



Office of the Investor Advocate

OFFICE OF THE INVESTOR ADVOCATE

REPORT ON OBJECTIVES

FISCAL YEAR 2017


Section 4(g) of the Securities Exchange Act of 1934 (“Exchange Act”), 15 U.S.C. § 78d(g), 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 no later than June 30 of each year, and its purpose is to set forth the objectives of the Investor Advocate for the following fiscal year.² The instant report is the Investor Advocate’s third annual Report on Objectives. It contains a summary of the Investor Advocate’s primary objectives for Fiscal Year 2017, beginning October 1, 2016.

A Report on Activities is due no later than December 31 of each year, and it describes the activities of the Investor Advocate during the immediately preceding fiscal year.³ The next Report on Activities will be filed by December 31, 2016, and will describe the activities of the Office of the Investor Advocate (“Office”) during Fiscal Year 2016, covering the period from October 1, 2015 through September 30, 2016. For Fiscal Year 2017, the activities and accomplishments of the Office will be reported not later than December 31, 2017.

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

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I believe our efforts to enhance the use of investor testing will help to alleviate a significant shortcoming of the traditional rulemaking process . . . unfortunately, the voices of individual investors and consumers tend to be under-represented in this process, even though their interests should be paramount.

MESSAGE FROM THE INVESTOR ADVOCATE

Since the creation of the Office of the Investor Advocate in February 2014, we have seen steady growth in staffing as we continue to build up our office and operations. We expect to begin Fiscal Year 2017 with 11 full-time staff, two participants in the SEC Pathways Program, and two contractors who support our work. As you can see from the contents of this report, these 15 individuals will be very busy on behalf of investors in Fiscal Year 2017.

Our work in the coming year will revolve around four core functions, each of which requires considerable effort. We will advocate for policies that benefit investors, conduct investor testing, help investors resolve problems with the SEC or self-regulatory organizations (“SROs”), and support the SEC’s Investor Advisory Committee.

The majority of our resources are devoted to the advocacy function, where we endeavor to provide a persuasive voice for investors in the policymaking process. Our statutory mandate, codified in Exchange Act Section 4(g)(4), requires us to analyze the potential impact on investors of proposed rules of the Commission and SROs. Accordingly, we spend considerable time evaluating proposed rules and advocating for investors, through informal means as well as formal recommendations.

Much of our policy work is reactive, meaning that we must analyze whatever rulemakings are flowing through the Commission and SROs at any given time. However, there are policy areas that are of particular interest to us, where we will tend to engage more

proactively for changes that will benefit investors. We focus our finite resources more intently on these issues in hopes that we can develop deeper expertise and ultimately achieve the greatest impact for investors.

Our policy agenda for Fiscal Year 2017 is described in detail in this report. In broad terms, we will focus on public company disclosure, equity market structure, municipal market reforms, accounting and auditing issues, corporate governance, and fund fees and expenses.

Some items on our agenda are new this year. For example, we will begin to consider whether investors understand the fees and expenses they pay for an array of products and service providers, including funds, investment advisers, and broker-dealers. As part of this initiative, we will explore whether the various fees and expenses could be disclosed more effectively.

Other items on our agenda may appear to be static from year to year. For example, we will continue a multi-year focus on disclosure effectiveness for public companies. However, under that expansive topic, in the coming year we intend to focus more narrowly on the question of whether it is appropriate for disclosure requirements to be scaled based upon the size of the issuer providing the disclosure. Similarly, under the wider category of “equity market structure” that is under consideration by the Commission, we will focus more specifically on exchange access fees and



rebates (“maker-taker”), as well as on disclosures that will help investors evaluate whether they are receiving best execution.

In addition, we will continue our engagement in reforms related to the municipal securities markets, with a particular focus on markup disclosure, pre-trade price transparency, and curtailing certain problematic practices. We will also examine the duties and disclosures of audit committees, as well as issues related to accounting standards, such as a proposal by the Financial Accounting Standards Board to reinterpret the definition of materiality. Our efforts to improve corporate governance will focus largely on the proxy voting process, and we will continue to examine the listing standards of the national securities exchanges with respect to shareholder approval of certain corporate actions.

For many of these issues, it would be useful to have better data to inform the policymaking process. Toward this end, the Office of the Investor Advocate, in consultation with the Division of Economic and Risk Analysis and other divisions and offices at the Commission, has begun laying the foundation for increased utilization of investor testing. We have issued a Request for Information and anticipate finalizing a contract with one or more vendors in the near term. This will give the Commission a variety of tools, such as surveys, A/B testing, and focus group testing, to evaluate the efficacy of policy choices or potential benefits to investors from proposed regulations.

I believe our efforts to enhance the use of investor testing will help to alleviate a significant shortcoming of the traditional rulemaking process. The traditional process, whereby a proposed rule is published in the Federal Register for “public” comment, tends to favor those industry participants who can retain professionals to track rulemakings, absorb the hundreds of pages of complex text, and respond to the hundreds of questions that are posed. Unfortunately, the voices of individual investors

and consumers tend to be under-represented in this process, even though their interests should be paramount. Thus, it is imperative that policymakers more actively seek to engage investors in order to properly evaluate policy options, and investor testing will give the Commission an opportunity to do so.

In addition to our policy and testing work, we continue our efforts on the other core functions of the Office. The SEC Ombudsman, Tracey L. McNeil, continues to build the infrastructure for her office while helping individual investors resolve problems they may have with the Commission or SROs. A summary of Ms. McNeil’s plans and activities is set forth below in the Ombudsman’s Report.

