas that would be the primary focus of the Office during Fiscal Year 2018:⁷ public company disclosure, equity market structure, municipal market reform, accounting and auditing, and fiduciary duty. This Report on Activities describes our activities and recommendations within each of those policy areas during Fiscal Year 2018.

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 2018, our Office closely followed developments in this area.

On June 28, 2018, the Commission adopted amendments to the “smaller reporting company” definition in order to permit more companies to qualify for a set of scaled-back disclosure requirements thought to be less burdensome.⁸ The definition features a size threshold, as measured by public float and revenues.⁹ Our view generally, as expressed in a speech on November 19, 2016, was that there should have been more analysis of the differences between small and large companies, and how those differences inform what disclosure

requirements would be appropriate.¹⁰ Such an analysis would be focused on firm-level traits and corresponding information needs of investors. The rulemaking went in a different direction, assessing the informational needs of investors not directly but rather by inference from market indicators associated with information environment, liquidity and growth during timeframes involving other changes in disclosure regulation.¹¹ For example, as one measure of the information environment for investors, the economic analysis looked at average institutional ownership statistics for a set of companies providing scaled-back disclosures as compared to the same statistics for a control group.¹² We would have liked to see more institutional investors interviewed and asked about the decision-usefulness of the disclosures in question.

On June 28, 2018, the Commission also adopted amendments requiring the use of the Inline XBRL format for the submission of public company financial statement information.¹³ Inline XBRL has the potential to benefit investors and other market participants while decreasing, over time, the cost of preparing information for submission to the Commission. This was a rulemaking which we encouraged from the beginning because it is an advance in the Commission’s long-term initiative to make all filing data not just human-readable but also machine-readable, and thereby easier to access and use.¹⁴

On July 18, 2018, the Commission adopted amendments to Securities Act Rule 701(e) that were mandated by the Economic Growth, Regulatory Relief, and Consumer Protection Act.¹⁵ Rule 701 is a registration exemption for offers and sales of securities pursuant to certain compensatory benefit plans and contracts related to compensation. The amendment provides that companies issuing \$10 million or less on an annual basis, up from \$5 million, no longer need to provide certain information (notably, financial statements). Unfortunately, without this information, there may be virtually no information about a non-public issuer available at all. However, given that this was a congressionally mandated rulemaking, we did not object to the adoption of the amendments.

At the same time, the Commission published a concept release and request for comment on possible ways to modernize rules related to compensatory arrangements, including Securities Act Rule 701.¹⁶ We believe some updates to these rules may be beneficial given the significant evolution in both the types of compensatory offerings and the composition of the workforce since the Commission last substantively amended the applicable rules in 1999.

On July 24, 2018, the Commission proposed amendments to Regulation S-X intended to simplify and streamline the financial disclosure requirements applicable to registered debt offerings.¹⁷ A major premise of the rulemaking is that reducing disclosure burdens should encourage issuers to conduct registered offerings in lieu of private Rule 144A offerings, or to add guarantees where under current circumstances they do not.¹⁸ Registered offerings come with greater investor protections, not the least of which is the ability of investors to bring certain statutory claims in securities litigation that they cannot bring in the private offering context. However, the proposed rules entail, in part, removing certain disclosures from the scope of an audit, which would appear to diminish the ability of investors to recover from an auditor in the event of securities litigation. The proposition that issuers should be able to choose from a set of disclosure and audit options based on investor demand¹⁹ seems questionable in the context of a long-running bull market and one in which institutional asset managers purchase increasingly for index-linked strategies. Ultimately, if investors have limited market power to demand robust disclosure, measuring the economic effect of a reduction in disclosure may not be as



straightforward as measuring transaction statistics (as the economic analysis in the proposing release suggests).²⁰ There may be some other diminution in welfare that is more difficult to measure but no less important. We are trying to obtain more investor input on this rulemaking.

Lastly, on August 17, 2018, the Commission adopted amendments to financial disclosure requirements principally in Regulation S-X that had become duplicative, overlapping, or outdated in light of other Commission disclosure requirements, U.S. Generally Accepted Accounting Principles (GAAP), or changes in the information environment.²¹ The Commission also referred certain disclosure requirements that overlapped with, but required information incremental to, GAAP to the Financial Accounting Standards Board for potential incorporation into GAAP. This rulemaking, like many of the aforementioned ones, was intended to simplify and update disclosure requirements and reduce compliance burdens for companies without significantly altering the total mix of information available to investors. After an in-depth review of this highly technical proposal, we viewed it as largely benign from an investor's perspective because it did not impede investors' access to material information.

EQUITY MARKET STRUCTURE

In Fiscal Year 2018, the Office worked with Commission staff and relevant SROs to encourage equity market structure reforms designed to enhance market resilience, efficiency, transparency, and fairness. We continued to analyze proposed rules, including significant Commission proposals concerning alternative trading venue regulation and the disclosure of broker order handling activity, to examine their potential impact on investors. We spent considerable time and effort advocating in formal and informal ways for improvements that would benefit and protect investors.

In July 2018, the Commission adopted significant amendments to Regulation ATS to enhance the operational transparency of venues that trade

listed equity securities.²² Our Office had previously submitted a letter to the Commission in support of the proposed amendments.²³ We are pleased that the Commission has finalized this proposal and brought greater transparency into the equity market. In our letter, we had also suggested a modest expansion of certain aspects of the proposal in order to enhance the operational transparency of venues that trade fixed income securities, including those that solely trade government securities.²⁴ Although the Commission did not act on our suggestion at this time, it has committed to review the regulatory framework for fixed income electronic trading venues.²⁵ We will encourage the Commission to consider amendments to Regulation ATS that benefit investors in municipal securities and corporate bonds.

Several efforts continue to be under way to improve Regulation NMS.²⁶ After the Reporting Period, 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.²⁷ This should provide customers with better information to evaluate the quality of execution for the orders they place.²⁸ 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.

Similarly, in March 2018, the Commission proposed a rule to conduct a transaction fee pilot for NMS stocks.²⁹ The pilot would subject the stock exchanges to new temporary pricing restrictions across various test groups and thereby reduce or eliminate the use of so-called "maker-taker" fee-and-rebate pricing for transactions in those securities.³⁰ We have 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,³¹ and we have continued to support the proposed pilot during our informal interactions with Commissioners and staff.

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.³² In furtherance of this objective, the Office has analyzed the potential impact of various SRO proposals related to equity market structure. For example, in February 2018, the Chicago Stock Exchange, Inc. (CHX) proposed a new pilot to create a 350-microsecond speedbump for all orders submitted to the exchange, except for those from a special class of market makers that would be able to bypass the speedbump.³³ Although the speedbump in this proposal was similar to a rule adopted by Investor Exchange LLC (IEX), our analysis indicated that the significant discriminatory advantage provided to one class of market makers would be unfair, and we therefore recommended that the Commission not allow the pilot to proceed.³⁴ Ultimately, CHX withdrew the proposal and the Commission set aside its consideration of the matter.³⁵

During the Reporting Period, there were numerous other SRO rule proposals that we monitored closely. As examples, we have reviewed proposed fee amendments to the NMS plans governing reporting to the consolidated tape,³⁶ an application by NASDAQ to permit issuer choice to consolidate liquidity by suspending Unlisted Trading Privileges,³⁷ and a proposed rule change by IEX to create a Long-Term Shareholders Exchange.³⁸

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.³⁹ In our view, this is a development of monumental importance because, once implemented, regulators will have ready access to all trade and order data, facilitating

more prompt and complete analysis of market events such as the May 6, 2010 "Flash Crash" that saw U.S. equity and futures markets experience a sudden breakdown of orderly trading. The data also will make it easier for the Commission and other regulators to detect practices such as front-running, churning, and insider trading, so the new system has the potential to eliminate or significantly curtail abuses that have plagued investors for decades. Of course, it is imperative that the trading data be guarded from cyber intrusions that would cause harm to investors and the markets, but we encourage policymakers to not lose sight of the enormous potential benefits of the Consolidated Audit Trail.

The Office also monitored the Commission's Tick Size Pilot through September 2018, which required, for a two-year period, the national securities exchanges and FINRA to widen the minimum quoting and trading increments—or "tick sizes"—for stocks of some smaller companies.⁴⁰ We were skeptical about the underlying hypothesis that wider tick sizes would enhance the market quality of smaller stocks enough to outweigh the additional costs borne by investors,⁴¹ and the pilot data recently submitted by the SROs, combined with data to be collected for the next several months, should allow the Commission to assess whether this hypothesis was correct.

In addition to analyzing active SEC and SRO rulemakings, we also monitor the Commission's Equity Market Structure Roundtables,⁴² with an eye toward championing ideas and concepts that appear most likely to enhance equity market structure for the benefit of investors. For example, in September 2018, the Commission hosted a roundtable on regulatory approaches to combating retail investor fraud.⁴³ We support these roundtables, as they have provided staff with views from a broad range of market participants, and we hope that the discussion will lead toward regulatory actions that will enhance the ability of regulators and market intermediaries to combat retail fraud.

Finally, we have monitored enforcement cases involving abusive market practices. For example, we are pleased that recent SEC and FINRA enforcement actions have sanctioned misconduct by alternative trading systems known as “dark pools.” However, these actions tend to focus on black-and-white allegations such as misrepresentations, rather than more gray areas such as a broker’s obligation to achieve the “best execution” of customer orders. In our outreach to investors, we have heard particular concerns that troubling practices may proliferate if regulators do not bring cases that specifically address best execution. We continue to evaluate these concerns.

MUNICIPAL MARKET REFORM

Throughout Fiscal Year 2018, the Office of the Investor Advocate reviewed proposed rules, rule amendments, and requests for comment relating to the regulation of the fixed income markets and, in particular, municipal securities markets. The Office reviewed seventeen such proposals, making it a priority to consider the impact on retail investors of each proposed rule and rule amendment.⁴⁴

Two proposals required significant staff attention during the Reporting Period: (1) the Commission’s Proposed Amendments to Exchange Act Rule 15c2-12 and (2) Municipal Securities Rulemaking Board (MSRB) Regulatory Notice 2018-15, Request for Comment on Draft Amendments to MSRB Rules on Primary Offering Practices.

Proposed Amendment’s to Municipal Securities Disclosure Rule 15c2-12

Throughout Fiscal Year 2018, the Office actively engaged with Commissioners, Commission staff, and the MSRB regarding enhancements to municipal securities disclosure. On March 1, 2017, the Commission published for public comment Proposed Amendments to Municipal Securities Disclosure Rule 15c2-12⁴⁵ under the Exchange Act.⁴⁶ The proposal sought to amend the list of event notices that a broker, dealer, or municipal securities dealer acting as an underwriter in a

primary offering of municipal securities must provide to the MSRB for public dissemination. These additional event notices would include incurrence of a material financial obligation (such as a bank loan) or related event (such as a default) that could materially affect the rights of the bondholders.

It is important that investors have complete and accurate information when making investment decisions. The availability of secondary market disclosure to all municipal securities market participants enables investors to, among other things, evaluate the creditworthiness of an issuer of bonds.⁴⁷ Information relating to financial obligations, debt obligations, and bank loans are critical to the understanding of solvency, viability, and financial health of a municipal entity—each of which plays an important role in investment decisions.

For these reasons, the Office of the Investor Advocate supported the Commission’s proposed amendments to enhance municipal securities disclosure under Exchange Act Rule 15c2-12. In fact, this Office has previously highlighted the lack of, and untimeliness of, municipal securities disclosure as a potentially problematic area for municipal market participants.⁴⁸ Specifically, in our Report on Activities for Fiscal Year 2015, the Office highlighted the lack of bank loan disclosures as an area of concern for municipal market participants, and in our Report on Objectives for Fiscal Year 2017 we discussed the adverse effects on retail investors from the lack of bank loan disclosures or the delay in such disclosures.⁴⁹

On August 20, 2018, the Commission adopted the proposed amendments to Exchange Act Rule 15c2-12. The Commission stated, and we agree, “[t]he amendments add transparency to the municipal securities market by increasing the amount of information that is publicly disclosed about material financial obligations incurred by issuers and obligated persons.”⁵⁰ The information disclosed may provide investors with insight into

a municipal entity's financial position and may facilitate a better pricing and trading of securities, as well as enhance liquidity before purchasing a municipal security, and on an on-going basis.⁵¹ The amendments to Exchange Act Rule 15c2-12 became effective on October 30, 2018.⁵²

MSRB Regulatory Notice 2018-15

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).⁵³ 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;⁵⁴ and (2) whether to require additional information on Form G-32 that is not currently provided to NIIDS.⁵⁵

Among other things, the MSRB proposed adding initial minimum denomination information to Form G-32, which would be auto-populated with information underwriters already entered into NIIDS.⁵⁶ The Office of the Investor Advocate's Report on Objectives for Fiscal Year 2018 highlighted our concern that municipal securities are being sold in amounts below the minimum denomination.⁵⁷ We believe the proposed change is a step in the right direction because it would improve the ability of investors and their representatives to locate the minimum denomination for a bond, and we supported the proposed amendments to add minimum denomination information to Form G-32. We also expressed our hope that the MSRB would take additional steps to address the sale of bonds below the minimum denomination.⁵⁸

In addition to monitoring rule proposals, amendments, and requests for comment, staff

continued to monitor the implementation of past Commission and SRO rulemakings. On May 14, 2018, for example, the MSRB and FINRA rules relating to confirmation disclosure and prevailing market price took effect.⁵⁹ These rules require the disclosure of mark-ups and mark-downs to retail investors when they buy or sell bonds. As described in prior reports from our Office, these rules incorporated many suggestions made by the Office of the Investor Advocate and generally followed the Office's recommended course of action.⁶⁰ The Office monitored the lead-up to the rule's effective date by, among other things, reviewing the MSRB's New and Updated FAQs on Confirmation Disclosure and Prevailing Market Price published on March 19, 2018.⁶¹

ACCOUNTING AND AUDITING

During the Reporting Period, we focused on developments involving a range of accounting and auditing issues, including FASB's Definition of Materiality, non-GAAP financial measures, and internal control over financial reporting. We monitored activities at accounting and auditing standard setters, and we engaged internally and externally with investors and other stakeholders.

FASB's Definition of Materiality

This Reporting Period, FASB resolved a contentious issue regarding its definition of materiality by adopting an approach that we had recommended. As reported in our FY 2017 Report on Activities, this Office had submitted a comment letter to FASB in which we proposed that the standard setter take a different approach to achieve its goal.⁶²

That goal was to align FASB's definition of materiality with that of the courts, the SEC, and the PCAOB. FASB believed that its definition of materiality, as stated in Concepts Statement No. 8, was "inconsistent with the legal concept of materiality in the United States," as defined by the U.S. Supreme Court. To achieve its goal of alignment, FASB proposed to strike its definition and instead say, in effect, that materiality is whatever the courts say it is. That proposal,

however, sparked strong criticism from investors, who feared that accounting decisions would be turned over to attorneys and that the level and transparency of financial reporting would be reduced.

We recognized both the investors' concerns and FASB's goal of harmonizing its definition. Therefore, we recommended that, rather than moving forward with its proposal, FASB return to an earlier definition of materiality as expressed in Concepts Statement No. 2,⁶³ which Concepts Statement No. 8 had superseded. In addition, we recommended that FASB reference the SEC's Staff Accounting Bulletin No. 99,⁶⁴ which itself references the Supreme Court definition of materiality. In August 2018, FASB did indeed reinstate the definition in Concepts Statement No. 2 and explained:

Some stakeholders suggested that the definition in Concepts Statement 2 would be a better definition. After considering the feedback, the Board decided to replace the current definition of materiality in this chapter with the superseded definition in Concepts Statement 2. The definition of materiality that is in Concepts Statement 2 is quoted in SEC Staff Accounting Bulletin No. 99, *Materiality*. SAB 99 notes that the definition that is in Concepts Statement 2 is in substance identical to the definition of the U.S. Supreme Court, which in turn results in the definition in this chapter being in substance identical to the definition in the auditing standards of the AICPA and the PCAOB.⁶⁵

We commend FASB for its deliberative and transparent decision-making process, which included soliciting public comments and holding a roundtable on the topic. More generally, we strongly support the independence of FASB, which is essential for FASB to succeed in its mission to set accounting standards for the benefit of investors.⁶⁶ Its independence is also essential for FASB to instill

public confidence in our financial markets and thus to facilitate capital formation.

Non-GAAP Financial Measures

In our Report on Objectives for Fiscal Year 2018, we observed that a number of investors had given us a two-part message on non-GAAP financial measures (NGFMs) and key operating metrics: on the one hand, investors found value in those metrics, but, on the other hand, some of these same investors objected to what they viewed as inconsistent and changing disclosures of measures that companies had not adequately defined. These investors called for greater standardization to enable them to compare disclosures across companies and at the same company over time. Our Report on Objectives applauded the attention that Commission staff has paid in recent years to problems involving NGFMs, and we urged continuing vigilance.

During the Reporting Period, we continued to hear investor concerns about NGFMs, and we relayed those concerns to colleagues at the Commission. In grappling with this issue, we have recognized the challenges to achieving greater standardization through further rulemaking. That is because NGFM standards may be most meaningful at the industry level, whereas accounting standards generally seek to be universally applicable across industries, thus enabling investors and other stakeholders to compare financial disclosures across companies and across industries. Moreover, universal standards can more readily be applied by companies whose businesses straddle more than one industry. In analyzing policy issues raised by the misuse or overuse of NGFMs, it is also worth distinguishing non-GAAP financial measures from non-financial metrics and Key Performance Indicators, such as the number of subscribers.

Although the SEC has not initiated a rulemaking in this area during Fiscal Year 2018, we believe its attention to these issues has been heightened. For example, SEC Chief Accountant Wesley Bricker has emphasized the important role of

audit committees in overseeing a company's use of NGFMs. In a speech in May 2018, he encouraged audit committees "to understand how management evaluates performance, whether the metrics are consistently prepared and presented from period to period, and the related disclosure policies."⁶⁷

Internal Control over Financial Reporting (ICFR)

In our FY 2018 Report on Objectives, we emphasized the importance of a company's internal control over financial reporting (ICFR). Effective controls, we noted, confer critical benefits on investors and companies alike: controls help to reduce the risks of material errors or fraud, enhance information flows, and contribute to better internal accountability. We also highlighted the role of independent auditor attestations of internal controls in promoting confidence in U.S. capital markets and in helping to lower a company's cost of capital.

During the Reporting Period, the Commission adopted changes to the definition of a "smaller reporting company."⁶⁸ In the process, the Commission declined to change the definition of an "accelerated filer," which triggers a requirement that companies provide investors with an auditor's assessment of the company's ICFR. However, Chairman Clayton directed the staff to formulate recommendations for a potential future rulemaking to reduce the number of companies that qualify as accelerated filers and thereby alleviate the compliance cost of auditor attestation.⁶⁹

In 2013, the U.S. Government Accountability Office published an extensive study examining the impact of the existing exemption from the auditor-attestation requirement on the quality of financial reporting by small public companies and on investors.⁷⁰ It found that companies that obtained an auditor attestation generally had fewer financial restatements than those that did not. These findings, together with additional economic literature, led

the Council of Institutional Investors and the Center for Audit Quality to express their strong opposition to any further weakening of the auditor-attestation requirement.⁷¹ We continue to believe that a reduction of auditor attestation requirements, though advanced in the name of capital formation, could have the opposite effect, and we will continue to monitor any further developments in this area.

Internal and External Engagement

Finally, we engaged both internally and externally on accounting and auditing issues. Externally, we attended meetings of the PCAOB and its advisory groups and followed developments at both the PCAOB and FASB. In addition, we engaged in communication with institutional and retail investors to understand the types of financial information they need and how they use it.

Internally, we sought out opportunities for staff-level engagement with colleagues in other divisions and offices, including the Office of the Chief Accountant (OCA). This deepened our understanding of current developments in accounting and auditing, while also allowing us to distill and share our impressions from our investor outreach visits. Over the summer of 2018, one member of our staff gave two interactive presentations to a subset of the staff of OCA on types of investors, their diverse strategies, and their needs and perspectives relating to financial reporting.

STANDARDS OF CONDUCT FOR BROKER-DEALERS AND INVESTMENT ADVISERS

In our Report on Objectives for Fiscal Year 2018, published on June 29, 2017, we stated that we would encourage the Commission to pursue a thoughtful approach to the complex issue of the standards of conduct for financial professionals who provide advice to investors "so that the SEC can create stronger protections for investors while avoiding unintended consequences."⁷² Since then, there have been some significant developments in this area.

SEC Rulemaking

On April 18, 2018, the Commission voted to propose a package of rulemakings and interpretations intended to improve the quality and transparency of relationships that retail investors have with investment advisers and broker-dealers while preserving access to different types of advice relationships and investment products.⁷³ Specifically, the regulatory package includes the following proposals: (1) a new rule called “Regulation Best Interest;” (2) an interpretation reaffirming and, in some cases, clarifying the Commission’s view of the fiduciary duty that investment advisers owe to their clients; and (3) a new short-form disclosure document called a customer or client relationship summary, as well as a restriction on the use of the terms “adviser” or “advisor” by certain broker-dealers and their associated persons as part of their firm names or professional titles.⁷⁴

Proposed Regulation Best Interest would require a broker-dealer to act in the best interest of a retail customer when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer, without putting the financial or other interest of the broker-dealer ahead of the interests of the retail customer.⁷⁵ Under proposed Regulation Best Interest, a broker-dealer would discharge this duty by complying with each of the following three specific obligations:

- A disclosure obligation, which would require the broker-dealer to disclose to the retail customer the key facts about the relationship, including material conflicts of interest.
- A care obligation, which would require the broker-dealer, in making a recommendation, to exercise reasonable diligence, care, skill, and prudence, to (i) understand the potential risks and rewards associated with the recommendation, and have a reasonable basis to believe that the recommendation could be in the best interest of at least some retail customers; (ii) have a reasonable basis to believe that the

recommendation is in the retail customer’s best interest; and (iii) have a reasonable basis to believe that a series of recommended transactions is not excessive and is in the retail customer’s best interest.

- A conflict of interest obligation, which would require the broker-dealer to establish, maintain, and enforce policies and procedures reasonably designed to identify and then, at a minimum, to disclose and mitigate (or eliminate), material conflicts of interest arising from financial incentives; and to at least disclose other material conflicts of interest.⁷⁶

The proposed investment adviser interpretation would reaffirm and clarify certain aspects of the fiduciary duty that an investment adviser owes to its clients.⁷⁷ The aim of the proposed interpretation is to provide greater clarity to investment advisers and their clients regarding advisers’ legal obligations toward their clients.⁷⁸

The proposed short-form disclosure document known as the customer or client relationship summary—Form CRS—would be a standardized disclosure of no more than four pages that would highlight key differences in the principal types of services offered by an investment adviser or broker-dealer, the legal standards of conduct that apply to each, the fees a client or customer might pay, and certain conflicts of interest that may exist.⁷⁹ This proposed rule, if adopted, would require investment advisers and broker-dealers, and their respective associated persons, to provide retail investors with a relationship summary.⁸⁰ Proposed Form CRS is intended to furnish retail investors with simple, easy-to-understand information about the nature of their relationship with their investment professional and would supplement other more detailed disclosures.⁸¹

The proposed restriction on certain broker-dealers and their associated persons from using the terms “adviser” or “advisor” as part of their name or title

in communications with investors and prospective investors is meant to allay investor confusion regarding investment professionals' registration status.⁸² The rule, if adopted, would require investment advisers and broker-dealers, as well as their associated persons, to be direct and clear about their registration status in communications with investors and prospective investors.

Given the significance of this rulemaking package, we have expended substantial effort to provide the Commission with the relevant data to assist it in making evidence-based decisions. For example, we have been researching whether investors understand the distinctions among different types of investment professionals, how effectively investors navigate the market for financial advice, investor perceptions of financial conflicts of interest, and the types of conduct investors expect from an investment professional who is required to act in an investor's best interest.⁸³

On October 12, 2018, the Commission published a research report prepared by staff of our Office in conjunction with the RAND Corporation (RAND).⁸⁴ This "Retail Investment Advice Study" consisted of a literature review, focus group interviews, and a quantitative survey. The focus group portion of the Retail Investment Advice Study found, among other things, that participants' understanding of the types of financial services and professionals was low.⁸⁵ Similarly, the quantitative survey portion of the Retail Investment Advice Study found, among other things, that there was some degree of confusion, or ambiguity, in the marketplace for investment advice and, consequently, potentially significant matching and search frictions for investors.⁸⁶ These and other findings are discussed in greater detail in the section below entitled "Report on Investor Testing."

On November 7, 2018, the Commission published additional research from RAND, focusing on

proposed Form CRS.⁸⁷ This "Investor Testing of Form CRS Relationship Summary" involved one-on-one interviews with individual testing subjects as well as surveys with a pool of respondents to explore, among other things, the optimal length and content of the proposed Form CRS.⁸⁸

FINRA Regulatory Notice 18-13, Quantitative Suitability

FINRA Regulatory Notice 18-13 requested comment on FINRA's proposal to amend FINRA's Rule 2111, which imposes general suitability obligations on all broker recommendations for particular transactions and investment strategies.⁸⁹ Among other things, Rule 2111 prohibits a broker from engaging in excessive trading in a customer account (a practice also known as "churning"). Currently, to demonstrate that a broker has violated this quantitative suitability obligation, FINRA must prove: (1) that the broker exercised control over the customer's account; (2) that the transactions were recommended by the broker; and (3) that the level of trading was excessive and unsuitable in light of the customer's investment profile.⁹⁰ FINRA has proposed to remove the requirement that it prove the broker exercised control over the account.

On June 19, 2018, we submitted a comment letter to FINRA in support of its proposal.⁹¹ We felt compelled to respond to FINRA's request for comment on the proposal because of our strong interest in potential rule changes involving FINRA's supervision of broker-dealer conduct, and particularly "the rules that promote fair dealing and ethical sales practices, because they play such a key role in protecting retail investors."⁹² As we stated in our comment letter, we believe FINRA would be well-served by the rule change, which would allow it to better protect the interests of retail investors by holding brokers responsible for recommendations that result in excessive trading. Moreover, the proposed rule change will serve as a deterrent to future misconduct.

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.⁹³

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 2018;
- SEC enforcement actions and FINRA disciplinary actions during the Reporting Period;
- NASAA's Annual Report,⁹⁴ 2018 Enforcement Report,⁹⁵ and Top Investor Threats;⁹⁶
- The SEC's Office of Compliance Inspections and Examinations' Examination Priorities for 2018;⁹⁷
- SEC and SRO staff reports providing guidance and interpretations relating to investment products;
- Discussions and correspondence with SRO staff, including an October 19, 2018, letter from Lynnette Kelly, Executive Director, MSRB, highlighting municipal market practices that may have an adverse impact on retail investors;⁹⁸ and
- Discussions with the SEC Retail Strategy Task Force.⁹⁹



The table below lists certain potentially problematic products or practices during Fiscal Year 2018 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 ¹⁰⁰	NASAA ¹⁰¹
<ul style="list-style-type: none"> • Initial Coin Offerings, Cryptocurrency, and Blockchain • Scams and Schemes Relating to Impersonation of a “Regulator”, Natural Disasters, and Paid-to-Click Scams • Investment Fees and Expenses • Celebrity Endorsements • Cybersecurity • Online Security Relating to Investment Accounts • Suitability of Wrap Fee Programs • Microcap Stocks • Implementation of Fixed Income Order Execution • Risks Associated with Master Limited Partnerships • Risks Associated with Using Credit Cards to Purchase an Investment or Fund an Account • Self-Directed IRAs and Risks of Fraud • Marijuana Investments and Fraud • Unregistered or Unscrupulous Gate Keepers, Third Party Providers, and Marketers 	<ul style="list-style-type: none"> • Initial Coin Offerings • Emerging Financial Technologies such as Cryptocurrency Trading • Scams and Schemes Relating to Natural Disasters • Investing in “Unicorns”¹⁰⁴ • Online Binary Option Schemes • Real Estate Related Investments • Oil/Gas Investments • Ponzi Schemes • Promissory Notes
FINRA ¹⁰²	MSRB ¹⁰³
<ul style="list-style-type: none"> • Initial Coin Offerings • Cryptocurrency-Related Stock Scams • Scams and Schemes Including Regulator Imposter Scams and Stock Fraud in Wake of Natural Disasters • Trading on Margin • Data Aggregation Risks 	<ul style="list-style-type: none"> • Municipal Market Practices such as Pennyning,¹⁰⁵ and Prearranged Trading in Connection with Primary Offerings • Macroeconomic Environment, such as potential risks to retail investors from rising interest rate environment • Municipal Market Disclosure Practices

In addition, on September 26, 2018, the Commission’s Division of Trading and Markets hosted a Roundtable on Combating Retail Investor Fraud.¹⁰⁶ The roundtable consisted of three panels: a discussion on types of fraudulent and manipulative schemes currently targeting retail investors; a discussion on enhancing the ability of broker-dealers to combat retail investor fraud; and a discussion on additional ways to combat retail investor fraud.¹⁰⁷ During the roundtable, panelists identified numerous areas of concern

for retail investors, including initial coin offerings and cryptocurrencies, currency trading, pump and dump schemes, microcap stocks, high-fee products, non-traded real estate investment trusts (REITs), variable annuities, unregistered investments (specifically unregistered promissory notes), unregistered financial professionals, pre-IPO offerings, and cannabis investments.

Each of the products and practices listed above presented problems for investors during the

Reporting Period. Based on our review of the resources described above and consultations with knowledgeable professionals, however, we will highlight four areas of concern: initial coin offerings; broker “cockroaching”; outdated transfer agent regulations; and the increasing use of margin debt. Other issues have been highlighted in our previous reports, including binary options,¹⁰⁸ public non-traded REITS,¹⁰⁹ municipal market disclosure practices,¹¹⁰ sales practices involving variable annuities,¹¹¹ scams and schemes related to natural disasters,¹¹² and municipal bond positions that are below minimum denomination.¹¹³

INITIAL COIN OFFERINGS

Cryptocurrencies, initial coin offerings (ICOs), and related products and technologies, while still relatively novel, have proliferated in the last couple of years and seem to have captured the popular imagination. In 2016, ICOs reportedly raised in the aggregate less than \$100 million; in 2017, the amount was roughly \$4 billion; and in just the first two quarters of 2018, it was over \$16.7 billion.¹¹⁴ New financial products and technologies, like those associated with ICOs, often give rise to scams because these innovations can be used improperly to exploit unwitting investors with the promise of high returns in a rapidly developing market.

Cryptocurrencies purport to be digital assets of inherent value (comparable, for instance, to cash or gold) that are designed to enable purchases, sales, and other financial transactions.¹¹⁵ Coinciding with the emergence of cryptocurrencies, some companies and individuals are using ICOs to raise capital for businesses and projects. Such offerings typically involve the opportunity for individual investors to exchange currency, such as U.S. dollars or cryptocurrencies, for a digital asset labeled as a coin or token with associated rights and interests.¹¹⁶ Promoters may inform potential purchasers that the capital raised from the offerings will be used to fund development of a digital platform, software, or other project and that the virtual coins or tokens may be used to access the platform, use the

software, or otherwise participate in the project. Some promoters and initial sellers may lead buyers of the virtual coins or tokens to expect a return on their investment or to participate in a share of the returns provided by the project. After they are issued, the virtual coins or tokens may be resold to others in a secondary market on virtual currency exchanges or other platforms.¹¹⁷

Although there may be legitimate cryptocurrency investment opportunities,¹¹⁸ there are troubling signs of widespread fraud as well. In October 2018, EY (formerly known as Ernst & Young) studied 110 projects that had collected 87 percent of all ICO proceeds in 2017 to analyze the projects’ progress and investment returns.¹¹⁹ The firm found that 86 percent were below their listing price and 30 percent had already lost substantially all value.¹²⁰ An earlier report by the same firm noted high risks of fraud and theft, including theft from hacking. Although in theory blockchain-based transactions are supposed to be irreversible, and the records durable, in fact there have been coding errors and other vulnerabilities associated with blockchain. As of December 2017, more than 10 percent of ICO proceeds had been lost as a result of hacks.¹²¹

ICOs present special challenges for law enforcement. The lack of a centralized authority for a platform or system means that law enforcement agencies like the SEC must infer information about anonymous participants from other sources. Some participants may even be located overseas. Traditional financial institutions, such as banks, often are not involved with ICOs or virtual currency transactions, which makes it more difficult to trace funding.¹²²

We are encouraged by the ways in which the Commission is addressing the ICO phenomenon. In numerous speeches and public statements, Chairman Clayton has stressed that those seeking to raise capital to fund an enterprise, which many in the ICO space have sought to do, are obligated to consider whether they are engaging in an offer or sale of securities, which places the activity squarely



in the SEC’s jurisdiction.¹²³ In this context, he has emphasized that gatekeepers and others, including securities lawyers, accountants and consultants, have responsibilities under our securities laws.¹²⁴ The Division of Enforcement has marshaled resources and sought to bring cases that deliver broad messages and have an impact beyond the individual circumstances.¹²⁵ Additionally, the Office of Investor Education and Advocacy has published investor alerts, bulletins, and statements on cryptocurrency-related investments and ICOs.¹²⁶ For our part, we will continue to monitor this rapidly evolving space with an eye toward the effectiveness of our regulatory framework.

BROKER MIGRATION AND MISCONDUCT

Brokers who have committed securities violations or are the subject of multiple arbitration claims may find it difficult to find future employment in reputable firms. The migration of these brokers

from one high-risk firm to another, also known as “cockroaching,” has long been a persistent problem in the securities industry.¹²⁷ These brokers leave one firm to resume operations at the next. Frequently, they do so alongside groups of migrating brokers with similarly checkered disciplinary records.¹²⁸

In 2013, the *Wall Street Journal* highlighted “the pattern of brokers moving from one problem firm to another.”¹²⁹ As part of its investigation, the *Journal* found empirical links between the practice of broker migration and customer risk: “On average, a broker who left at least two firms that were eventually expelled and who joined another firm had more than eight times as many arbitration claims and other required disclosures as the industry average.”¹³⁰

The risk to customers is exacerbated by the propensity of recidivist brokers to congregate with other bad brokers. In fact, certain brokerages appear

to act as beacons for bad brokers.¹³¹ Rather than turning over a new leaf, migrating brokers often continue their business as usual.¹³² As a result, some encounter additional disciplinary issues with their new firms.¹³³ If the brokers are subsequently terminated or the firms are expelled or otherwise forced to close their doors due to financial hardship, which may be precipitated by broker malfeasance, the migration begins anew.¹³⁴

Four out of the past five years, FINRA has identified high-risk firms and brokers and broker migration as regulatory and examination priorities.¹³⁵ In 2013, FINRA launched a special oversight program targeting high-risk brokers.¹³⁶ As an example of this oversight, FINRA barred 10 employees of broker-dealer Global Arena Capital Corp. from the securities industry in 2015 after an on-site examination found numerous abuses.¹³⁷ Seven of the barred employees were surveilled as they migrated to Global Arena from HFP Capital Markets LLC, a firm expelled from FINRA membership in 2014.¹³⁸ At the time, FINRA noted that the sanctions were part of its “continued focus on tracking groups of brokers that move from one risky firm to another.”¹³⁹

Roving bad brokers are a minority of the broker population but they can do tremendous damage.¹⁴⁰ A 2017 study of all financial advisors registered with FINRA from 2005 to 2015 shows that almost 8 percent of registered advisers had committed misconduct and, of that group, 27 percent were recidivists with two or more disclosures.¹⁴¹ The study also supports the notion that bad brokers may congregate, noting that “relative to other advisors who left the same firm at the same time, advisors who engaged in misconduct are hired by firms that employ a greater percentage of other advisers with past misconduct records.”¹⁴²

Notably, recent reports show that troubled brokers often target seniors to take advantage of their presumed lack of financial sophistication.¹⁴³ These

brokers will often peddle risky, high-commission private placement investments to unsuspecting senior customers.¹⁴⁴ This practice is of particular concern because of the disproportionate rate at which private placement brokers are disciplined.¹⁴⁵ According to a study, 12 percent of brokers selling private placements had three or more instances of misconduct, compared to an industry average of roughly 2 percent.¹⁴⁶

FINRA has recently taken some initial steps to tighten restrictions on broker migration. In February 2018, FINRA requested comment on proposed amendments to limit the ability of individuals to switch firms to avoid payment of arbitration awards while staying in business.¹⁴⁷ In April 2018, FINRA requested comment on a proposal to require 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.¹⁴⁸ These proposed amendments are positive, if incremental, measures to prevent the harm caused when bad brokers relocate.

There are other recent and proposed FINRA amendments that are relevant but not limited in applicability to migrating brokers. For example, recent amendments modified sanctioning guidelines to provide for more severe punishment when broker backgrounds include prior misconduct.¹⁴⁹ Also, FINRA has requested comment on a proposed rule amendment to require firms to adopt heightened supervisory procedures for brokers during the period that an appeal of a disciplinary matter is pending or during which a statutory disqualification eligibility request is under review.¹⁵⁰ Another proposal would mandate that firms include disclosure on BrokerCheck if they are subject to FINRA’s taping rules, which provide that firms must record conversations between their registered representatives and customers if the percentage of risky brokers in the firm exceeds a specified threshold.¹⁵¹

Brokers identified by FINRA as high-risk and the models used to make those determinations are not publicly disclosed;¹⁵² therefore additional regulatory efforts are critical to protect the investing public from the threat posed by broker migration. We encourage the continued investigation of new methods to keep investors safe from risky migrating brokers and the firms that house them in sometimes dangerous concentrations. As part of its examination of these issues, we urge FINRA to take this opportunity to further consider the potential benefits to retail investors of expanding public access to the data sets, models, and rankings FINRA uses to assess broker risk. The availability of this information to the public would allow investors, industry groups, and other interested parties to build their own models to independently appraise the risk posed by brokers to the communities they serve.

OUTDATED TRANSFER AGENT REGULATIONS

As we stated in our June Report on Objectives for Fiscal Year 2019,¹⁵³ OIAD is following issues related to transfer agents, transfer agent rules, and the critical role transfer agents play as gatekeepers. Transfer agents issue and cancel stock certificates to reflect changes in ownership, act as an intermediary for the company, and handle lost, destroyed, or stolen certificates, among other key functions.¹⁵⁴ Additionally, transfer agents play an important role in monitoring the restrictive legends and “stop transfer” orders that distinguish restricted securities from freely-tradable securities.¹⁵⁵ The failure of a transfer agent to promptly, accurately, and safely perform its duties can, among other things, hinder the successful completion of secondary trades, disenfranchise investors, and expose issuers, investors, securities intermediaries, and the securities markets as a whole to significant financial loss.¹⁵⁶

As previously noted, in September 2018, the Division of Trading and Markets hosted a Roundtable on Combating Retail Investor Fraud,¹⁵⁷ during which the participants discussed transfer agents, among other topics. Specifically, the roundtable focused on the role transfer agents play in removing restrictive legends.¹⁵⁸ The improper or inappropriate removal of a restrictive legend can result in the illegal distribution of a security, which could potentially harm retail investors.¹⁵⁹ Distribution of unregistered securities is particularly problematic in the microcap market,¹⁶⁰ where there may be limited publicly available information and increased risk for fraud.¹⁶¹ Often, less sophisticated investors may be the victims of microcap fraud.¹⁶²

As discussed in our Report on Objectives for Fiscal Year 2019, transfer agents are positioned to play important gatekeeper functions to help prevent fraud.¹⁶³ We were encouraged to see the topic of transfer agents on the roundtable agenda, elevating the Commission’s awareness of the important role transfer agents play in preventing fraud affecting retail investors.¹⁶⁴ We believe the regulations governing transfer agents, adopted in 1977 and rarely amended since,¹⁶⁵ are in need of modernization, and we will be urging the Commission to make these reforms a priority.

INCREASING USE OF MARGIN DEBT

Given the recent market volatility, it is important for investors to understand some of the risks associated with margin debt and margin accounts. Over the past year, margin debt has attracted media coverage as the debt level has risen steadily.¹⁶⁶ Investors should be aware that margin accounts can be risky and may not be appropriate for everyone.

A margin account is a type of brokerage account in which the broker-dealer lends the investor cash, using the account as collateral, to purchase securities.¹⁶⁷ When securities are bought on margin, both the amount borrowed and interest must be repaid, even if money is lost on the investment.¹⁶⁸ If the securities used as collateral in the account decrease in price, the firm can issue a margin call,¹⁶⁹ which requires the investor to provide the broker with additional cash or securities.¹⁷⁰

For example, consider an investor who purchases a stock for \$50, and the price of the stock subsequently rises to \$75.¹⁷¹ If the investor bought the stock in a cash account and paid for it in full, the investor would earn 50 percent on the investment (the \$25 gain is 50 percent of the initial investment of \$50).¹⁷² However, if the stock was bought on margin—paying \$25 in cash, and borrowing \$25 from the broker—a 100 percent return is earned on the money invested (\$25 gain is 100 percent of the initial investment of \$25),¹⁷³ less the interest on the \$25 that was borrowed.¹⁷⁴

The downside to using margin is that, if the stock price decreases, substantial losses can mount quickly.¹⁷⁵ As an illustration, suppose the stock bought for \$50 falls to \$25. If the stock was fully paid for, 50 percent of the money was lost (\$25 loss is 50 percent of the initial investment of \$50).¹⁷⁶ However, if the stock was bought on margin, the loss will be 100 percent (\$25 loss is 100 percent of the initial \$25 investment), plus the interest owed on the loan.¹⁷⁷ Additional risks of margin accounts include the possibility of: losing more money than initially invested; an investor's obligation to deposit additional cash or securities into their account on short notice to cover market losses; the brokerage firm selling some or all of the investor's securities to pay off the margin loan without first consulting



the investor; the investor's inability to choose which securities the brokerage firm sells in the account to cover the margin loan; the brokerage firm increasing the margin requirements at any time without providing the investor advanced notice; and the investor not being entitled to an extension of time on a margin call.¹⁷⁸

In the past year, both the SEC and FINRA issued bulletins on margin debt and the importance of investors understanding the possible risks of trading on margin.¹⁷⁹ These alerts provide suggestions for investors to help protect themselves with respect to margin debt and margin accounts. Such guidance is timely in light of recent market volatility. Although we do not believe changes to regulations governing margin debt and trading are necessary at this time, we think that continued efforts to educate the public about the risks involved are essential. We also believe that continued regulatory vigilance is warranted because some financial professionals may have pecuniary incentives to inflate assets under management and promote transaction activity by encouraging investors to trade on margin.

INVENTORY OF INVESTOR ADVOCATE RECOMMENDATIONS AND SEC OR SRO RESPONSES

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. To the extent practicable, 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.¹⁸⁰

We engage in advocacy for investors in various ways. Most often, our written advocacy is in the form of a comment letter that is included in the public comment file. Our expectation is that our comments will be given due weight and that our recommendations will be addressed in a substantive way within the order or release in which a proposed amendment is approved or disapproved. However, we also have the authority to submit more formal recommendations directly to the Commission. Exchange Act Section 4(g)(7) requires the Commission to establish procedures requiring a formal response to all such recommendations not later than three months after the date of such

submission.¹⁸¹ Of course, while the Commission must respond to the Investor Advocate's recommendations, it is under no obligation to agree with or act upon the recommendations.

Exchange Act Section 4(g)(6) requires us to provide, within our Reports on Activities, an inventory of the most serious problems encountered by investors during the report period. The inventory must identify: any action taken by the Commission or SRO and the result of such action; the length of time that each item has remained on the 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.

To satisfy Section 4(g)(6), we provide the following inventory of comment letters and formal recommendations in which we call for action by the Commission or an SRO.¹⁸² We are very selective in choosing the issues to address in comments or recommendations and, accordingly, we believe these issues are among the most serious potential problems for investors. These matters are discussed in greater detail in the preceding sections of this Report.

Nature and Date of Submission	Recommendation of Investor Advocate	Action Taken by Commission or SRO	Reason for Inaction, If Applicable, and Responsible Official
Comment Letter, dated August 15, 2016, to PCAOB ¹⁸³	Supported proposal for the auditor's report to include discussion of critical audit matters, auditor tenure, and additional improvements.	On June 1, 2017, PCAOB adopted the new standard, subject to SEC approval. The SEC approved the rule on October 23, 2017.	Action Complete
Comment Letter, dated September 9, 2016, to Commission ¹⁸⁴	Supported proposal to require greater disclosure by ATSs that transact in NMS stocks, and encouraged Commission to make current Form ATS public for ATSs that transact in fixed income securities, including government securities.	On July 18, 2018, the Commission approved the proposed rule changes and committed to review the regulatory framework for fixed income electronic trading platforms.	Action Complete
Comment Letter, dated July 11, 2017, to FASB. ¹⁸⁵	Recommended new guidance on materiality based upon SAB 99 and CON 2 in lieu of proposed standard.	On August 28, 2018, FASB approved changes as recommended. ¹⁸⁶	Action Complete
Comment Letter, dated February 15, 2018, to FINRA. ¹⁸⁷	Encouraged improvements to existing process for the expungement of broker records from CRD.	Pending at end of Reporting Period.	
Formal Recommendation, dated February 27, 2018, to the Commission ¹⁸⁸	Recommended reversing the Order granting approval of the Chicago Stock Exchange's proposal to adopt an asymmetric trading delay on a pilot basis.	On July 25, 2018, CHX withdrew the proposed rule change. On October 2, 2018, the Commission set aside the original Order approving the proposal. ¹⁸⁹	Action Complete
Comment Letter, dated June 19, 2018, to FINRA. ¹⁹⁰	Supported proposed improvements to broker's quantitative suitability obligations for customer recommendations.	Pending at end of Reporting Period.	
Comment Letter, dated September 17, 2018, to MSRB. ¹⁹¹	Encouraged auto-population of minimum denomination information into Form G-32 and the creation of additional required data fields on Form G-32.	Pending at end of Reporting Period	

In the past, the Commission and SROs have taken actions that were responsive to earlier recommendations related to enhanced disclosure of markups, MSRB board qualifications, expedited

suspension proceedings to curb disruptive trading behavior, and other matters. Those recommendations were discussed in previous Reports on Activities.



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8 AM - 6 PM

OMBUDSMAN'S REPORT

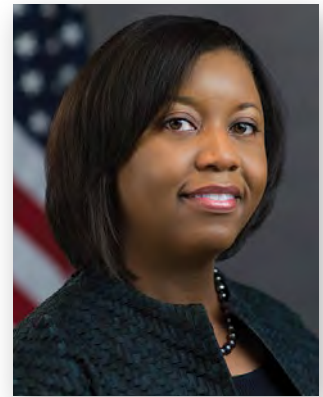
As set forth in Exchange Act Section 4(g)(8), 15 U.S.C. § 78d(g)(8), the Ombudsman is required to: (i) act as a liaison between the Commission and any retail investor in resolving problems that retail investors may have with the Commission or with self-regulatory organizations; (ii) review and make recommendations 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.¹⁹²

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).¹⁹³ 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’s 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 report provides a look back on the Ombudsman’s activities for the full fiscal year period from October 1, 2017 through September 30, 2018 (Reporting Period).

SERVICE BY THE NUMBERS

The Ombudsman¹⁹⁴ 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:

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 this information 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.

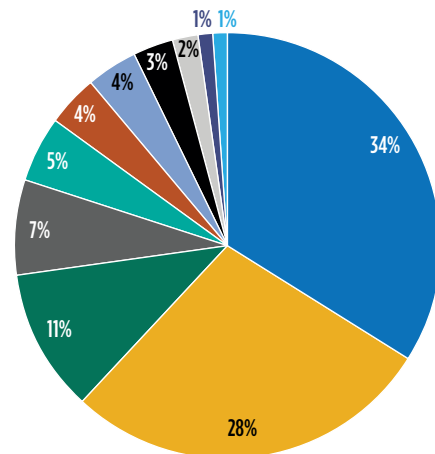
Inquiry volume is counted in terms of matters and contacts. The initial contact—a new, discrete inquiry received by or referred to the Ombudsman—is the contact that establishes the matter. When a matter is established, the Ombudsman reviews the facts, circumstances, and concerns raised, and assesses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

The matter established by the initial contact may generate subsequent contacts—related inquiries and communications to or from the Ombudsman staff deriving from the matter. These contacts often require further staff attention to answer additional questions, explain or clarify proposed resolution options, 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 449 new matters covering 11 primary issue categories:

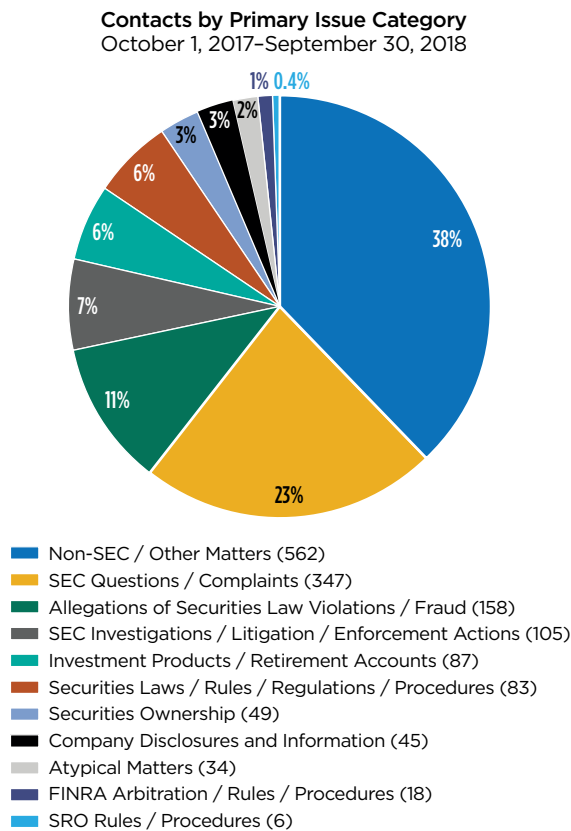
Matters by Primary Issue Category
October 1, 2017–September 30, 2018



- SEC Questions / Complaints (152)
- Non-SEC / Other Matters (125)
- Allegations of Securities Law Violations / Fraud (51)
- Investment Products / Retirement Accounts (32)
- SEC Investigations / Litigation / Enforcement Actions (21)
- Securities Ownership (19)
- Securities Laws / Rules / Regulations / Procedures (19)
- Company Disclosures and Information (14)
- Atypical Matters (10)
- FINRA Arbitration / Rules / Procedures (3)
- SRO Rules / Procedures (3)

The 449 new matters received during the Reporting Period represent a 99 percent increase over the 226 new matters received during the prior reporting period, Fiscal Year 2017. In addition to the 449 new matters, we fielded 1,045 contacts covering eleven primary issue categories during the Reporting Period, for a total of 1,494 contacts. Of the 1,045 contacts fielded, 254 contacts (24 percent) related to matters outside of the SEC’s purview received during prior reporting periods, where persistent investor communications to support the allegations raised in those matters yielded a disproportionate number of contacts.

The chart that follows displays the distribution of the 1,494 total contacts by primary issue category:



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 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.

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. In these situations, investors generally assume their preferred outcome is a viable option and expect that the Ombudsman is permitted to do whatever is necessary to reach that outcome.

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 believe they are entitled to a particular result and want the Ombudsman to provide it can be challenging to assist. At times, they resist the Ombudsman's efforts to engage in a productive dialogue and conclude that any outcome, other than the particular outcome they want, is untenable and unacceptable.

The vignettes that follow are provided to give a sense of the variety of issues we address. Together, 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 illustrate the value of the day-to-day work more effectively than the data alone.

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. He described the matter and his concerns, and the Ombudsman informed him that, while she could not promise any particular outcome, she would look into the matter and solicit the assistance of other SEC colleagues to provide him with additional information. The Ombudsman also took the opportunity to introduce the investor to the Chairman and other senior SEC staff in attendance. After returning to headquarters, the Ombudsman liaised with colleagues in several SEC divisions and offices who ultimately scheduled a conference call with the investor to discuss his matter and concerns in detail. In a follow up email, the investor expressed his appreciation for the SEC Town Hall and for the Ombudsman's personal attention to his matter, which he felt exemplified the agency's commitment to Main Street investors.

An elderly investor was referred to the Ombudsman for assistance replacing lost stock certificates. Ombudsman staff provided the investor with additional information on how to replace the certificates and recommended that he call the SEC Office of Investor Education and Advocacy as well. The investor appreciated the information and conversed with Ombudsman staff for approximately 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 and thanked our staff for listening.

An individual contacted the Ombudsman with questions about securities she received through a relative's estate. Due to the nature of her questions, we advised her to retain private legal counsel. Despite this, she repeatedly contacted us to discuss her issues and attempt to persuade us to act as her legal counsel. She ultimately sent a very emotional and heartfelt email to us pleading for help and legal representation, and she expressed her concerns about her ability to afford private counsel that would be willing to represent her. We again explained to her that SEC staff could not act as her private counsel, and we also gave her the contact information for several low-cost and no-cost legal resources, including law school investor advocacy clinics in her state. She was very grateful for our time and attention and for the additional resources we offered to help her resolve her matter.

A small business owner contacted the Ombudsman to complain about a request for proposal and related communications she received from the SEC Office of Acquisitions. Upon looking into her complaint, 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. The Ombudsman also gave the business owner contact information for staff in the Office of Acquisitions to whom she could direct any questions or concerns about the SEC contracting process.

The Ombudsman hosted a Federal Financial Ombudsmen Working Group meeting at SEC headquarters, where among several topics discussed, the Ombudsman discussed her work with law school investor advocacy clinics. Following the meeting, a few ombudsmen colleagues from other agencies contacted the Ombudsman for suggestions on how they could develop similar collaborations with law schools clinics relating to the work of their agencies. The Ombudsman put her colleagues in touch with several law school clinic directors and recommended other helpful resources.

The Ombudsman received several inquiries from investors outside of the U.S. relating to communications purportedly sent from, or sponsored by, government agencies or legitimate securities industry participants. In each instance, the details of the complaint bore the hallmark of an advance fee fraud, a common fraudulent scheme aimed at non-U.S. investors, where investors are directed to provide personal information and pay a fee in advance as a condition to purchase shares or receive investment proceeds. After the investor pays the advance fee as directed, the soliciting person or entity usually breaks off contact, the proposed transaction or settlement does not take place, and the investor is never paid and never recovers the advance fees. In each instance, the Ombudsman recommended that the investors not respond to the communications, and provided the investors with additional information and resources to help them recognize and avoid these types of scams.

Ultimately, our interactions with investors provide insight into the information investors rely upon and the assistance they want when making investment decisions. When our interactions with investors highlight a 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 investment decisions.

STREAMLINED COMMUNICATIONS WITH RETAIL INVESTORS

This Reporting Period marked the first full fiscal year using the Ombudsman Matter Management System (OMMS), an electronic platform for receiving inquiries and analyzing matter and contact information, while ensuring all necessary data management, confidentiality, and reporting requirements are met. The OMMS Form, a web-based form permitting the submission of investor inquiries, complaints, and documents directly to the Ombudsman, was made available to the public in September 2017 via the www.sec.gov/ombudsman webpage. The OMMS Form guides the user 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 users to upload and submit related documents for staff review. The OMMS Form is instructive and user-friendly and compatible for use on mobile devices, with features such as radio buttons, drop-down menu responses, pop-up explanation bubbles, webpage links, and fillable narrative text fields. The OMMS Form also incorporates response recognition functionality that pre-populates specific fields and prompts the user to provide additional information as necessary.

When an OMMS Form is submitted, OMMS creates a matter record that allows the Ombudsman

to review the matter details, track all related contacts and correspondence, and communicate with the investor via the OMMS platform. The Ombudsman and staff also create OMMS matter records for inquiries received by telephone, email, or other means. Once a matter record is created, OMMS allows the Ombudsman and staff to view the matter and related contacts by person, primary issue, fiscal year, and a number of other categories, and analyze data and customize reports for a deeper dive into the issues raised.

During the Reporting Period, the Ombudsman continued to work extensively with the SEC's Office of Information Technology (OIT) and a technology contractor to refine and improve OMMS functionality and capabilities for both the Ombudsman staff and for persons submitting the OMMS Form. During this Reporting Period, we received 154 new matters via the OMMS Form, representing 34 percent of the 449 new matters received this Reporting Period. 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 and the technology contractor to enhance the OMMS user experience. 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.

STANDARDS OF PRACTICE

Any retail investor with an issue or concern related to the SEC or an SRO organization 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 reports to Congress 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 SEC’s mission is to “protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.”¹⁹⁵ At the core 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 these situations, investors frequently assume the purpose for SEC investigations and enforcement actions is to protect investors by getting their money back. 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 an investor’s particular legal interest or to recover money a particular investor may have lost. Rather, the SEC is tasked with enforcing the federal securities laws to serve the broad interests of all citizens by maintaining fair, orderly, and efficient capital markets.

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 may choose to 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 choose 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 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. We look for ways in which processes or regulations of the SEC or SROs could be improved for the benefit of investors, and we advocate for those types of reforms.

To retail investors, FINRA is perhaps the most well-known SRO¹⁹⁶ under SEC oversight. FINRA operates BrokerCheck¹⁹⁷ and a dispute resolution forum,¹⁹⁸ both of which are commonly used by retail investors. As discussed in prior reports, the Ombudsman regularly monitors FINRA’s activities, especially FINRA’s dispute resolution forum, because of its direct impact on retail investors. Three of these areas of interest and importance to retail investors are discussed below. A fourth area of concern, related to broker migration and misconduct (known as “cockroaching”) was discussed in the section of this Report entitled Problematic Investment Products and Practices.

AREAS OF INTEREST AND IMPORTANCE TO RETAIL INVESTORS

Unpaid Arbitration Awards

The arbitration process is often challenging and costly for retail investors to navigate. For those who are successful, there is still no guarantee that hard-earned judgments will ever be paid.¹⁹⁹ This long-standing problem has festered for years.²⁰⁰ If a broker or firm is found liable for misconduct but unable or unwilling to pay the award, the customer is doubly aggrieved. That is, the customer is damaged by the initial broker misconduct and again by the broker’s subsequent failure to meet its obligation to recompense.

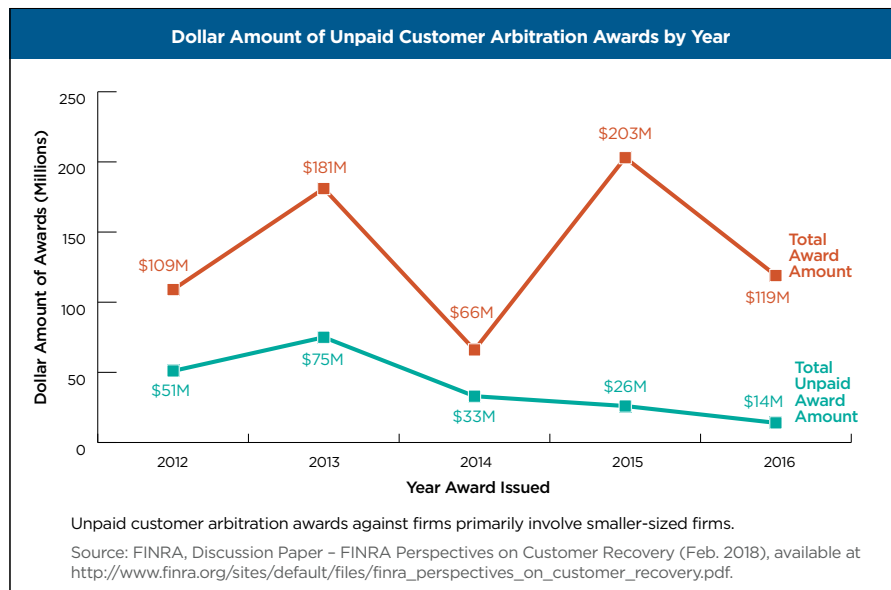
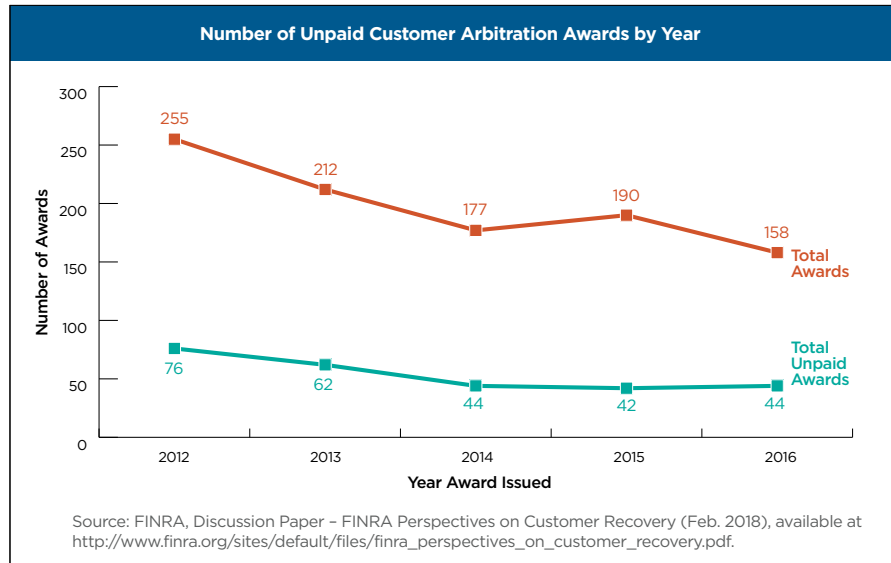
According to a recent FINRA study, 268 awards in an aggregate amount of \$199 million were unpaid from 2012 through 2016.²⁰¹ As shown, the awards were unpaid for 22 percent to 30 percent of the cases in which monetary relief was awarded each year.²⁰²

Viewed differently, the dollar amount of unpaid customer awards for the period from 2012 to 2016 has ranged from roughly 12 percent to 50 percent of the total arbitration awards each year.²⁰³

A supplemental third-party study of 2017 FINRA data shows that “36 percent of the investors who won their cases collected nothing, and 28 cents of each dollar awarded have gone unpaid.”²⁰⁴

While FINRA has incentivized respondents to pay awards within 30 days of receipt by suspending them if they do not, statistics suggest that these measures are insufficient to quell the problem.²⁰⁵ FINRA has acknowledged this inadequacy and outlined several proposals related to unpaid arbitration awards. These proposals include removing certain restrictions on claimants proceeding against an

inactive associated person,²⁰⁶ providing additional information to alert the public to associated persons who have unpaid claims,²⁰⁷ and adding additional safeguards to prevent broker migration and payment avoidance by firms.²⁰⁸



Other approaches outlined in FINRA's recent study require congressional legislation or SEC rulemaking initiatives. Some of these options include raising capital requirements for members to ensure that they have resources to pay arbitration claims²⁰⁹ or requiring firms to carry insurance to cover unpaid awards.²¹⁰ FINRA also raises the possibility of stricter requirements for firms to disclose unpaid awards,²¹¹ expanding the statutory disqualification definition to encompass firms and individuals that have unpaid awards,²¹² and changing existing laws to preclude discharge of unpaid arbitration claims in bankruptcy.²¹³

Satisfaction of unpaid claims by new or existing investor protection funds is another option suggested by various parties.²¹⁴ One possible source of funds could be the Securities Investor Protection Corporation's (SIPC) fund. The SIPC fund, established in 1970, provides that if a member brokerage goes out of business, an investor's cash and securities may be protected in an amount up to \$500,000, subject to a \$250,000 cash limit.²¹⁵ The SIPC fund currently has assets of \$2.5 billion and a credit line with the U.S. Treasury of \$2.5 billion.²¹⁶ Expanding the fund's mandate to backstop unpaid arbitration claims would protect investors who are wronged by deadbeat brokers or firms.

Others have advanced the idea of a new reserve funded by FINRA fines against its members, by FINRA profits, or by an assessment against all FINRA members.²¹⁷ While FINRA notes that such a dedicated fund could be established by Congress, the SEC, or FINRA rulemaking with SEC approval, it contends that "Congress or the SEC should be involved in any decision to create a second brokerage industry fund for unpaid arbitration awards, especially to the extent it would cover claims that Congress has determined should not be covered by SIPC."²¹⁸ Moreover, opponents of fund relief have expressed concern that recovery funds are artificial safety nets that may encourage, rather than deter, bad behavior by brokers.²¹⁹

The Ombudsman believes that each of the proposals described above merit serious consideration. As such, we encourage the relevant legislative and regulatory bodies to solicit actively the input of small retail investors, unpaid claimants, national organizations representing the rights of retail investors, and other stakeholders. The long and vexing history of unpaid arbitration claims is full of claimants who were never made whole. Time is of the essence for American investors.

FINRA Arbitrator Selection Process

Recent scholarship suggests that some arbitrators routinely grant awards that are higher than the average, while others routinely grant awards that are lower than the average.²²⁰ This differential may present arbitrage opportunities that advantage firms.

Under the FINRA process, arbitration cases are decided by one or three arbitrators based upon a claim threshold of \$100,000.²²¹ For claims up to \$100,000, the parties receive a list of ten chair-qualified public arbitrators, of which each separately represented party may strike up to four names.²²² For claims above \$100,000, FINRA provides a list of potential arbitrators in each of the following three categories: 10 chair-qualified public arbitrators, 10 non-public arbitrators and 15 public arbitrators.²²³ Each separately represented party may strike up to four of the 10 chair-qualified arbitrators, up to 10 of the 10 non-public arbitrators, and up to six of the 15 public arbitrators.²²⁴ Parties in both large and small claim arbitrations are permitted to rank the remaining arbitrators on their list(s) in order of preference.²²⁵

The ability to exclude and rank arbitrators may tip the scales in a proceeding if parties are able to identify and increase the likelihood of empaneling an arbitrator that is statistically more likely to provide higher awards (if you are an investor) or lower awards (if you are a firm). Although this appears, on its face, to be a potential advantage for either party, we believe FINRA should closely

scrutinize whether firms that participate more frequently in the arbitration process are unfairly benefitted by informational asymmetries which allow them to select industry-favorable panels.

Investors may also be hindered by the lack of diversity among the pool of arbitrators available to investors. A 2014 study found that approximately 80 percent of the arbitrators in the FINRA pool were men and 40 percent were over the age of 70.²²⁶ Since the study was released, FINRA has announced increased efforts to improve the representation of women and minorities in its arbitrator pool.²²⁷ As a result, a higher percentage of arbitrator applicants in 2017 were women and minorities.²²⁸ However, given the deep roots of the problem, a severe deficit remains.

The Ombudsman intends to monitor research related to arbitrator selection. We encourage retail investors and others with information about the process, and possible inequities within it, to contact our Office.

Representation of Investors in FINRA Arbitration

Broker-dealers typically require customers, when they open accounts, to consent to arbitration as a forum for resolving any disputes that may arise. Thus, despite the award collection and arbitrator selection issues outlined above, arbitration is the most utilized forum for the resolution of disputes between retail investors and brokers.²²⁹

Arbitration is often viewed as a simpler alternative to litigation. However, successful securities arbitration is not a simple, do-it-yourself process. Retail investors—especially *pro se* investors who face sophisticated opposing counsel representing broker-dealer firms—risk derailment in a forum that has become increasingly complex. Claimants tend to achieve much higher success rates when they are represented by legal counsel.²³⁰ Unfortunately,

many investors do not have the financial resources to afford legal representation and, if the amount in dispute is small relative to the complexity of the case, even contingency arrangements will not provide adequate incentives to encourage private legal counsel to handle the matter. As a result, most retail investors with modest incomes or small claims are predisposed to below average arbitration results when they represent themselves in arbitration disputes.²³¹

Given that the disputed dollar amount in an arbitration may be a small investor's life savings, it is concerning that many retail investors are essentially compelled to participate in the arbitration forum without the benefit of counsel. This is why we support the work of law school investor advocacy clinics, which serve a vital function for retail investors by helping to level the often uneven playing field of arbitration by representing clients with small claim amounts. The clinics also work to educate retail investors on investment products and protect them against scams.

Unfortunately, there are simply not enough investor advocacy clinics.²³² The clinics often do not have the funding and staffing resources necessary to service all of the retail investors in need.²³³ Moreover, client eligibility is driven, in part, by local court rules, student practice rules, and ethical rules.²³⁴ As a result of these rules, clients may need to be residents of the state in which the clinic operates, which limits a clinic's ability to assist clients outside of its jurisdiction.²³⁵ These rules effectively create representational gaps, particularly in middle America where few clinics are located.²³⁶

As discussed more fully in the Report on Objectives for Fiscal Year 2019, the investor advocacy clinics were started in response to concerns expressed to then SEC Chairman Arthur Levitt by small investors at SEC town hall meetings.²³⁷ In 1997, Chairman Levitt announced the start of pilot securities

arbitration clinics at two New York-area law schools to assist investors with small claims who had difficulty obtaining legal representation.²³⁸ Over the next fifteen years, additional clinics were launched across the country. Many were funded by state securities fraud enforcement cases²³⁹ and state securities commissions.²⁴⁰ From 2009 to 2012, FINRA's Investor Education Foundation (Foundation) provided another source of funding in the form of grants of \$250,000 each to eight law schools.²⁴¹

Since 2012, no Foundation funds have been awarded to clinics.²⁴² While the initial funding grants were adequate to launch the clinics, additional funds were needed in order for the clinics to sustain their operations. Several clinics were unable to secure this funding and were forced to shut down. Given the small number of clinics in operation, the unwinding of any clinic is a profound loss for retail investors. At present, 17 investor advocacy clinics exist across the United States (in California, District of Columbia, Florida, Georgia, Illinois, Nevada, New Jersey, New York, and Pennsylvania).²⁴³ The vast majority of these 17 clinics are located in the Northeast, creating a scarcity of much-needed resources for investors with small claims who live in other parts of the country.²⁴⁴

FINRA's Dispute Resolution Task Force has expressed that while it was not inclined to second-guess the Foundation's policy of limiting funding to "new or expanded projects with reasonable prospects for post-grant sustainability,"²⁴⁵ continued funding of investor advocacy clinics would be an appropriate use of FINRA fines and penalties.²⁴⁶ The Ombudsman concurs.

In March 2018, the SEC Investor Advisory Committee (IAC) recommended that the Commission explore short-term and long-term solutions to the funding crisis confronting law school investor advocacy clinics.²⁴⁷ In the short-term, the IAC recommended the SEC work with FINRA to provide continued funding of existing clinics, potentially through the use of fines and penalties levied by FINRA. As a more permanent solution to persistent funding issues, the IAC encouraged the SEC to request legislation from Congress to consider permanently funding law school investor advocacy clinics, possibly via a matching grant program through the SEC Investor Protection Fund. The grant program could be modeled after a similar program initiated by the IRS Office of the Taxpayer Advocate. The IRS program, which is designed to address the needs of unrepresented taxpayers, ensures the sustainability of low income taxpayer clinics by requiring qualifying organizations to match IRS grants dollar for dollar up to a maximum grant of \$100,000. The Committee noted that a similar SEC program would ensure the sustainability and long-term efficacy of existing clinics and "create capacity for new clinics in high need areas."²⁴⁸

Our Office highlighted the IAC recommendation in the Report on Objectives for Fiscal Year 2019.²⁴⁹ The Ombudsman remains committed to protecting retail investors, and believes investor advocacy clinics play a crucial role on the front lines of investor protection. Moreover, the Ombudsman feels there should be widespread support for the work of these clinics and the need to find predictable and dependable sources of funding. Given the breadth of services investor advocacy clinics provide to vulnerable retail investors, the Ombudsman fully supported, and continues to support, the recommendation made by the IAC.²⁵⁰

OUTREACH ACTIVITIES

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

- Coalition of Federal Ombudsmen Annual Conference;
- American Bar Association Section of Dispute Resolution—Ombuds Subcommittee;
- Federal Financial Ombudsmen Working Group quarterly meetings;
- Northeast Ombudsmen Working Group quarterly meetings;
- Investor Advocacy Project, Investor Education Roadshow program visit, Seton Hall University School of Law;
- Panelist, *Fordham Journal of Corporate & Financial Law* Symposium, “What Would We Do Without Them: Whistleblowers in the Era of Sarbanes-Oxley and Dodd-Frank,” Fordham University School of Law;
- Panelist, “The Role of Ombudsmen in Dispute Resolution,” Securities Arbitration Clinic, St. John’s University School of Law;
- Panelist, SEC Regulatory Updates, ALI Life Insurance Company Products 2017 CLE program;
- Panelist, Roundtable on Financial Responsibility in Communities of Color, *Corporate Law and Governance Initiative*, George Washington University School of Law;
- Moderator, “The Role and Impact of Chief Diversity Officers,” *Corporate Law and Governance Initiative*, George Washington University School of Law;
- International Ombudsman Association 2018 Annual Conference;

- Panelist, “Securities Arbitration: Where We Are and Where We’re Headed,” North American Securities Administrators Association 2018 Spring Meeting;
- Securities Arbitration Clinics’ 2018 Roundtable;
- International Network of Financial Services Ombudsmen Schemes 2018 Conference; and
- In-person visits with law school securities arbitration and investor advocacy clinics, both on-site and at the SEC.

Law School Clinic Outreach Program

As discussed in prior reports, the Ombudsman, working directly with the Investor Advocate and other staff, developed the Law School Clinic Outreach Program (LSCOP) to connect with law schools with securities arbitration and investor advocacy clinics, and to benefit law student clinic participants and the investing public. Several law schools across the country run securities arbitration and investor advocacy clinics that provide legal representation to retail investors who are unable to hire legal counsel to handle their claims.²⁵¹ Not only do clinics provide legal advice and representation during the arbitration process, they also help retail investors by informing them about various financial products, saving and investing wisely, and avoiding scams—particularly those aimed at specific communities such as immigrants, veterans, and senior investors.

The primary goal of LSCOP is to provide an opportunity for clinic faculty and students to hear directly from and work with Office staff through on-site visits and collaborative policy assignments and discussions. As participants on the front lines of investor protection, the faculty and students provide an important conduit of information to our Office with respect to “real world” concerns of Main Street investors. Thus, the clinics create an additional path for retail investors and law students

to provide the Ombudsman and the Investor Advocate with direct feedback on SEC rulemakings and policy.

Throughout the Reporting Period, the Ombudsman continued to develop relationships with the law school clinics. The Office's major LSCOP initiatives fell into two categories during the Reporting Period: on-site visits by the Ombudsman and clinic visits hosted at SEC Headquarters. During the Reporting Period, the Ombudsman conducted on-site visits with three investor advocacy clinics. In October 2017, the Ombudsman and Office staff attended an Investor Education Roadshow in Teaneck, New Jersey, sponsored by Seton Hall University School of Law's Investor Advocacy Project. The opportunity to observe first-hand clinic investor education enabled the Ombudsman to gain a better understanding of direct clinic outreach efforts.

Also during the Reporting Period, the Ombudsman conducted an on-site visit to the University of Miami School of Law Investor Rights Clinic in October 2017 and to the newly-established UNLV William S. Boyd School of Law's Investor Protection Clinic, which opened its doors in January 2018. As with prior on-site visits, the students at each destination raised extremely insightful questions and provided input aimed at ameliorating common problems experienced by clinic clients. In addition, the Ombudsman and staff were able to solicit their perspectives and policy feedback on retail investor concerns.²⁵²

The relationships developed during on-site visits by the Ombudsman also provided other benefits for retail investors. In June 2018, because of the Ombudsman's existing relationship with the Georgia State University College of Law Investor Advocacy



Clinic, the Ombudsman helped connect the clinic and the Commission. Subsequently, the Commission, in co-sponsorship with the Georgia State University College of Law, hosted the first SEC Town Hall held outside of the Washington, D.C. area to be attended by all five commissioners.²⁵³ At this event, investors in Atlanta, Georgia had the opportunity to talk directly to SEC commissioners and senior SEC staff about key topics of importance.²⁵⁴

The Ombudsman and Office of the Investor Advocate also hosted clinic directors and students for visits to SEC Headquarters during the Reporting Period. The first visit was held in October 2017 for clinic directors and students from five law schools; the second was held in March 2018 for clinic directors and students from seven law schools; and the third was held in September 2018 for the clinic director and students from one law school. Each visit was scheduled to coincide with a public meeting of the Investor Advisory Committee (IAC) to allow the clinic directors and students to attend the meeting.

Of note, at the October 2017 IAC meeting, two clinic directors and one law student presented formal remarks to the IAC relating to the scope of clinic advocacy efforts and the critical need for ongoing funding, and engaged in a dynamic discussion with the IAC following their remarks. At the March 2018 IAC meeting, the IAC recognized the important work clinics do in protecting retail investors and made a formal recommendation to the Commission to improve funding sources for investor advocacy clinics, as discussed above.²⁵⁵ At the September 2018 IAC meeting, attendees were able to hear firsthand the discussions by the IAC and panels of experts on timely issues and research directly affecting retail investors.²⁵⁶

In addition to attending the IAC meetings, the clinic directors and students visiting SEC Headquarters during the Reporting Period were also afforded the opportunity to engage in interactive discussions with the Investor Advocate, the Ombudsman,

and SEC leadership, including Chairman Clayton, Commissioner Stein, Commissioner Piwowar, Commissioner Peirce, Commissioner Jackson, Division of Investment Management Director Blass, Division of Enforcement Associate Director Hodgman, and other senior staff. These discussions generated great dialogue about the work of law school clinics and the challenges they face, including securing ongoing sources of funding.

In June 2018, the Ombudsman traveled to the Securities Arbitration Clinic's 2018 Roundtable held at Fordham University School of Law in New York. As at past gatherings, this roundtable provided the Ombudsman the opportunity to meet and engage with clinic directors and hear about their current work, including cases involving problematic products and practices affecting retail investors. During this Reporting Period, a few law schools and faculty again expressed interest in starting investor advocacy clinics at their institutions. Although our Office does not assist with establishing clinics, the Ombudsman did serve as a liaison, providing appropriate resources and connections related to establishing investor advocacy clinics to several law school administrators and faculty, as well as to industry professionals interested in supporting the growth of clinics across the country.

OUTLOOK FOR FISCAL YEAR 2019

During the Reporting Period, OMMS proved to be a highly effective method for fielding investor questions and complaints, reviewing related documents, and maintaining important information. In addition, the full transition from manual recordkeeping systems to the OMMS platform created significant efficiencies, which allowed the Ombudsman and her small team to track and analyze matter and contact data in a more streamlined fashion while continuing to offer personalized, thoughtful service to retail investors.

In Fiscal Year 2019, the Ombudsman will continue to reallocate staff resources and responsibilities as necessary to accommodate additional work


volume and outreach efforts. These outreach efforts include investor-focused speaking engagements, expanded use of social and traditional media to share information with the investing public, and more involvement in ombudsmen and securities industry conferences and events.

The Ombudsman will also continue to build on the success of the Law School Clinic Outreach Program and seek out additional opportunities to establish channels of communication with retail investors, including through the law school clinics. The LSCOP engagement strategy will continue to include visits by the Ombudsman to the clinics and clinic visits to the SEC to facilitate the exchange of ideas relating to the potential impact of SEC policy considerations on their clients. We will also explore the feasibility of hosting an LSCOP summit for law school clinic faculty and students at SEC Headquarters. We recognize the importance of convening the different clinics to collaborate and exchange ideas with each other and with us about how to best serve retail investors. In addition, a summit would create valuable opportunities for the clinic directors and students to meet with a wider agency audience to discuss their efforts on behalf

of retail investors. These interactions would also provide the Office and the agency with an excellent opportunity to enhance our recruitment efforts by demonstrating the value we place on diversity and inclusion and highlighting the wide variety of career paths and staff that come together to enable the agency to fulfill its mission.

In Fiscal Year 2019, we are also preparing to roll out new initiatives to increase the public's understanding of the Office and the agency. These initiatives will incorporate greater use of technology and create directed efforts to embrace a wide array of investors and communities. We believe these efforts will foster more active and informed participation by retail investors in SEC policy discussions.

The Ombudsman is committed to working with retail investors, industry groups, ombudsmen at other agencies and institutions, and law school investor advocacy clinics. Through ongoing engagement with stakeholders, the Ombudsman hopes to generate innovative and impactful ways to understand and respond to the needs and concerns of retail investors, and looks forward to providing updates on our progress in the next report.



Tracey L. McNeil
Ombudsman

REPORT ON INVESTOR TESTING

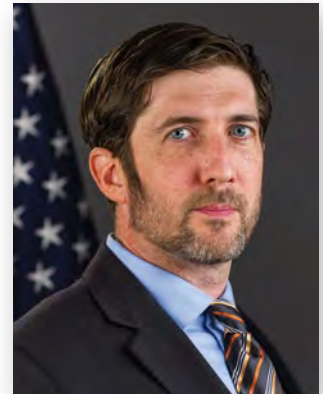
In the Office of the Investor Advocate, we believe we will be most effective in our mission to support investors when our advocacy is based on the best available evidence. Generally, we view regulations that are appropriately attuned to the needs of investors as contributing to the long-term stability of financial markets and capital formation.

Investors (owners of securities)—and more broadly households (that either own or do not own securities)—are the ultimate beneficiaries of the SEC’s regulatory apparatus. Yet, when the Office was established in 2014, there was no systematic mechanism in place for the agency to regularly obtain information from and about investors that was grounded in fundamental principles of social science research. For the most part, the agency relied upon the notice and comment process mandated by the Administrative Procedure Act—a process that tends to elicit far more comment from regulated entities than the general public and consequentially may distort the Commission’s view of investor issues.

To address this data vacuum, the Office of the Investor Advocate developed a research initiative that would become POSITIER (Policy-Oriented Stakeholder and Invester Testing for Innovative and Effective Regulation). POSITIER was designed to integrate and build on evidence- and data-driven policy and performance management initiatives that have received broad support over the years, and it incorporates lessons learned from successful evidence programs across government

and industry.²⁵⁷ It provides a framework for using and building government data capacities to develop regulatory policies that truly improve outcomes for stakeholders while minimizing the costs to all parties.

POSITIER is unique among regulatory agencies. Because of limited resources, it was necessary to construct an architecture that was innovative and agile, cost-effective, and one that would allow for growth as new resources became available. Most important, the data had to adhere to the highest feasible standards of data quality. POSITIER thus offers a broad range of high-quality standing research capacities that can be deployed rapidly for data collection.



With these tools, we seek to provide evidence to help inform the Commission’s policymaking efforts. Our research is geared toward a policy purpose because it is intended to help us achieve our Office’s statutory mandates, which include examining the impact on investors of proposed changes to SEC or SRO rules and identifying changes to existing rules that would benefit investors. POSITIER has delivered immediate results and has the potential to become a major component of the Commission’s policy-oriented evidence generation process.

POSITIER currently has a number of active research streams: retail disclosure effectiveness, financial advice, and investor participation. To date, our efforts have focused principally on understanding the conditions and behaviors of investing and non-investing households—the retail market. We strive to serve the interests of all investors, including institutional investors such as portfolio managers and pension funds, but we have chosen to focus initially on households because we believe that is an area of particular data scarcity in the Commission’s policymaking process.

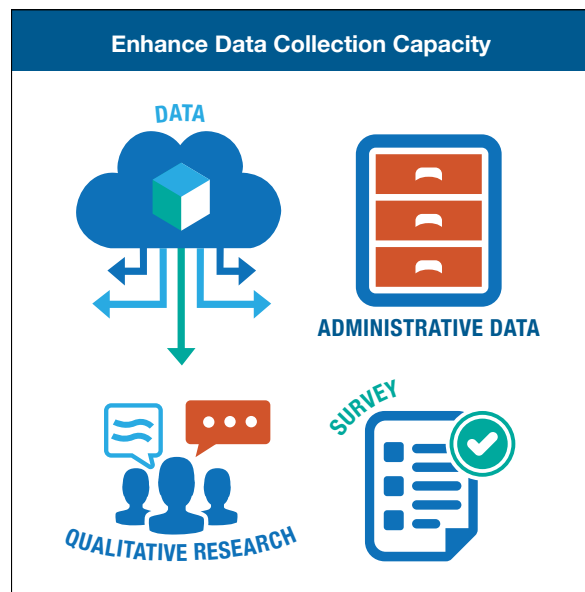
Work Process

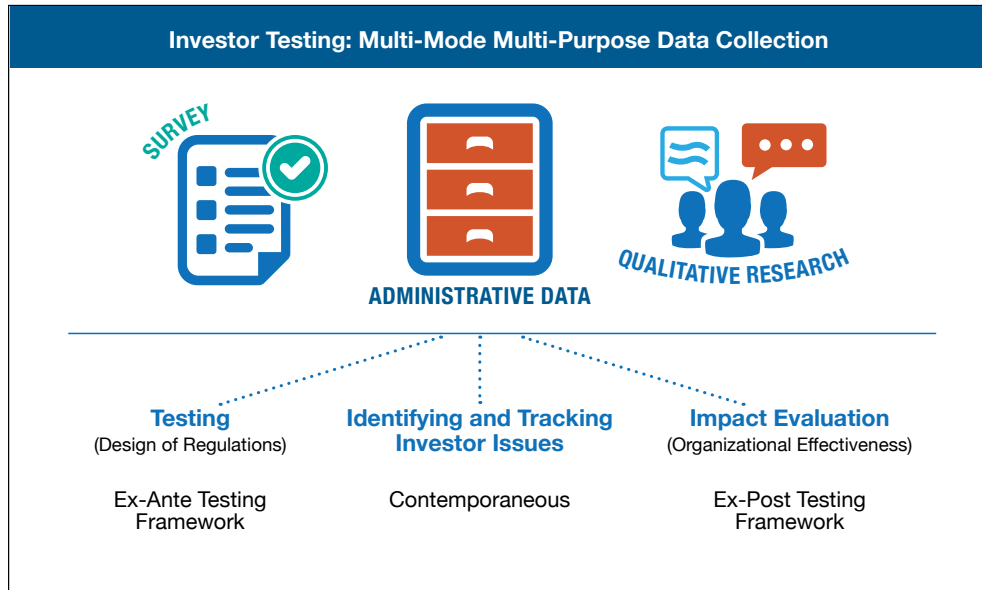
The tools POSITIER deploys are sophisticated, with a mix of quantitative and qualitative methods. POSITIER attempts to use a set of research tools that is appropriate for each particular situation and seeks to leverage, to the extent possible, existing research and data on the particular topic. Initially, a major focus has been the conduct of online surveys of households and individuals. We utilize third parties to field high-quality, nationally representative, probability-based online surveys, and we do not bring any personally identifiable information (PII) from these surveys into the Commission. In addition to surveys, we have made considerable use of qualitative research methods—in particular, in-depth interviews and focus groups. Such qualitative methods help us to develop deeper insights into what the quantitative data may be telling us and enable us to design better quantitative data collection projects.

Our philosophy on survey data collection is specific: we tend not to favor opinion polls, especially when the topics in which we are interested are highly complex and not easily understood by investors.²⁵⁸ We generally look for better ways of understanding an issue. Instead of asking investors their opinions, we ask them about objective facts, or we build

tests into the survey instrument to determine how investors will react under certain conditions; for example, we can test ways to improve the relevance and accessibility of decision-relevant information.

Even though we conduct a number of surveys, POSITIER should not be viewed as a survey product or a survey initiative. POSITIER is a testing initiative—seeing how something actually works in practice using the best available social science research and tools. For some research questions, surveys and qualitative methods are appropriate, while for other issues they may not be the right approach. We are always looking to innovate and can utilize other research methods that are better suited for future projects. In particular, we are interested in using administrative data sources, as anticipated by the Evidence-Based Policymaking Commission Act of 2016.²⁵⁹ In many instances, administrative data can be more informative about circumstances than survey or other methods. However, significant barriers still exist to using this data for policy formulation purposes.²⁶⁰





The overall vision of the POSITIER architecture is to have a diverse arsenal of data collection and analysis tools available in order to contribute rapidly to *ex-ante* testing of potential regulatory changes, ongoing tracking and identification of investor issues, and *ex-post* evaluation and outcomes data in order to promote better organizational management.

An example may help to illustrate our approach. The marketplace for mutual funds offers much potential for retail investors, but there are many pitfalls. Generally, investors are expected to understand and navigate a complex set of decision variables in order to meet their financial goals over time. The lack of basic financial literacy is a recognized impediment for households wishing to achieve desirable financial outcomes.²⁶¹ However, much of the academic literature on financial literacy correlates low financial literacy to big picture outcomes, such as investors' level of assets or contributions to a retirement account.

In contrast, in the context of the Commission's policy environment, we have a more specific interest in understanding the extent to which investors understand key features of the products regulated by the SEC. As such, instead of general literacy questions, we may want to ask questions specifically targeted to investment products geared for the retail market. Specifically, we could focus on whether investors have the knowledge that can help them to navigate the complexities of the mutual fund market and make appropriate choices. After all, choosing the wrong mutual fund can leave an investor worse off than if they had simply put their money into a savings account.

To better understand investor knowledge about the mutual fund market, we can use some simple techniques. For example, we can ask investors a battery of technical questions about mutual funds that vary in their level of difficulty, such as whether it is possible to lose money in a mutual fund or questions about fees. Using a general population

household survey, we can obtain results for households that own mutual funds, as well as those that do not own mutual funds.

Data of this nature can help us discern the extent of the knowledge problem and the extent of any knowledge gap between mutual fund owners and non-owners. However, such data alone do not reveal much about the reasons behind such a gap. Is it that limited knowledge is a barrier to ownership? Or do investors learn about their investments after they have purchased the assets? Understanding these questions requires slightly different data and alternative means of investigation, and that is the heart of POSITIER as an initiative. The answers to those research questions matter for how we might design a policy to deal with the problem of limited information—if the issue is a lack of knowledge causing limited participation, we might choose to target literacy interventions to households that do not own mutual funds, but if owners learn about investments by owning them, then it may be that literacy interventions are unlikely to be effective in encouraging participation.²⁶² POSITIER is an initiative that is set up not only to establish baseline facts, but also to dig deeper so that we can develop actionable policies to address the problem effectively. Furthermore, when a policy is developed we can concurrently design a plan for evaluating that policy's effectiveness over time.

Recent Achievements

In March 2017, we launched POSITIER with an Evidence Summit on the topic of Disclosure Effectiveness while the Commission was under the stewardship of Acting Chairman Michael Piwowar. During the Summit, leading academics in the fields of economics, decision science, psychology,

marketing, and law presented leading-edge thinking and debated key issues related to retail disclosure. Approximately two hundred individuals attended in person, and portions of the Summit were viewed via webcast by more than 12,000 estimated viewers across the globe. We favor launching our most serious research endeavors with an evidence summit.

In light of the significant challenges we face, including budget constraints and the fact that we have only a single full-time staff member devoted to POSITIER, we are very proud of the work we have accomplished so far. Working with colleagues in the SEC's Office of Acquisitions, we have greatly reduced the timeframe required for contracting. Once contracted, we estimate the approach pioneered within the POSITIER framework has compressed the government's typical data collection time by at least 95 percent. As a result, since we started collecting data in June of 2017, we have been able to conduct five qualitative studies and 13 surveys—a total of about 14.8 million quantitative data elements and nearly 20,000 individual nationally representative survey questionnaires completed by respondents across extremely diverse economic, demographic and geographic populations.

Some of this work has been small-scale and was in the nature of beta testing. Yet, a large portion of the data was recently included in our first public report that was released in October 2018. This report, entitled "The Retail Market for Investment Advice," documented new facts about the retail market, investor understanding of key issues, and usage of investment advice.²⁶³ It is our intention to make additional data public once we validate the quality of the data.

At the same time, we need to proceed at a measured pace given our limited resources. The online surveys that we have typically deployed due to budget constraints have certain drawbacks for the study of many phenomena in which the Commission is interested. Other types of data collection are more expensive and time-consuming efforts, but we believe they are warranted in order to understand the ways that very complex issues may impact individual investors. In most cases, the resource commitment required to undertake such higher-cost research is likely to be a fraction of the costs that would be incurred by industry and investors if regulatory policy were not appropriately tuned to their needs.

Research on the Market for Investment Advice

One way in which investors (or non-investors) might navigate complex financial instruments such as mutual funds and ever-changing financial markets is to seek the advice of a financial professional who understands the technical features of assets in which an investor is interested. Yet, this is not a sure-fire solution to the investor's problem. After all, a financial professional can have limitations in their own capability,²⁶⁴ they may be dishonest,²⁶⁵ or they may have conflicts of interest that mean that their advice is not a great match for the investor.²⁶⁶ As such, the investor's problem may shift from being able to determine if particular investments are good for them to being able to determine if a particular financial professional is good for them. These are among the concerns that have created interest in increased regulation of the market for professional advice, and in fact, the Commission proposed a set of regulations in early 2018 as a response to some of these concerns.²⁶⁷

To gather data that could be relevant for the rulemaking, OIAD utilized POSITIER for a study of the retail market for investment advice. With the invaluable assistance of our colleagues across the agency, including in the Division of Trading and Markets, the Division of Investment Management, the Division of Economic Risk and Analysis (DERA), the Office of Investor Education and Advocacy, and the Office of Compliance, Inspections, and Examinations, among others, we compiled a set of research questions for the project. In October 2018, the results were released in a major study, entitled "The Retail Market for Investment Advice," for which I served as co-Principal Investigator along with Angela Hung of the RAND Corporation.²⁶⁸ The study documents a rich collection of new and important facts about the market for retail advice as well as the assets investors own and their knowledge and perceptions of key terms and key aspects of the marketplace. We highlight three interesting findings below and in the accompanying infographic, but encourage interested readers to examine the full study.²⁶⁹

First, while many individuals have some financial assets, most investors do not currently receive financial advice regarding investments. This is a difficult question to ask in a survey so we tried to triangulate answers in a number of ways. In our data, 38.7 percent of investors reported currently using a financial professional for advice about investment strategies, specific financial investments, or the types of accounts to open. When we tried to discern why individuals do not consult a professional, search costs (how difficult it is to find and screen a professional) were among the factors that seemed important.

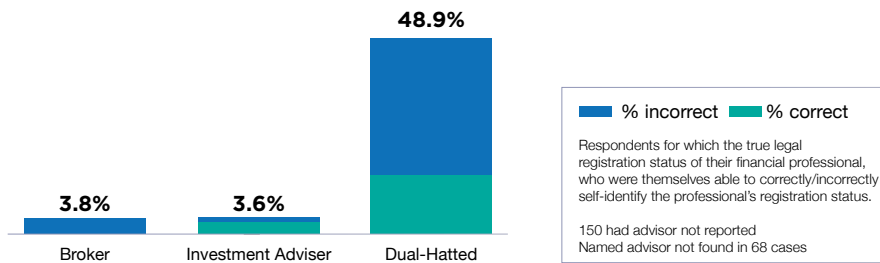
Investment Advice—Key Survey Results



of investors reported using a financial professional for advice about:

- Investment strategies
- Specific financial investments
- Types of accounts to open

The overwhelming majority of professional advice-users consult a **dual-hatted professional** (professional is both broker and investment adviser)



Current investment advice consumers believe that financial professionals acting in an investor's **“best interest”** would be required to:

Avoid taking higher compensation for selling one product when a similar but less costly one is available

61%

Help them choose the lowest cost products, all else being equal

73%

Monitor their accounts on an ongoing basis

86%



A second fact relates to the legal registration status of SEC-regulated financial professionals: namely, that dual registrants dominate the marketplace. It is important for investors to understand the legal registration status of a professional—i.e. “broker,” “investment adviser” or both (known as dually registered or “dual-hatted”)²⁷⁰—in order to properly assess the advice they are

provided.²⁷¹ The legal registration status helps to define the conflicts of interest that may be affecting a financial professional as they provide advice, and it is the major delineation status within current regulations of the professional types. Data provided by DERA suggests that brokers and “dual-hatted” professionals are about equal in prevalence in employment levels at retail-facing

firms.²⁷² While that may be accurate, our study paints a quite different picture when we look at it from the perspective of investors. We verified that the overwhelming majority of advice-consumers use a professional that is dual-hatted. In fact, we found very few investors working with a professional that is exclusively a broker.²⁷³ Perhaps more important, we found little evidence that investors were able to accurately identify the legal registration status of financial professional with whom they were working.

These facts could have interesting policy implications. One possibility is that the legal distinctions that have been so fundamental to the Commission's regulatory conceptualizations of the issue are simply not very meaningful in the retail marketplace for professional financial advice because few individuals use professionals that are exclusively an investment adviser or broker. With dual-hatted professionals, the key issue is the specific relationship that the professional has with their customer. Does the same professional sometimes operate with a particular client as a broker and other times as an investment advisor? (And if so, is it clear to clients at which time the profession wears each particular hat?) Do these professionals generally operate as an investment adviser with the client, retain a brokerage license just because it is easy for them to do so, but they do not ever operate in a brokerage capacity? Or does the brokerage registration allow them to provide additional services to clients even though they always operate under a fiduciary standard with the client? We continue not to know very much about these "dual-hatted" relationships even though they seem to be much more prevalent than any other type of relationship that investors have with a professional. Nonetheless, their strong prevalence in terms of the number of advice-providing relationships suggests some rethinking of the regulatory approach to the retail marketplace for financial advice may be warranted.

A third fact of interest is that, at least in our data, the public seems to believe that a requirement to act in a customer's "best interest" is an extremely strong standard of ethical conduct. Some of this could possibly be attributed to naivete about the investment marketplace, but some may relate to how the term "best interest" is interpreted in the vernacular. Such discrepancies between definitions contained in arcane legal and regulatory guidelines on one hand, and the vernacular usage of those terms on the other, are critically important for understanding the effect that regulatory terminology signals are sending to retail investors who may not have the time, education, nor research skills required to parse legal nuances in order to understand how the information should affect their decision-making process.

To understand investor understanding of the term "best interest," we asked respondents "What do you think it means if a financial professional is required to act in your "best interest?" We offered respondents eight attributes to which they could respond yes, no, or I don't know. Panel 3 of the infographic on the previous page summarizes three of the responses we want to highlight for the individuals that reported currently using a financial professional for investment advice. Current advice users overwhelmingly believed (86 percent) that a professional required to act in their best interest monitors their accounts on an ongoing basis. This is somewhat of a concern because the best interest standard, as proposed, will apply to broker-dealers who are not required to provide this service as part of their typical offerings. The next two questions relate to cost and conflicts of interest. Seventy-three percent of current advice users believed that a professional acting in their best interest "will help me to choose the lowest cost products, all else being equal." Sixty-one percent indicated that the professional would "avoid taking higher compensation for selling me a product when a similar but less costly product is available."

If the change in standards as adopted actually achieves results that match investor expectations, investors will benefit. But, if the standard falls short, the term “best interest” may actually confuse and mislead investors. Investors could also be confused about the distinction between the new standard and a fiduciary standard, which is often described to investors using terms like “best interest.” To underscore this concern, one striking and unexpected feature of the data is that when we limit the sample from all respondents to more experienced individuals—investors or persons that currently get advice from a financial professional—the level of expectation associated with best interest actually climbs appreciably. In our view, if the standard as adopted does not match reasonable investor expectations, it becomes all the more important for the Commission to find effective means to educate investors so that their expectations can be adjusted to match the standard.

These data highlight the importance of understanding exactly where investors are on a particular issue so that regulatory policy can be designed and communicated appropriately to the benefit of investors. Furthermore, efforts to implement policies that are well-intentioned, but not sufficiently grounded in empirical evidence, may actually backfire and harm investors more than they help them.

The research undertaken in this situation was intended to be formative in nature to simply assess the state of the marketplace rather than testing

specific policy innovations. The research was designed and conducted when the rule proposals were at a fairly preliminary stage. Nevertheless, it provides some interesting insights. It also demonstrates an aspect of the rapid deployment approach that POSITIER brings: on this project, researchers produced a draft report of findings mere months after the project funds became available, whereas a project of this nature typically takes agencies years to complete.

Looking Forward

POSITIER is a highly ambitious, exciting, and innovative new outcomes-focused approach to policy. We have developed a framework for better attuning rulemaking so that investors can be better-served and the costs to industry minimized. We view POSITIER as a more effective approach to regulation, and we believe it has the potential to transform the way the Commission carries out its mission for the benefit of investors and industry alike. We also are hopeful that POSITIER will eventually provide outcome-oriented metrics to the SEC that will provide potential tools for organizational management.

We have made great strides in developing survey instruments and understanding some key cognitive and conceptual barriers for investors. 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.



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.²⁷⁴ 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.²⁷⁵

Exchange Act Section 39 authorizes the Committee to submit findings and recommendations for review and consideration by the Commission.²⁷⁶ 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.²⁷⁷ While the Commission must respond to the IAC’s recommendations, it is under no obligation to agree with or act upon the recommendations.²⁷⁸

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.²⁷⁹

In the past, the Commission has taken action that was responsive to the IAC’s recommendations related to target date mutual funds,²⁸⁰ general solicitation and advertising in private offerings,²⁸¹ crowdfunding²⁸² a shortened trade settlement cycle,²⁸³ electronic delivery of investment company shareholder reports,²⁸⁴ and increasing the number investment adviser examinations.²⁸⁵ This Report covers all other recommendations the IAC has made since its inception. For more detailed summaries, 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.²⁸⁶ Therefore, any such initiatives are not reflected in this Report.

Topic	Date	IAC Recommendation	SEC Response
<p>Proposed Regulation Best Interest, Form CRS, and IA Fiduciary Guidance²⁸⁷</p> <p>For a related recommendation, see “Broker-Dealer Fiduciary Duty” below.</p>	Nov. 7, 2018	<p>Clarify the standards of conduct for broker-dealers and investment advisers with regard to the obligation to act in customers’ best interests; expand the best interest obligation to cover rollovers and recommendations regarding account types; explicitly characterize the best interest standard as a fiduciary duty; conduct usability testing of the proposed Form CRS and, if necessary, revise the proposed disclosures.</p>	Pending.
Transaction Fee Pilot for NMS Stocks ²⁸⁸	Sept. 13, 2018	<p>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.</p>	Pending.
Select Enhancements to Protect Retail Investors in Municipal and Corporate Bonds ²⁸⁹	June 14, 2018	<p>Adopt proposed amendments to Rule 15c2-12 related to disclosure of bank debt and other obligations; update interpretive guidance; continue to work with MSRB on improved functionality for EMMA; undertake a comprehensive study of the corporate bond market and produce a follow-up report similar to the 2012 Report on the Municipal Securities Market.</p>	<p>On Aug. 20, 2018, the SEC adopted amendments to Rule 15c2-12 to enhance transparency in the municipal securities market, including disclosure of bank debt and other material financial obligations of the issuer that could impact an issuer’s liquidity, overall creditworthiness, or an existing security holder’s rights.²⁹⁰</p>
Financial Support for Law School Clinics that Support Investors ²⁹¹	March 8, 2018	<p>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.</p>	Pending.

Topic	Date	IAC Recommendation	SEC Response
Dual Class and Other Entrenching Governance Structures in Public Companies ²⁹²	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.
Enhance Information for Bond Market Investors ²⁹³	June 7, 2016	Provide post-trade price transparency, including markups or markdowns, in municipal, corporate and agency bonds and, over the longer term, provide pre-trade price transparency as well.	On November 17, 2016, the SEC approved rules requiring disclosure of mark-ups and markdowns on most municipal and corporate bond transactions, calculated from the bond's prevailing market price. ²⁹⁴ The SEC's Fixed Income Market Structure Advisory Committee is exploring ways to improve pre-trade price transparency. ²⁹⁵
Mutual Fund Cost Disclosure ²⁹⁶	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.	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 solicits investor feedback on fund fees and expenses, and it includes other questions related to the IAC recommendation (e.g., dollar vs. percentage disclosure, disclosure within account statements, etc.). The public comment period closed on Oct. 31, 2018. ²⁹⁷
Empowering Elders and Other Investors: Background Checks ²⁹⁸	July 16, 2015	Develop a disciplinary database to allow easy searches to determine whether a person or firm has been sanctioned for securities law violations. Reduce the complexity of background searches.	On May 2, 2018, the SEC launched a new online search tool that enables investors to research whether the person trying to sell them investments has a judgment or order entered against them in an enforcement action. The new tool is called SEC Action Lookup for Individuals (SALI). ²⁹⁹
Accredited Investor Definition ³⁰⁰	Oct. 9, 2014	Consider enabling individuals to qualify as accredited investors based on their financial sophistication.	On December 18, 2015, the SEC issued a staff report that discussed, among other alternatives, using sophistication as an element of the accredited investor definition. ³⁰¹

Topic	Date	IAC Recommendation	SEC Response
Impartiality in the Disclosure of Preliminary Voting Results ³⁰²	Oct. 9, 2014	Ensure impartiality in the disclosure of preliminary proxy voting results.	Pending.
Decimalization and Tick Sizes ³⁰³	Jan. 31, 2014	Oppose any test or pilot programs to increase the minimum quoting and trading increments (“tick sizes”) in the securities markets.	The 2-year pilot program ended on Sept. 28, 2018. ³⁰⁴ The exchanges and FINRA submitted a joint assessment of the impact of the Tick Pilot on July 3, 2018, and a revised report on Aug. 2, 2018. ³⁰⁵
Broker-Dealer Fiduciary Duty ³⁰⁶	Nov. 22, 2013	Establish a fiduciary duty for broker-dealers when they provide personalized investment advice to retail investors.	On April 18, 2018, the SEC voted to propose Regulation Best Interest, under which a broker-dealer would be required to act in the best interest of a retail customer when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer. On Nov. 27, 2018, the IAC issued a related recommendation: see “Proposed Regulation Best Interest, Form CRS, and IA Fiduciary Guidance” above.
Universal Proxy Ballots ³⁰⁷	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. ³⁰⁸ This topic was discussed on Nov. 15, 2018, at an SEC public roundtable on the proxy process.
Data Tagging ³⁰⁹	July 25, 2013	Promote the use of machine-readable data tagging formats for data filed with the SEC.	The SEC has addressed data tagging in a number of rulemaking projects. ³¹⁰ During the Reporting Period, the SEC proposed amendments requiring that operating companies and funds tag all of the information on the cover pages of Form 10-K, Form 10-Q, Form 8-K, Form 20-F, and Form 40-F. ³¹¹ In addition, the SEC adopted amendments that require operating companies and funds to use Inline XBRL for certain information ³¹² and proposed a new rule for ETFs that requires Inline XBRL. ³¹³ Lastly, the SEC proposed a new Form CRS Relationship Summary, which would require broker-dealers and investment advisers to file their relationship summaries electronically in a text-searchable format. ³¹⁴

END NOTES

- 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 2018* (June 29, 2017) [hereinafter *Report on Objectives, Fiscal Year 2018*], <https://www.sec.gov/advocate/reportspubs/annual-reports/sec-office-investor-advocate-report-on-objectives-fy2018.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. Because the Office of the Investor Advocate is new, this Report on Activities is the first to describe problems, recommendations, and resulting actions. Therefore, we do not set forth a separate inventory of pre-existing items.
- 6 *Report on Objectives, Fiscal Year 2018, supra* note 3.
- 7 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.
- 8 See Amendments to Smaller Reporting Company Definition, Securities Act Release No. 10513, 83 Fed. Reg. 31,992 (July 10, 2018) [hereinafter Amendments to Smaller Reporting Company Definition].
- 9 The new smaller reporting company definition enables a company with less than \$250 million of public float to provide scaled-back disclosures, as compared to the \$75 million threshold under the prior definition. The final rules also expand the definition to include companies with less than \$100 million in annual revenues if they also have either no public float or a public float that is less than \$700 million. This reflects a change from the revenue test in the prior definition, which allowed companies to provide scaled-back disclosure only if they had no public float and less than \$50 million in annual revenues.
- 10 See Rick A. Fleming, Investor Advocate, SEC, Speech at NASAA Corporation Finance Training, Moving Forward with the Commission’s Disclosure Effectiveness Initiative, Houston, TX (Nov. 19, 2016), <https://www.sec.gov/news/speech/moving-forward-with-the-disclosureeffectiveness-initiative.html>.
- 11 See Amendments to Smaller Reporting Company Definition, *supra* note 8, at Section IV.B.3.b.
- 12 See *id.*
- 13 See Inline XBRL Filing of Tagged Data, Securities Act Release No. 10514, 83 Fed. Reg. 40,846 (Aug. 16, 2018).
- 14 See Rick A. Fleming, Investor Advocate, SEC, Remarks Before XBRL US Investor Forum 2016: Finding Value with Smart Data: Improving Disclosure with Smart Data (Oct. 24, 2016), <https://www.sec.gov/news/speech/improving-disclosure-with-smart-data.html>.
- 15 See Exempt Offerings Pursuant to Compensatory Arrangements, Securities Act Release No. 10520, 83 Fed. Reg. 34,940 (July 24, 2018).
- 16 See Concept Release on Compensatory Securities Offerings and Sales, Securities Act Release No. 10521, 83 Fed. Reg. 34,958 (July 24, 2018).
- 17 See Financial Disclosures About Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize a Registrant’s Securities, Securities Act Release No. 10526, 83 Fed. Reg. 49,630 (Oct. 2, 2018). The proposed amendments pertain to the financial disclosure requirements in Rule 3-10 of Regulation S-X for guarantors and issuers of guaranteed securities registered or being registered, and also to the financial disclosure requirements in Rule 3-16 of Regulation S-X for affiliates whose securities collateralize securities registered or being registered.
- 18 See *id.* at Section IV.A.
- 19 See *id.* at Section III.C.2.d. (describing the advantages of the “proposed optionality” in the rule amendments).
- 20 See *id.* at Section VII.C.
- 21 See Disclosure Update and Simplification, Securities Act Release No. 10532, 83 Fed. Reg. 50,148 (Oct. 4, 2018).
- 22 See Regulation of NMS Stock Alternative Trading Systems, Exchange Act Release No. 83663, 83 Fed. Reg. 38,768 (published Aug. 7, 2018).
- 23 See Comment Letter, Rick A. Fleming, Investor Advocate, SEC, RE: File No. S7-23-15, Regulation of NMS Stock Alternative Trading Systems (Sept. 9, 2016), <https://www.sec.gov/about/offices/investorad/investor-advocate-comment-letter-regulation-ats.pdf> [hereinafter Fleming, Letter on Regulation of NMS Stock ATS].
- 24 See *id.*
- 25 See Regulation of NMS Stock Alternative Trading Systems, *supra* note 22, at 38,783.
- 26 Regulation NMS, Exchange Act Release No. 51808, 70 Fed. Reg. 37,495 (adopted June 29, 2005).
- 27 See Disclosure of Order Handling Information, Exchange Act Release No. 84528, 83 Fed. Reg. 58,338 (adopted Nov. 2, 2018).
- 28 See *id.*
- 29 See Transaction Fee Pilot for NMS Stocks, Exchange Act Release No. 82873, 83 Fed. Reg. 13,008 (proposed Mar. 14, 2018).
- 30 See *id.* at 13,026.
- 31 See 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>.
- 32 See Exchange Act § 4(g)(4), 15 U.S.C. § 78d(g)(4).
- 33 See, e.g., CHX; Order Instituting Proceedings To Determine Whether To Approve or Disapprove a Proposed Rule Change To Adopt the CHX Liquidity Enhancing Access Delay, Exchange Act Release No. 80740, 82 Fed. Reg. 24,412 (published May 26, 2017).
- 34 See Comment Letter, Rick A. Fleming, Investor Advocate, SEC, RE: File No. SR-CHX-2017-04, (Feb. 27, 2018), <https://www.sec.gov/comments/sr-chx-2017-04/chx201704-3169295-161957.pdf>.

- 35 See Order Setting Aside the Order by Delegated Authority Approving SR-CHX-2017-04, Exchange Act Release No. 84337, 83 Fed. Reg. 50,720 (Oct. 9, 2018), <https://www.federalregister.gov/d/2018-21761>.
- 36 See, e.g., Joint Industry Plan, Order of Summary Abrogation of the Forty-Second Amendment to the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchanges on an Unlisted Trading Privileges Basis, Exchange Act Release No. 83149, 83 Fed. Reg. 20,129 (published May 7, 2018).
- 37 See Nasdaq Inc., Application to Permit Issuer Choice to Consolidate Liquidity By Suspending Unlisted Trading Privileges (Apr. 25, 2018), <https://www.sec.gov/comments/265-31/26531-3515735-162293.pdf>.
- 38 See, e.g., Order Scheduling Filing of Statements on Review in the Matter of the Investors Exchange LLC, for an Order Granting the Approval of Proposed Rule Change To Establish a New Optional Listing Category on the Exchange, “LTSE Listings on IEX”, Securities Exchange Act Release No. 83678 (July 20, 2018), 83 Fed. Reg. 35,300 (July 25, 2018), <https://www.federalregister.gov/d/2018-15926>.
- 39 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>.
- 40 See Joint Industry Plans, Order Approving the National Market System Plan to Implement a Tick Size Pilot Program by BATS Exchange, Inc., BATS Y-Exchange, Inc., Chicago Stock Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., Financial Industry Regulatory Authority, Inc., NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC, The Nasdaq Stock Market LLC, New York Stock Exchange LLC, NYSE MKT LLC, and NYSE Arca, Inc., as Modified by the Commission, for a Two-Year Period, Exchange Act Release No. 74892, 80 Fed. Reg. 27,513 (published May 13, 2015); see also Commission Statement on the Expiration of the Tick Size Pilot (Sept. 10, 2018), <https://www.sec.gov/news/public-statement/tm-dera-expiration-tick-size-pilot>.
- 41 See Assessment of the Plan to Implement a Tick Size Pilot Program (July 3, 2018), <https://www.sec.gov/files/TICK%20PILOT%20ASSESSMENT%20FINAL%20Aug%202018.pdf>.
- 42 See, e.g., SEC, Press Release, SEC Staff to Host Roundtable on Market Structure for Thinly-Traded Securities, 2018-65 (Apr. 13, 2018), <https://www.sec.gov/news/press-release/2018-65>.
- 43 See SEC, Press Release, SEC Staff to Host Roundtable on Regulatory Approaches to Combating Retail Investor Fraud, 2018-200 (Sept. 18, 2018), <https://www.sec.gov/news/press-release/2018-200> [hereinafter Press Release, Retail Investor Fraud Roundtable].
- 44 The Office of the Investor Advocate considers a proposed rule or rule amendment with comment periods expiring between October 1, 2017 and September 30, 2018, to be included in its FY 2018 rulemaking review. In Fiscal Year 2018, fifteen proposed rule or rule amendments have been closed and two proposals remain open, action pending.
- 45 In pertinent part, under Rule 15c2-12, a dealer that acts as an underwriter in a primary offering of municipal securities with an aggregate principal amount of \$1,000,000 or more is prohibited from purchasing or selling municipal securities in connection with an offering unless the participating underwriter reasonably determines, among other things, that an issuer of municipal securities or obligated person has undertaken in a written agreement or contract to provide the MSRB in a timely manner not in excess of 10 business days after the occurrence of the event, notice of certain events listed in Rule 15c2-12. Underwriters comply with this requirement by requiring that issuers of municipal securities and obligated persons undertake in a written agreement or contract to provide event notices to the MSRB consistent with Rule 15c2-12. Rule 15c2-12 also prohibits any dealer from recommending the purchase or sale of a municipal security unless the dealer has procedures in place that provide reasonable assurance that it will receive prompt notice of events. Dealers typically comply with this by having procedures in place that, among other things, require registered representatives who recommend municipal securities to customers in secondary markets to have access to the MSRB’s Electronic Municipal Market Access (EMMA) system. Proposed Amendments to Municipal Securities Disclosure, Securities Exchange Act Release No. 80130 (Mar. 1, 2017), 82 Fed. Reg. 13,928 at 13,929 (proposed Mar. 15, 2017), <https://www.gpo.gov/fdsys/pkg/FR-2017-03-15/pdf/2017-04323.pdf>
- 46 Proposed Amendments to Municipal Securities Disclosure, Exchange Act Release No. 80130 (Mar. 1, 2017), 82 Fed. Reg. 13,928 at 13,935 (proposed Mar. 15, 2017), <https://www.gpo.gov/fdsys/pkg/FR-2017-03-15/pdf/2017-04323.pdf> [hereinafter Proposed Amendments to Municipal Securities Disclosures].
- 47 Municipal Securities Disclosure, Exchange Act Release No. 34-34961, 59 Fed. Reg. 59,590 at 59,591 (Nov. 17, 1994) (codified at 17 CFR pt. 240).
- 48 See SEC, Office of the Investor Advocate, *Report on Activities, Fiscal Year 2015* (Dec. 23, 2015) at 7, 16, <https://www.sec.gov/advocate/reportspubs/annual-reports/sec-investor-advocate-report-on-activities-2015.pdf>.
- 49 *Id.*; SEC, Office of the Investor Advocate, *Report on Objectives, Fiscal Year 2017*, at 11, 13 (June 30, 2016), <https://www.sec.gov/advocate/reportspubs/annual-reports/sec-office-investor-advocate-report-on-objectives-fy2017.pdf>.
- 50 Amendments to Municipal Securities Disclosure, Exchange Act Release No. 34-83885, 83 Fed. Reg. 44,700 at 44,701 (Aug. 31, 2018), <https://www.gpo.gov/fdsys/pkg/FR-2018-08-31/pdf/2018-18279.pdf> [hereinafter Amendments to Municipal Securities Disclosure].
- 51 Proposed Amendments to Municipal Securities Disclosure, *supra* note 46, at 13,935; see also Municipal Market Bank Loan Disclosure Task Force, Considerations Regarding Voluntary Secondary Market Disclosure About Bank Loans (May 1, 2013), at 7, <http://www.nfma.org/assets/documents/position.stmt/wp.direct.bank.loan.5.13.pdf> (issuers typically do not prepare official statements or other offering documents for bank loans, which may leave secondary market participants without current information that is relevant to a timely assessment of a bank loan’s

- impact on the issuer's credit position and any additional risk (e.g., liquidity, refinancing)).
- 52 Amendments to Municipal Securities Disclosure, *supra* note 50.
- 53 Comment Letter, Rick A. Fleming, Investor Advocate, SEC, 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].
- 54 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].
- 55 *Id.* at 9.
- 56 *Id.* at 12-15.
- 57 *See Report on Objectives, Fiscal Year 2018*, *supra* note 3.
- 58 Comment Letter, Regulatory Notice 2018-15, *supra* note 53. In Regulatory Notice 2018-15, the MSRB also proposed including eight additional data fields to Form G-32 that could not auto-populate from any information already entered by underwriters in NIIDS, including a “yes” or “no” indicator as to whether the minimum denomination is subject to change. We argued that the use of a “yes” or “no” indicator to signal whether the minimum denomination is subject to change does not go far enough to help ensure that current, accurate information is easily accessible to investors. Without an ongoing obligation to update minimum denomination information over the life of the security, the investor is expected to not only bear the burden of deciphering the relevancy of events that could trigger changes in minimum denomination but to locate this important information. In our comment letter, we encouraged the MSRB to consider facilitating a requirement for ongoing disclosure of minimum denomination information over the life of the security.
- 59 FINRA, Regulatory Notice 17-08, Pricing Disclosure in Fixed Income Markets (Feb. 2017), http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-17-08.pdf; MSRB, Regulatory Notice 2016-28, New Disclosure Requirements Under MSRB Rule G-15 and Prevailing Market Price Guidance Pursuant to Rule G-30 Effective May 14, 2018 (Nov. 29, 2016), <http://msrb.org/~media/Files/Regulatory-Notices/Announcements/2016-28.ashx?n=1>.
- 60 *See* Comment Letter, Rick A. Fleming, Investor Advocate, SEC, RE: Recommendation of the Investor Advocate, File Nos. SR-FINRA-2016-032; SR-MSRB-2016-12 at Appendix A, 9-10 (Nov. 7, 2016), <https://www.sec.gov/comments/sr-finra-2016-032/finra2016032-10.pdf>. For a summary of our comment letters, see SEC, Office of the Investor Advocate, *Report on Activities, Fiscal Year 2016* (Dec. 21, 2016), <https://www.sec.gov/advocate/reportspubs/annual-reports/sec-investor-advocate-report-on-activities-2016.pdf> [hereinafter *Report on Activities, Fiscal Year 2016*]. *See also* Comment Letter, Rick A. Fleming, Investor Advocate, SEC, RE: MSRB Notice 2015-16, RE: FINRA Notice 15-36 (Dec. 11, 2015), <https://www.sec.gov/about/offices/investorad/comment-letter-msrb-finra-investor-advocate-121115.pdf>.
- 61 MSRB, MSRB Notice 2018-05, MSRB Provides New and Updated FAQs on Confirmation Disclosure and Prevailing Market Price (Mar. 19, 2018), <http://www.msrb.org/~media/Files/Regulatory-Notices/Announcements/2018-05.ashx?n=1>.
- 62 Comment Letter, Rick A. Fleming, Investor Advocate, SEC, RE: File Reference No. 2015-300, Proposed Amendments by the Financial Accounting Standards Board (FASB) to Concepts Statement No. 8, Conceptual Framework for Financial Reporting, (July 11, 2017), http://www.fasb.org/cs/BlobServer?blobkey=id&blobnocache=true&blobwhere=1175835179218&blobheader=application%2Fpdf&blobheadername2=ContentLength&blobheadername1=Content-Disposition&blobheadervalue2=565918&blobheadervalue1=filename%3DDISFR-C.ED.0056.SEC_OFFICE_INVESTOR_ADVOCATE_RICK_A._FLEMING.pdf&blobcol=urldata&blobtable=MungoBlobs.
- 63 Statement of Financial Accounting Concepts No. 2, Qualitative Characteristics of Accounting Information (As Issued), FIN. ACCOUNTING STANDARDS Bd. 29 (May 1980), http://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1218220132599&acceptedDisclaimer=true.
- 64 SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45,150 (Aug. 12, 1999).
- 65 *Amendments to Statement of Financial Accounting Concepts No. 8, Conceptual Framework for Financial Reporting, Chapter 3: Qualitative Characteristics of Useful Financial Information*, FIN. ACCOUNTING STANDARDS Bd., 5, BC3.18B (Aug. 2018) [hereinafter *Amendments to Statement of Financial Accounting Concepts No. 8*].
- 66 FASB's mission is “to establish and improve financial accounting and reporting standards to provide useful information to investors and other users of financial reports and educate stakeholders on how to most effectively understand and implement those standards.” *See* FASB, *About Us, About the FASB*, <https://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1176154526495> (last visited Nov. 26, 2018).
- 67 Wesley Bricker, Chief Accountant, SEC, Remarks before the 2018 Baruch College Financial Reporting Conference: *Working Together to Advance Financial Reporting*, (May 3, 2018), <https://www.sec.gov/news/speech/speech-bricker-040318>.
- 68 *See* Amendments to Smaller Reporting Company Definition, Securities Act Release No. 10513, 83 Fed. Reg. 31,992 (July 10, 2018).
- 69 *See* SEC, Press Release, SEC Expands the Scope of Smaller Public Companies that Qualify for Scaled Disclosures, 2018-116 (June 28, 2018), available at <https://www.sec.gov/news/press-release/2018-116>.
- 70 *See* U.S. Gov't Accountability Office, GAO-13-582, Report to Congressional Committees, Internal Controls, SEC Should Consider Requiring Companies to Disclose Whether They Obtained an Auditor Attestation (July 2013), <http://www.gao.gov/assets/660/655710.pdf>.
- 71 *See* Letter from Center for Audit Quality and Counsel of Institutional Investors (Aug. 30, 2016), SEC File No. S7-12-

- 16, <https://www.sec.gov/comments/s7-12-16/s71216-17.pdf>; see also Letter from Center for Audit Quality and Counsel of Institutional Investors (May 6, 2014), <https://www.thecaq.org/caq-and-cii-oppose-any-legislation-eroding-sox-section-404b-or-revising-definition-accelerated-filer>.
- 72 *Report on Objectives, Fiscal Year 2018, supra* note 3, at 11.
- 73 SEC, Press Release, SEC Proposes to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships With Investment Professionals, 2018-68 (Apr. 18, 2018), <https://www.sec.gov/news/press-release/2018-68>.
- 74 *Id.*
- 75 See Regulation Best Interest, Exchange Act Release No. 83062, 83 Fed. Reg. 21,574 (proposed May 9, 2018) [hereinafter Regulation Best Interest].
- 76 SEC, Press Release and Fact Sheet, SEC Proposes to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships With Investment Professionals, 2018-68 (Apr. 18, 2018), <https://www.sec.gov/news/press-release/2018-68> [hereinafter Proposal to Enhance Protections and Preserve Choice for Retail Investors Fact Sheet]; see also *id.*
- 77 See Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation, Exchange Act Release No. 4889, 83 Fed. Reg. 21,203 (proposed May 9, 2018) [hereinafter Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Enhancing Investment Adviser Regulation]; Proposal to Enhance Protections and Preserve Choice for Retail Investors Fact Sheet, *supra* note 76.
- 78 See Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Enhancing Investment Adviser Regulation, *supra* note 77 Proposal to Enhance Protections and Preserve Choice for Retail Investors Fact Sheet, *supra* note 76.
- 79 See Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the Use of Certain Names or Titles, Exchange Act Release No. 83063, Investment Advisers Act Release No. 4888, 83 Fed. Reg. 21,416 (proposed May 9, 2018) [hereinafter Form CRS Relationship Summary]; Proposal to Enhance Protections and Preserve Choice for Retail Investors Fact Sheet, *supra* note 76.
- 80 See Form CRS Relationship Summary, *supra* note 79; Proposal to Enhance Protections and Preserve Choice for Retail Investors Fact Sheet, *supra* note 76.
- 81 See Form CRS Relationship Summary, *supra* note 79; Proposal to Enhance Protections and Preserve Choice for Retail Investors Fact Sheet, *supra* note 76.
- 82 See Form CRS Relationship Summary, *supra* note 79; Proposal to Enhance Protections and Preserve Choice for Retail Investors Fact Sheet, *supra* note 76.
- 83 Jay Clayton, Chairman, SEC, Public Statement: Statement on Public Engagement Regarding Standards of Conduct for Investment Professional Rulemaking (Apr. 24, 2018), <https://www.sec.gov/news/public-statement/public-engagement-standards-conduct-investment-professionals-rulemaking>.
- 84 Brian Scholl, Ph.D. & Angela Hung, Ph.D., SEC, Office of the Investor Advocate, *The Retail Market for Investment Advice* (Oct. 12, 2018), <https://www.sec.gov/comments/s7-07-18/s70718-4513005-176009.pdf>.
- 85 *Id.* at 78.
- 86 *Id.* at 79.
- 87 Angela A. Hung *et al.*, *Investor Testing of Form CRS Relationship Summary* (Nov. 7, 2018), <https://www.sec.gov/about/offices/investorad/investor-testing-form-crs-relationship-summary.pdf>.
- 88 *Id.*
- 89 FINRA, Regulatory Notice 18-13, Quantitative Suitability (Apr. 20, 2018), <http://www.finra.org/industry/notices/18-13>.
- 90 See generally FINRA Rule 2111 (2012).
- 91 Comment Letter, Rick A. Fleming, Investor Advocate, SEC, RE: FINRA Regulatory Notice 18-13, Quantitative Suitability (June 19, 2018), <https://www.sec.gov/about/offices/investorad/letter-from-sec-investor-advocate-finra-regulatory-notice-18-13.pdf>.
- 92 *Id.*
- 93 Exchange Act § 4(g)(6)(B)(ii)(V), 15 U.S.C. § 78d(g)(6)(B)(ii)(V).
- 94 NASAA, *NASAA 2016-2017 Year In Review, Serving & Protecting Investors* (Sept. 2017), <http://www.nasaa.org/newsroom/nasaa-annual-report/> [hereinafter NASAA, *Annual Report*].
- 95 NASAA, *NASAA Enforcement Report: 2018 Report Based on 2017 Data* (Sept. 2018), <http://www.nasaa.org/wp-content/uploads/2018/10/2018-Enforcement-Report-Based-on-2017-Data-FINAL.pdf> [hereinafter NASAA *Enforcement Report*].
- 96 NASAA, *Top Investor Threats*, <http://www.nasaa.org/top-investor-threats/> (last visited Oct. 11, 2018).
- 97 SEC, Office of Compliance Inspections and Examinations, *Examination Priorities for 2017* (Jan. 12, 2017), <https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2017.pdf>.
- 98 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?> (last visited Nov. 13, 2018).
- 99 Throughout FY 2018, OIAD staff has engaged in conversations with the Division of Enforcement's Retail Strategy Task Force. During FY 2018, the Division of Enforcement continued to target violations that harm retail investors including, but not limited to, new and emerging issues, such as unregistered or fraudulent digital asset- or crypto-related investments or schemes, as well as traditional concerns such as offering frauds, Ponzi schemes, pyramid schemes, penny stock fraud, undisclosed and excessive fees charged in connection with advisory or brokerage services, and the role of unregistered or unscrupulous gate keepers and third party providers and marketers.
- 100 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 2018. See SEC, Office of Investor Education and Advocacy, Investor Alerts and Bulletins,

- <https://www.sec.gov/investor/alerts> (last visited Oct. 11, 2018); *see also* SEC, Office of Compliance Inspections and Examinations, Risk Alerts, <https://www.sec.gov/ocie> (last visited Oct. 11, 2018).
- 101 *See* NASAA, Investor Alerts & Tips, <http://www.nasaa.org/category/investor-education/investor-alerts-tips/> (last visited Sept. 18, 2017); *see also* NASAA, *Annual Report*, *supra* note 94; *see also* NASAA *Enforcement Report*, *supra* note 95; *see also* NASAA, Top Investor Threats, *supra* note 96.
- 102 This list of problematic products is based on the alerts and bulletins issued by FINRA for investors during FY 2018.
- 103 Kelly, *supra* note 98.
- 104 The term “Unicorn” has come to refer to a privately held company with a supposed valuation on paper of more than \$1 billion. NASAA, Informed Investor Advisory: Unicorns, <http://www.nasaa.org/44461/informed-investor-advisory-unicorns/>.
- 105 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. Kelly, *supra* note 98.
- 106 Press Release, Retail Investor Fraud Roundtable, *supra* note 43.
- 107 SEC, Equity Market Structure Roundtables, *September 26, 2018: Roundtable on Combating Retail Investor Fraud* (Sept. 26, 2018), <https://www.sec.gov/spotlight/equity-market-structure-roundtables>.
- 108 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> [hereinafter *Report on Activities, Fiscal Year 2014*].
- 109 *Id.* at 8.
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- 114 *See* Stephanie Avakian, Co-Director, Div. of Enf’t, SEC, Speech, Measuring the Impact of the SEC’s Enforcement Program (Sep. 20, 2018), <https://www.sec.gov/news/speech/speech-avakian-092018> [hereinafter Avakian, Measuring the Impact of the SEC’s Enforcement Program].
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- 116 *See* Jay Clayton, Chairman, SEC, Testimony, Chairman’s Testimony on Virtual Currencies: The Roles of the SEC and CFTC (Feb. 6, 2018), <https://www.sec.gov/news/testimony/testimony-virtual-currencies-oversight-role-us-securities-and-exchange-commission>.
- 117 *See* SEC, *Investor Bulletin: Initial Coin Offerings* (July 25, 2017), <https://www.investor.gov/additional-resources/news-alerts/alerts-bulletins/investor-bulletin-initial-coin-offerings> [hereinafter *Investor Bulletin: Initial Coin Offerings*].
- 118 To be clear, many people believe that cryptocurrencies, ICOs, and products and technologies have great potential for a number of e-commerce applications and will lower transaction costs, including in our capital markets.
- 119 *See* EY study: Initial Coin Offerings (ICOs), The Class of 2017—one year later (Oct. 19, 2018), <https://assets.ey.com/content/dam/ey-sites/ey-com/global/news/2018/10/ey-ico-research-web-oct-17-2018.pdf>.
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- 123 *See, e.g.*, Jay Clayton, Chairman, SEC, Opening Remarks at the Securities Regulation Institute (Jan. 22, 2018), <https://www.sec.gov/news/speech/speech-clayton-012218> [hereinafter Clayton, Opening Remarks at the Securities Regulation Institute]. *See also* Jay Clayton, Chairman, SEC, Remarks on Capital Formation at the Nashville 36186 Entrepreneurship Festival (Aug. 29, 2018), <https://www.sec.gov/news/speech/speech-clayton-082918>.
- 124 *See* Clayton, Opening Remarks at the Securities Regulation Institute, *supra* note 123.
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- 128 *See id.*
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- 130 *Id.*
- 131 *See id.*
- 132 *See id.*
- 133 *See id.*
- 134 *See id.*
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- Regulatory and Examination Priorities Letter (Jan. 4, 2017), <http://www.finra.org/industry/2017-regulatory-and-examination-priorities-letter>; FINRA, *2015 Regulatory and Examination Priorities Letter* (Jan. 6, 2015), <http://www.finra.org/industry/2015-exam-priorities-letter>; FINRA, *2014 Regulatory and Examination Priorities Letter* (Jan. 2, 2014), <http://www.finra.org/industry/2014-exam-priorities-letter> [hereinafter FINRA, *2014 Priorities*]. In 2016, FINRA did not include high-risk firms and brokers or migration among its top regulatory and examination priorities, however, it broadly referenced the importance of “firm culture.” See FINRA, *2016 Regulatory and Examination Priorities Letter* (Jan. 5, 2016), <http://www.finra.org/industry/2016-regulatory-and-examination-priorities-letter>.
- 136 See Jean Eaglesham and Rob Barry, *FINRA Is Cracking Down on “High-Risk” Brokers*, WALL ST. J. (Nov. 21, 2013), https://www.wsj.com/articles/finra-is-cracking-down-on-8216highrisk8217-brokers-1385075688?mod=article_inline&tesla=y; see also FINRA, *2014 Priorities* (stating that FINRA launched a “High Risk Broker initiative” in 2013 to identify brokers with “a pattern of complaints and disclosures” that could harm investors, the securities industry and the financial markets); see also Scott Patterson and Matthias Rieker, *New Push to Stamp Out Bad Brokers—FINRA, Wall Street’s Self-Regulator, Forms Special Enforcement Team; Squashing “Cockroaching,”* WALL ST. J. (Jan. 3, 2014); see also Mathias Rieker, *FINRA to Crack Down on Brokers With High Number of Complaints*, Dow Jones Newswires (Jan. 2, 2014).
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- 138 BrokerCheck, FINRA, <https://brokercheck.finra.org/firm/summary/44351> (last visited Nov. 8, 2018); see also FINRA, *Global Arena Release*.
- 139 See FINRA, *Global Arena Release*, *supra* note 137.
- 140 See Eaglesham and Barry, *5,000 Stockbrokers*, *supra* note 128 (quoting former Texas state securities commissioner, Denise Voigt Crawford).
- 141 See Mark Egan, et al., *The Market for Financial Adviser Misconduct* 12 (Nat’l Bureau of Econ. Research, Working Paper No. 22050, Rev. Sept. 2017), <https://www.nber.org/papers/w22050.pdf> (noting that unlike medical malpractice which broadly ensnares doctors throughout the industry, financial advisor misconduct is “concentrated in around 8% of the active population”) [hereinafter Egan, *The Market for Financial Adviser Misconduct*].
- 142 *Id.* at 23.
- 143 See Jean Eaglesham and Coulter Jones, *A Private-Market Deal Gone Bad: Sketchy Brokers, Bilked Seniors and a Cosmetologist*, WALL ST. J. (May 7, 2018) [hereinafter Eaglesham, *A Private Market Deal*]; Miami Law School, *Investor Rights Clinic Helps Elderly Couple Recoup Financial Investment* (Dec. 1, 2017) (detailing a broker’s scheme to misstate an elderly couple’s net worth in order to qualify the couple as accredited investors eligible to purchase the private placements he hoped to sell them), <https://www.law.miami.edu/news/2017/december/investor-rights-clinic-helps-elderly-couple-recoup-financial-investment>; see also Egan, *The Market for Financial Adviser Misconduct*, *supra* note 141, at 27 (stating that “counties with a smaller share of college graduates and a larger share of retirees experience more misconduct and employ more advisors with past misconduct records”); see also SEC, *Litigation Release No. 24287, SEC Charges Ohio Broker with Defrauding Senior Customers* (Sept. 25, 2018), <https://www.sec.gov/litigation/litreleases/2018/lr24287.htm>.
- 144 See Jean Eaglesham and Coulter Jones, *Regulators Step Up Scrutiny of Sales of Private Stakes*, WALL ST. J. (July 2, 2018); see also Jean Eaglesham and Coulter Jones, *Private Placements Draw Troubled Brokers*, WALL ST. J. (June 25, 2018); see also Emily Zulz, *SEC Charges Ex-UBS Broker With Bilking 15 Clients*, THINKADVISOR (Aug. 9, 2018) (alleged use of high pressure tactics to convince elderly to invest in private fund), <https://www.thinkadvisor.com/2018/08/09/sec-charges-ex-ubs-broker-with-bilking-15-clients/>.
- 145 See Eaglesham, *A Private Market Deal*, *supra* note 143.
- 146 See *id.*
- 147 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*]. The proposed amendments would include limitations on 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. The restrictions under Regulatory Notice 18-06 are generally subject to materiality consultations.
- 148 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*]. This proposed amendment was discussed in our Report on Activities Fiscal Year 2017 shortly after the FINRA board authorized FINRA to amend its rules. See also FINRA, *Regulatory Notice 18-23, Membership Application Proceedings* at 42 (July 26, 2018) (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.”).
- 149 FINRA, *Regulatory Notice 18-17, Sanctioning Guidelines* (May 2, 2018), <https://www.finra.org/sites/default/files/Regulatory-Notice-18-17.pdf>.

- 150 See FINRA, Regulatory Notice 18-06, *supra* note 147; see also FINRA, Regulatory Notice 18-15, Heightened Supervision (April 30, 2018) (reiterating existing obligations of member firms to supervise associated persons with a history of past misconduct).
- 151 Under FINRA Rule 3170, a firm incurs an obligation to adopt significant monitoring measures, including recording of certain calls to customers, if the percentage of brokers hired from expelled or disciplined firms exceeds a certain threshold. See http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=11348. The proposed amendment to Rule 8312 would require a firm disclose on BrokerCheck its status as a “taping firm.” See FINRA, Regulatory Notice 18-16, *supra* note 148.
- 152 Robert W. Cook, President and CEO, FINRA, Protecting Investors From Bad Actors (June 12, 2017), <http://www.finra.org/newsroom/speeches/061217-protecting-investorsbad-actors> (citing fairness and due process concerns as reasons FINRA does not publish the names of the high-risk firms and brokers identified by the regulator).
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- 155 SEC, Division of Trading and Markets, *Transfer Agents* (last modified Apr. 28, 2016), <https://www.sec.gov/divisions/marketreg/mrtransfer.shtml>.
- 156 Concept Release, Transfer Agent Regulations, Exchange Act Release No. 34-76743, 80 Fed. Reg. 81,948, at 81,949 (Dec. 31, 2015) [hereinafter Transfer Agent Concept Release].
- 157 SEC, Press Release, SEC Staff to Host Roundtable on Regulatory Approaches to Combating Retail Investor Fraud, 2018-200 (Sept. 18, 2018), <https://www.sec.gov/news/press-release/2018-200>.
- 158 SEC, Webcast: Retail Investor Fraud Roundtable (Sept. 26, 2018) (on file with SEC), https://www.sec.gov/video/webcast-archive-player.shtml?document_id=investor-fraud-roundtable-092618 [hereinafter Webcast: Retail Investor Fraud Roundtable].
- 159 *Id.*
- 160 Transfer Agent Concept Release, *supra* note 156, at 81,949.
- 161 SEC, Investor Publications, *Microcap Stock: A Guide for Investors* (Sept. 18, 2013), <https://www.sec.gov/reportspubs/investor-publications/investorpubsmicrocapstockhtm.html>.
- 162 SEC, Press Release, SEC Announces Enforcement Initiatives to Combat Financial Reporting and Microcap Fraud and Enhance Risk Analysis, 2013-121 (July 2, 2013), <https://www.sec.gov/news/press-release/2013-2013-121htm>.
- 163 See SEC, Office of the Investor Advocate, *Report on Activities, Fiscal Year 2019* (June 29, 2018) at 14-15, <https://www.sec.gov/advocate/reportspubs/annual-reports/sec-office-investor-advocate-report-on-objectives-fy2019.pdf>; Webcast: Retail Investor Fraud Roundtable, *supra* note 158.
- 164 See, e.g., Hester M. Peirce, Commissioner, SEC, Lies and Statistics: Remarks at the 26th Annual Securities Litigation and Regulatory Enforcement Seminar (Oct. 26, 2018), https://www.sec.gov/news/speech/peirce-speech-lies-statistics-102618#_ftnref27 (“The enforcement actions I see also inspire me to think about areas in which we need better rules. To address some of the issues we see in the microcap space, for example, the Commission could consider a rulemaking to amend the transfer agent rules and reporting requirements.”).
- 165 Transfer Agent Concept Release, *supra* note 156; SEC, Division of Trading and Markets, *Transfer Agents* (last modified Apr. 28, 2016), <https://www.sec.gov/divisions/marketreg/mrtransfer.shtml> (listing Transfer Agent rules); see also Luis A. Aguilar, Commissioner, SEC, The Importance to the Capital Markets of Updating the Rules Regarding Transfer Agents (Dec. 17, 2014), at n.6 (listing transfer agent rules adopted under the Securities and Exchange Act of 1934, including Exchange Act Rules 17Ac2-1, 17Ac2-2, 17Ac3-1, 17Ad-1 through 7 and Rule 17f-1 which were originally adopted in 1977; Exchange Act Rule 17Ad-8 adopted in 1980; Exchange Act Rule 17f-2 adopted in 1982; Rules 17Ad-9 through 13 adopted in 1983; Rule 17Ad-14 adopted in 1984; Rule 17Ad-15 and Rule 17Ad-16 adopted in 1992; Rule 17Ad-17 adopted in 1997; and Rule 17Ad-19 adopted in 2003), https://www.sec.gov/news/statement/spch121714-2laa.html#_edn6.
- 166 See, e.g., Michael Wursthorn and Chelsey Dulaney, *Investors’ Zeal to Buy Stocks With Debt Leaves Markets Vulnerable*, WALL ST. J. (Feb. 25, 2018), <https://www.wsj.com/articles/investors-zeal-to-buy-stocks-with-debt-leaves-markets-vulnerable-1519560001> (“Margin debt has been on the rise of years and is generally considered a gauge of investor confidence. The long-running stock rally has helped push debt levels higher since investors tend to be more willing to take loans against investments that are rising in value.”); Yakob Peterseil and Cecile Gutscher, *Winning ‘Black Swan’ Investor in 2008 says Market’s More Fragile*, BLOOMBERG (Apr. 17, 2018), <https://www.bloomberg.com/news/articles/2018-04-17/winning-black-swan-investor-in-2008-says-market-s-more-fragile> (“Leverage is up on every single metric, in just about every category, and debt has increased.”); FINRA, *Margin Debt at Record Levels: Know the Risks* (Jan. 18, 2018), <http://www.finra.org/investors/highlights/margin-debt-record-levels-know-risks> (In January 2018, FINRA reported that “borrowing by investors in November 2017 stood at an all-time high of \$627.4 billion.”).
- 167 SEC, *Investor Bulletin: Understanding Margin Accounts* (May 14, 2018), https://www.sec.gov/oiaa/investor-alerts-and-bulletins/ib_marginaccount [hereinafter *Understanding Margin Accounts*].
- 168 *Margin Debt at Record Levels: Know the Risks, supra* note 166.
- 169 FINRA, Investor Alerts, *Updated: Investing with Borrowed Funds: No “Margin” For Error* (last updated Jan. 18, 2018), <http://www.finra.org/investors/alerts/investing-borrowed-funds-no-margin-error>.
- 170 *Id.*; *Understanding Margin Accounts, supra* note 167.
- 171 *Understanding Margin Accounts, supra* note 167.
- 172 *Id.*
- 173 *Id.*
- 174 *Id.*
- 175 *Id.*
- 176 *Id.*
- 177 *Id.*

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- 179 *E.g.*, FINRA, Investor Alerts, *Know What Triggers a Margin Call* (Nov. 8, 2018), <http://www.finra.org/investors/highlights/know-what-triggers-margin-call>; *Margin Debt at Record Levels: Know the Risks*, *supra* note 166; *Understanding Margin Accounts*, *supra* note 167; FINRA, Investor Alerts, *Updated: Investing with Borrowed Funds: No “Margin” For Error* (last updated Jan. 18, 2018), <http://www.finra.org/investors/alerts/investing-borrowed-funds-no-margin-error>.
- 180 Exchange Act § 4(g)(4), 15 U.S.C. § 78d(g)(4).
- 181 Exchange Act § 4(g)(7), 15 U.S.C. § 78d(g)(7).
- 182 Some of our comment letters respond to Concept Releases and set forth our views on certain matters, but a specific call for action may be premature. Comment letters of this nature are not included in this inventory. *See, e.g.*, Rick A. Fleming, Investor Advocate, SEC, Comment Letter RE: Solicitation of Comments by the NASDAQ Listing and Hearing Review Council about Shareholder Approval Rules, (Feb. 12, 2016). Moreover, we are required to provide an inventory outlining actions of the SEC or SROs. Letters to Congress or other organizations such as NASAA are not included in this inventory, but are available at <https://www.sec.gov/advocate/investor-advocate-comment-letters.html>.
- 183 *See* Comment Letter, Rick A. Fleming, Investor Advocate, SEC, RE: PCAOB Rulemaking Docket Matter No. 034, The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion, (Aug. 15, 2016), <https://www.sec.gov/about/offices/investorad/comment-investor-advocate-pcaob-auditor-reports-8-15-2016.pdf>.
- 184 *See* Fleming, Letter on Regulation of NMS Stock ATS, *supra* note 23 and accompanying text.
- 185 Comment Letter, Rick A. Fleming, Investor Advocate, SEC, RE: File Reference No. 2015-300, Proposed Amendments by the Financial Accounting Standards Board (FASB) to Concepts Statement No. 8, Conceptual Framework for Financial Reporting, (July 11, 2017), http://www.fasb.org/cs/BlobServer?blobkey=id&blobnocache=true&blobwhere=1175835179218&blobheader=application%2Fpdf&blobheadername2=Content-Length&blobheadername1=Content-Disposition&blobheadervalue2=565918&blobheadervalue1=filename%3DDISFR-C.ED.0056.SEC_OFFICE_INVESTOR_ADVOCATE_RICK_A._FLEMING.pdf&blobcol=urldata&blobtable=MungoBlobs.
- 186 FASB, *Amendments to Statement of Financial Accounting Concepts No. 8*, *supra* note 65; *see* FASB, Press Release, FASB Improves the Effectiveness of Disclosures in Notes to Financial Statements (Aug. 8, 2018), https://www.fasb.org/cs/ContentServer?c=FASBContent_C&cid=1176171117438&d=&pagename=FASB%2FFASBContent_C%2FNew.sPage.
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- 188 Comment Letter, Rick A. Fleming, Investor Advocate, SEC, RE: Recommendation of the Investor Advocate, File No. SR-CHX-2017-04 (Feb. 27, 2018), <https://www.sec.gov/comments/sr-chx-2017-04/chx201704-3169295-161957.pdf>.
- 189 *See* Order Setting Aside the Order by Delegated Authority Approving SR-CHX-2017-04, Exchange Act Release No. 84337, 83 Fed. Reg. 50,720 (Oct. 9, 2018), <https://www.federalregister.gov/d/2018-21761>.
- 190 Comment Letter, Rick A. Fleming, Investor Advocate, SEC, RE: Regulatory Notice 18-13, Quantitative Suitability (June 19, 2018), <https://www.sec.gov/about/offices/investorad/letter-from-sec-investor-advocate-finra-regulatory-notice-18-13.pdf>.
- 191 Comment Letter, Rick A. Fleming, Investor Advocate, SEC, 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>.
- 192 Exchange Act § 4(g)(8)(B), 15 U.S.C. § 78d(g)(8)(B).
- 193 Exchange Act § 4(g)(8)(D), 15 U.S.C. § 78d(g)(8)(D).
- 194 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.
- 195 *What We Do*, SEC (June 10, 2013), <https://www.sec.gov/Article/whatwedo.html>.
- 196 There is debate whether FINRA constitutes a self-regulatory organization. In 1996, the SEC censured the NASD due to the undue influence by NASDAQ market makers over NASD’s operations and regulatory affairs. As a consequence, the SEC required NASD to increase the role of public members on the NASD board among other remedies, which in turn changed the organization to one independent of its membership which, in the view of one critic, shifted the organization from an SRO to a regulator with industry representation. *See, e.g.*, Hester Peirce, *The Financial Industry Regulatory Authority: Not Self-Regulation after All* 8-9, 18 (Mercatus Working Paper, Jan. 2015). <https://www.mercatus.org/system/files/Peirce-FINRA.pdf>; *see* David R. Burton, *Reforming FINRA*, THE HERITAGE FOUND. BACKGROUNDER No. 3181, 2 (Feb. 1, 2017), <http://www.heritage.org/sites/default/files/2017-02/BG3181.pdf>.
- 197 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).
- 198 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.
- 199 *See* Jean Eaglesham, *Arbitration Awards Go Unpaid*, WALL ST. J. (Feb. 25, 2016) (noting “[i]t isn’t easy to win an arbitration award against a Wall Street stockbroker. What also is hard is getting paid.”).
- 200 U.S. GOV’T ACCOUNTABILITY OFFICE, GAO/GDD-00-115, SECURITIES ARBITRATION: ACTIONS NEEDED TO ADDRESS PROBLEM OF UNPAID AWARDS (2000), <https://www.gao.gov/>

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- 201 FINRA, Discussion Paper—FINRA Perspectives on Customer Recovery, (Feb. 2018) [hereinafter Discussion Paper], http://www.finra.org/sites/default/files/finra_perspectives_on_customer_recovery.pdf; see also FINRA, Statistics on Unpaid Customer Awards in FINRA Arbitration (May 2018), <https://www.finra.org/arbitration-and-mediation/statistics-unpaid-customer-awards-finra-arbitration>.
- 202 See Discussion Paper, *supra* note 201, at 6; see also PIABA, Unpaid Arbitration Awards: The Case For An Investor Recovery Pool (March 7, 2018), available at <https://piaba.org/piaba-newsroom/unpaid-awards> [hereinafter PIABA].
- 203 See Discussion Paper, *supra* note 201, at 7; see also PIABA, *supra* note 202.
- 204 See PIABA, *supra* note 202.
- 205 See Discussion Paper, *supra* note 201, at 11.
- 206 See *id.* at 15.
- 207 See *id.*
- 208 See *id.* Broker migration and misconduct (known as “cockroaching”) was also discussed in the section of this Report entitled Problematic Products and Practices.
- 209 See Discussion Paper *supra* note 201, at 16.
- 210 See *id.* at 17.
- 211 See *id.* at 18.
- 212 See *id.*
- 213 See *id.*
- 214 See *id.* at 17; see also PIABA, *supra* note 202.
- 215 See SEC, Fast Answers, *Securities Investor Protection Corporation (SIPC)* (last modified Mar. 27, 2012), <https://www.sec.gov/fast-answers/answerssipchtm.html>.
- 216 The fund is maintained by SIPC member assessments and interest on U.S. government securities. See <https://www.sipc.org/about-sipc/the-sipc-fund>.
- 217 See PIABA, *supra* note 202.
- 218 See Discussion Paper, *supra* note 201, at 17.
- 219 Ted Knutson, *Proposed FINRA Fund to Pay for Unpaid Arbitration Award Gets Business/Labor Leaders Sparring*, FORBES (June 28, 2018), <https://www.forbes.com/sites/teedknutson/2018/06/28/proposed-finra-fund-to-pay-for-unpaid-arbitration-awards-gets-businesslabor-leaders-sparring/#33f4781a57af>.
- 220 See Egan, et al, *Arbitration with Uninformed Consumers* (Nat'l Bureau of Econ. Research, Working Paper 25150, Oct. 2018), <https://www.nber.org/papers/w25150.pdf>.
- 221 FINRA, Arbitrator Selection, <https://www.finra.org/arbitration-and-mediation/arbitrator-selection>.
- 222 See *id.*
- 223 See *id.*
- 224 See *id.*
- 225 See *id.*
- 226 PIABA, *Study: Industry-Rum FINRA Arbitrator Pool Lacks Diversity and Fails to Detect, Communicate Potential Biases*, (Oct. 7, 2014), [https://piaba.org/sites/default/files/newsroom/2014-10/The%20Importance%20of%20Arbitrator%20Disclosure%20\(October%207,%202014\).pdf](https://piaba.org/sites/default/files/newsroom/2014-10/The%20Importance%20of%20Arbitrator%20Disclosure%20(October%207,%202014).pdf).
- 227 In December 2015, FINRA's Dispute Resolution Task Force set forth 51 recommendations to improve FINRA's dispute resolution forum. The final report included recommendations to develop strategies to improve “the depth and diversity” of the arbitrator pool and convey inclusiveness to “qualified and diverse individuals with a variety of educational backgrounds and work experiences.” See FINRA, FINAL REP. AND RECOMMENDATIONS OF THE FINRA DISP. RESOL. TASK FORCE 6 (Dec. 16, 2015), <https://www.finra.org/sites/default/files/Final-DR-taskforce-report.pdf>.
- 228 *FINRA Pushes For Arbitrator Diversity*, BARRON'S, (Sept. 22, 2017), <https://www.barrons.com/articles/finra-pushes-for-arbitrator-diversity-1506101664>.
- 229 Jill I. Gross, *The Improbable Birth and Conceivable Death of the Securities Arbitration Clinic*, 15 *Cardozo J. Conflict Resol.* 597, 599 (2014) [hereinafter Gross].
- 230 See *id.* at 600.
- 231 See *id.* at 600-01.
- 232 As formal clinic names vary, for purposes of this Report, all securities law, securities arbitration, and investor protection focused clinics referenced herein are referred to as investor advocacy clinics or clinics.
- 233 SEC, *Recommendation of the Investor Advisory Committee: Financial Support for Law School Clinics that Support Investors* 6 (Mar. 8, 2018), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/law-clinics-recommendation.pdf>.
- 234 See Gross, *supra* note 229, at 604-05.
- 235 The vast majority of states do not have investor clinics and therefore many clients are disqualified. See *id.*
- 236 As another aspect of client eligibility, clinics may also give preference to senior citizens. For example, the Pittsburgh region is considered to have one of the highest aging populations in the country and, as a result, has many senior citizen clients. Senior citizens and retirees, however, are not a clinic's only clients. Clinic clients also include regular, middle-class Americans such as hairdressers, mail carriers, welders, schoolteachers, librarians, 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_GSU_comment.pdf [hereinafter Iannarone Letter].
- 237 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), <https://www.sec.gov/news/press/pressarchive/1997/97-101.txt>.
- 238 See *id.*
- 239 Office of the New York State Attorney General, Press Release, Former Telecom Executive Agrees to Turn Over IPO Profits (Dec. 4, 2003), <https://ag.ny.gov/press-release/former-telecom-executive-agrees-turn-over-ipo-profits>.
- 240 Press Release, University 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>.
- 241 See FINRA Investor Education Foundation, Press Release, FINRA Foundation Announces \$1 Million in Grants to Fund Securities Advocacy Clinics (Jan. 28, 2010), <http://www.finra.org/newsroom/2010/finra-foundation-announces-1-million-grants-fund-securities-advocacy-clinics>; see also Gross, *supra* note 229, at 604 (“As a result of these

- [FINRA] 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.”).
- 242 See Gross, *supra* note 229, at 619.
- 243 There are currently seventeen clinics in operation: seven located in New York (Benjamin N. Cardozo School of Law, Cornell Law School, Fordham University School of Law, New York Law School, Pace University Elisabeth Haub School of Law, St. John’s University School of Law, Syracuse University College 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), Georgia (Georgia State University College of Law), Illinois (Northwestern University Pritzker School of Law), Nevada (UNLV William S. Boyd School of Law), New Jersey (Seton Hall University School of Law), and Pennsylvania (University of Pittsburgh School of Law). In addition, Brooklyn Law School maintains an investor advocacy clinic with a unique structure, however, it is unclear if the clinic is currently active. See SEC, Office of the Investor Advocate, *Report on Objectives, Fiscal Year 2019*, at 26 (June 29, 2018) (showing a map of locations of investor advocacy clinics as of Mar. 31, 2018), <https://www.sec.gov/advocate/reportspubs/annual-reports/sec-office-investor-advocate-report-on-objectives-fy2019.pdf> [hereinafter *Report on Objectives, Fiscal Year 2019*].
- 244 See *id.*
- 245 FINRA Dispute Resolution Task Force, Final Report and Recommendations of the FINRA Dispute Resolution Task Force (Dec. 16, 2015) at 52, <http://www.finra.org/sites/default/files/Final-DR-task-force-report.pdf>.
- 246 See *id.*
- 247 In June 2017, 13 investor advocacy clinic directors submitted a joint letter to the SEC containing recommendations for clinic funding. The directors recommended that fines and penalties levied by FINRA would be an appropriate source of continued funding. The directors also recommended legislation to secure additional or alternative funding from the FINRA Investor Education Foundation or a government grant-matching program similar to the successful Internal Revenue Service model used to fund low-income taxpayer clinics. See Iannarone Letter, *supra* note 236.
- 248 See *id.*
- 249 *Report on Objectives, Fiscal Year 2019*, *supra* note 243, at 23-29.
- 250 *Id.*
- 251 *Report on Objectives, Fiscal Year 2019*, *supra* note 243, at 26.
- 252 The Investor Advocate, the Ombudsman, and the Office are extremely appreciative of the time and effort extended, and the comprehensive recommendations made, by the clinic faculty and students in helping us make meaningful changes to policies affecting retail investors, particularly those investors in vulnerable populations.
- 253 SEC, Investing in America: Commissioners Hear from Investors and Share Insights in Atlanta (last modified July 12, 2018), <https://www.sec.gov/page/atlanta-town-hall>.
- 254 SEC, Press Release, Investing in America: SEC Commissioners are Heading to Atlanta to Interact with Investors, 2018-91 (May 23, 2018), <https://www.sec.gov/news/press-release/2018-91>.
- 255 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/iac030818-law-clinics-recommendation.pdf>.
- 256 At the September 2018 IAC meeting, committee members discussed the implications of passive investing on retail investors and how changes to the proxy voting infrastructure could improve retail investor participation. See Investor Advisory Committee, Agenda for September 13, 2018, Meeting, <https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac091318-agenda.htm> (last visited Oct. 25, 2018).
- 257 Including, for example, Evidence-Based Policymaking Commission Act of 2016, the GPRM Modernization Act of 2010, and various OMB directives and executive orders. Evidence-Based Policymaking Commission Act of 2016, Pub. L. No. 114-140, 130 Stat. 317 (2016); GPRM Modernization Act of 2010, Pub. L. No. 111-352, 124 Stat. 3866 (2011) (codified at 31 USC § 1101).
- 258 From time to time, the Office may use its contracting platform to facilitate Commission-sponsored surveys or other testing methods that seek investors’ opinions. See, e.g., Angela A. Hung, et al, *Investor Testing of Form CRS Relationship Summary* (Nov. 2018), <https://www.sec.gov/about/offices/investorad/investor-testing-form-crs-relationship-summary.pdf>. These projects do not bear the POSITIER brand and should not be considered POSITIER projects.
- 259 Evidence-Based Policymaking Commission Act of 2016, Pub. L. No. 114-140, 130 Stat. 317 (2016).
- 260 See, e.g., OFFICE OF MGMT. & BUDGET, *Barriers to Using Administrative Data for Evidence Building* (white paper submitted for the Commission on Evidence-Based Policymaking) (2016), https://obamawhitehouse.archives.gov/sites/default/files/omb/mgmt-gpra/barriers_to_using_administrative_data_for_evidence_building.pdf
- 261 Annamaria Lusardi & Olivia S. Mitchell, *The Economic Importance of Financial Literacy: Theory and Evidence*, 52(1) J. OF ECON. LITERATURE, 5-44 (2014).
- 262 In fact, on the relevance of financial literacy interventions, a recent meta-analysis suggests caution about the effect of literacy interventions. Daniel Fernandes, John G. Lynch, Jr., & Richard G. Netemeyer, *Financial Literacy, Financial Education, and Downstream Financial Behaviors*, 60 MGMT. SCI. 1861 (2014), <https://pubsonline.informs.org/doi/abs/10.1287/mnsc.2013.1849>.
- 263 Scholl & Hung, *supra* note 84.
- 264 Linnainmaa, Melzer and Previtero provide evidence that financial advisors may suffer from behavioral biases in their own personal portfolios (e.g. chasing returns and underdiversifying). See Juhani T. Linnainmaa, Brian Melzer

- & Alessandro Previtero, *The Misguided Beliefs of Financial Advisors*, (last revised May 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3101426. Fisch, Wilkinson-Ryan and Firth conduct an allocation experiment and test for knowledge with financial professionals and other population groups; while professionals do better than non-professionals, a not insubstantial number make poor choices. See Jill E. Fisch, Tess Wilkinson-Ryan & Kristin Firth, *The Knowledge Gap in Workplace Retirement Investing and the Role of Professional Advisors*, 66 DUKE L.J. 633 (2016).
- 265 See Stephen G. Dimmock, William C. Gerken, & Nathaniel P. Graham, *Is Fraud Contagious? Coworker Influence on Misconduct by Financial Advisors*, 73 J. OF FIN. 1417 (2018).
- 266 See Jeremy Burke, Angela Hung, Jack Clift, Steven Garber, & Joanne Yoong, *Impacts of Conflicts of Interest in the Financial Services Industry* (Feb. 2015), https://www.rand.org/content/dam/rand/pubs/working_papers/WR1000/WR1076/RAND_WR1076.pdf.
- 267 See Regulation Best Interest, *supra* note 75; see Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Enhancing Investment Adviser Regulation *supra* note 77; see Form CRS Relationship Summary, *supra* note 79.
- 268 Scholl & Hung, *supra* note 84.
- 269 We are happy to provide briefings to congressional staff upon request.
- 270 An individual representative may be a registered representative or “broker,” an investment advisor representative “investment advisor,” or have both registrations “dual-hatted.”
- 271 See Webcast: Investing in America: Atlanta Town Hall Meeting (June 13, 2018), https://www.sec.gov/video/webcast-archive-player.shtml?document_id=061318-townhall.
- 272 Regulation Best Interest, *supra* note 75, at 21,639 tbl.6.
- 273 The DERA data and the POSITIER data are actually two different measurements. The DERA data counts the number of employees of a certain type at retail financial services firms, while ours presents a picture of what investors indicate is their primary professional. This discrepancy could arise for a number of reasons—for example, if brokers that are employed by the firm operate in some non-client-facing role. A significant number of individuals that use a financial professional did not provide information that would allow us to determine the true registration status of the professional, and it is possible that some number of these are brokers who provide incidental advice. However, even in the unlikely event that *all* of the professionals for which we could not identify a type were actually brokers, dual-hatted professionals would still represent 59 percent of the professionals that our investors report as their primary financial professional.
- 274 Exchange Act § 39(a), 15 U.S.C. § 78pp(a).
- 275 *Id.*
- 276 Exchange Act § 39(a)(2)(B), 15 U.S.C. § 78pp(a)(2)(B).
- 277 Exchange Act § 39(g), 15 U.S.C. § 78pp(g).
- 278 Exchange Act § 39(h), 15 U.S.C. § 78pp(h).
- 279 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.”
- 280 SEC, *Recommendation of the Investor Advisory Committee: Target Date Mutual Funds* (Apr. 11, 2013), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-recommendation-target-date-fund.pdf>.
- 281 SEC, *Recommendations of the Investor Advisory Committee Regarding SEC Rulemaking to Lift the Ban on General Solicitation and Advertising in Rule 506 Offerings: Efficiently Balancing Investor Protection, Capital Formation and Market Integrity* (2012), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-general-solicitation-advertising-recommendations.pdf>.
- 282 SEC, *Recommendation of the Investor Advisory Committee: Crowdfunding Regulations* (Apr. 10, 2014), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-adviser-crowdfunding-recommendation.pdf>; SEC, Final Rule, Crowdfunding, Securities Act Release No. 9974, 80 FR 71,387 (Nov. 16, 2015). See *Report on Objectives, Fiscal Year 2017*, *supra* note 49 for an analysis of how the final rules correspond with the IAC recommendations.
- 283 SEC, *Recommendation of the Investor Advisory Committee: Shortening the Trade Settlement Cycle in U.S. Financial Markets* (Feb. 12, 2015), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/settlement-cycle-recommendation-final.pdf>. See also Press Release, SEC, SEC Adopts T+2 Settlement Cycle for Securities Transactions, 2017-68 (Mar. 22, 2017), <https://www.sec.gov/news/press-release/2017-68-0>; Securities Transaction Settlement Cycle, Exchange Act Release No. 80295, 82 Fed. Reg. 15,564 (Mar. 29, 2017).
- 284 SEC, *Recommendation of the Investor Advisory Committee: Regarding Promotion of Electronic Delivery and Development of a Summary Disclosure Document for Delivery of Investment Company Shareholder Reports* (Dec. 7, 2017), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-promotion-of-electronic-delivery-and-development.pdf>.
- 285 See SEC, *Recommendation of the Investor Advisory Committee: Legislation to Fund Investment Adviser Examinations* (Nov. 22, 2013), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-adviser-examinations-recommendation-2013.pdf>.
- 286 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); SEC18-2, Section 8.5 (Nonpublic Information) (July 31, 2005).
- 287 SEC, *Recommendation of the Investor Advisory Committee Regarding Proposed Regulation Best Interest, Form CRS, and Investment Advisers Act Fiduciary Guidance* (Nov. 7, 2018).
- 288 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>.
- 289 SEC, *Recommendation of the Investor Advisory Committee: Select Enhancements to Protect Retail Investors in Municipal and Corporate Bonds* (June 14, 2018), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-mf-fee-disclosure-041916.pdf>.

- 290 SEC, Amendments to Municipal Securities Disclosure, Release No. 34-83885 (Aug. 20, 2018), <https://www.sec.gov/rules/final/2018/34-83885.pdf>.
- 291 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>.
- 292 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/iac030818-minutes.pdf>.
- 293 SEC, *Recommendation of the Investor Advisory Committee to Enhance Information for Bond Market Investors* (June 7, 2016), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-enhance-information-bond-market-investors-060716.pdf>; *see also* MSRB, Regulatory Notice 2016-28, New Disclosure Requirements Under MSRB Rule G-15 and Prevailing Market Price Guidance Pursuant to Rule G-30 Effective May 14, 2018 (Nov. 29, 2016), <http://www.msrb.org/~media/Files/Regulatory-Notices/Announcements/2016-28.ashx> [hereinafter MSRB Notice 2016-28]; FINRA, Regulatory Notice 17-08, Pricing Disclosure in the Fixed Income Markets (Feb. 2017), https://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-17-08.pdf [hereinafter FINRA Notice 17-08].
- 294 FINRA; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, Relating to FINRA Rule 2232 (Customer Confirmations) to Require Members to Disclose Additional Pricing Information on Retail Customer Confirmations Relating to Transactions in Certain Fixed Income Securities, Exchange Act Release No. 79346, 81 Fed. Reg. 84,637 (Nov. 23, 2016); MSRB, Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, to MSRB Rules G-15 and G-30 To Require Disclosure of Mark Ups and Mark Downs to Retail Customers on Certain Principal Transactions and To Provide Guidance on Prevailing Market Price, Exchange Act Release No. 79347, 81 Fed. Reg. 84, 637 (Nov. 23, 2016).
- 295 See agenda of Oct. 24, 2018 meeting of the Fixed Income Market Structure Advisory Committee, <https://www.sec.gov/news/press-release/2018-244>.
- 296 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>.
- 297 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. 26,891 (June 11, 2018).
- 298 SEC, *Recommendation of the Investor Advisory Committee: Empowering Elders and Other Investors Re: Background Checks in the Financial Markets* (July 16, 2015), https://www.sec.gov/spotlight/investor-advisory-committee-2012/final_iac_backgroundcheck_recommendation_071615.pdf.
- 299 SEC, Press Release, SEC Launches Additional Investor Protection Search Tool, 2018-78 (May 2, 2018), <https://www.sec.gov/news/press-release/2018-78>.
- 300 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>.
- 301 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>.
- 302 SEC, *Recommendation 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>.
- 303 SEC, *Recommendation of the Investor Advisory Committee Decimalization and Tick Sizes*, <https://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-adviser-decimalization-recommendation.pdf>.
- 304 SEC, Public Statement, Statement on the Expiration of the Tick Size Pilot, Div. of Econ. and Risk Analysis and Div. of Trading and Markets (Sept. 10, 2018), <https://www.sec.gov/news/public-statement/tm-dera-expiration-tick-size-pilot>.
- 305 Assessment of the Plan to Implement a Tick Size Pilot Program (rev. Aug. 2, 2018), at <https://www.sec.gov/files/TICK%20PILOT%20ASSESSMENT%20FINAL%20Aug%202.pdf>.
- 306 SEC, *Recommendation of the Investor Advisory Committee: Broker-Dealer Fiduciary Duty* (Nov. 22, 2013), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/fiduciary-duty-recommendation-2013.pdf>.
- 307 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>.
- 308 Universal Proxy, Exchange Act Release No. 79164, Investment Company Act Release No. 32339, 81 Fed. Reg. 79,122 (proposed Nov. 10, 2016).
- 309 SEC, *Recommendations of the Investor Advisory Committee Regarding the SEC and the Need for the Cost Effective Retrieval of Information by Investors* (July 25, 2013), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/data-tagging-resolution-72513.pdf>.
- 310 For a list of rulemakings that require data tagging, see *Report on Activities, Fiscal Year 2016*, *supra* note 60, at 53-55.
- 311 FAST Act Modernization and Simplification of Regulation S-K, Securities Act Release No. 10425, 82 Fed. Reg. 50,988 (Nov. 2, 2017).
- 312 Inline XBRL Filing of Tagged Data, *supra* note 13.
- 313 Exchange Traded Funds, Securities Act Release No. 10515, Investment Company Act No. 33140, 83 Fed. Reg. 37,332, 37,393, n.495 (proposed July 31, 2018), <https://www.sec.gov/rules/proposed/2018/33-10515.pdf>.
- 314 Form CRS Relationship Summary, *supra* note 79.



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