Finally, we will continue to provide support services for the SEC’s Investor Advisory Committee in Fiscal Year 2017. The Investor Advocate is a statutory member of the Committee and participates in its work, and the Office of the Investor Advocate provides the necessary staff support to the Committee. This involves many tasks, including the drafting of meeting minutes, processing the appointments of new members, assisting with travel arrangements and reimbursements, scheduling and setting up meeting rooms, publishing meeting notices and agendas, and helping to arrange briefings by Commission staff and outside parties. A summary of the recommendations made by the Investor Advisory Committee is included in this report.

I am pleased to submit this Report on Objectives for Fiscal Year 2017 on behalf of the Office of the Investor Advocate, and I would be happy to answer any questions from Members of Congress.

Sincerely,



Rick A. Fleming
Investor Advocate

OBJECTIVES OF THE INVESTOR ADVOCATE

As set forth in Exchange Act Section 4(g)(4), 15 U.S.C. § 78d(g)(4), the Investor Advocate is required to perform the following functions:

- (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.

ASSISTING RETAIL INVESTORS

Exchange Act Section 4(g)(4)(A) directs the Investor Advocate to assist retail investors in resolving significant problems such investors may have with the Commission or with SROs.⁴ To help accomplish that objective, the Investor Advocate has appointed an Ombudsman to, among other

things, act as a liaison between the Commission and any retail investor in resolving problems that retail investors may have with the Commission or with SROs.⁵ 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” (“Ombudsman’s Report”).⁶ As required by statute, the Ombudsman’s Report is included within this Report on Objectives.⁷

IDENTIFYING AREAS IN WHICH INVESTORS WOULD BENEFIT FROM REGULATORY CHANGES

Exchange Act Section 4(g)(4)(B) requires the Investor Advocate to identify areas in which investors would benefit from changes in the regulations of the Commission or the rules of SROs.⁸ This is a broad mandate that authorizes the Investor Advocate to examine the entire regulatory scheme, including existing rules and regulations, to identify those areas that could be improved for the benefit of investors. For example, the Investor Advocate may look at the rules and regulations governing existing equity market structure to determine whether any regulatory changes would benefit investors. Similarly, the Investor Advocate may review current municipal market practices to evaluate whether any changes might benefit investors. These and similar other concerns are discussed in greater detail below in the section entitled *Policy Agenda for Fiscal Year 2017*.

IDENTIFYING PROBLEMS WITH FINANCIAL SERVICE PROVIDERS AND INVESTMENT PRODUCTS

Exchange Act Section 4(g)(4)(C) requires the Investor Advocate to identify problems that investors have with financial service providers and investment products.⁹ The Investor Advocate continues to monitor investor inquiries and complaints, SEC and SRO staff reports, enforcement actions, and other data to determine which financial service providers and investment products may be problematic. As required by Exchange Act Section 4(g)(6), these problems will be described in the Reports on Activities to be filed in December of each year.

ANALYZING THE POTENTIAL IMPACT ON INVESTORS OF PROPOSED RULES AND REGULATIONS

Exchange Act Section 4(g)(4)(D) directs the Investor Advocate to analyze the potential impact on investors of proposed regulations of the Commission and proposed rules of SROs.¹⁰ As required, the Office reviews all significant rulemakings of the Commission and SROs. We also communicate with investors and their representatives to determine the potential impact of proposed rules.

PROPOSING APPROPRIATE CHANGES TO THE COMMISSION AND TO CONGRESS

Exchange Act Section 4(g)(4)(E) provides that, to the extent practicable, the Investor Advocate may 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.¹¹ As we study the issues in our *Policy Agenda for Fiscal Year 2017*, as set forth below, we will likely make recommendations to the Commission and Congress for changes that will mitigate problems encountered by investors.

SUPPORTING THE INVESTOR ADVISORY COMMITTEE

Exchange Act Section 39, as amended by Section 911 of the Dodd-Frank Act, establishes the Investor Advisory Committee (“IAC” or “Committee”).¹² As discussed in greater detail below in the section entitled *Summary of IAC Recommendations and SEC Responses*, the purpose of the Committee is to advise and consult with the Commission on regulatory priorities, issues impacting investors, initiatives to protect investors, and related matters. By statute, the Investor Advocate is a member of the IAC.¹³ In addition, the Office continues to provide staff and operational support to the IAC.

POLICY AGENDA FOR FISCAL YEAR 2017

As described above, the statutory mandate for the Office of the Investor Advocate is broad, and much of our time is consumed with the review of rulemakings that flow through the Commission and SROs. We monitor all rulemakings, but we prioritize certain issues so that we can develop expertise in those areas and maximize our impact for investors with the resources we have available. After discussions with numerous knowledgeable parties, both inside and outside the Commission, and after due consideration, the Investor Advocate has determined that the Office will focus upon the following issues during Fiscal Year 2017:

- Public Company Disclosure
- Equity Market Structure
- Municipal Market Reform
- Accounting and Auditing
- Corporate Governance
- Fund Fees and Expenses

Undoubtedly, other issues will arise that require the attention of the Office, but these issues will remain on our policy agenda.

PUBLIC COMPANY DISCLOSURE

Disclosure is a cornerstone of the securities laws and the capital markets. Before a company sells securities, it must disclose all material facts to prospective investors so they can make fully informed decisions about purchasing the securities. Public companies must then provide ongoing disclosure

so that investors have access to the information they need to vote as shareholders or to buy and sell securities in the secondary markets.

For a company issuing securities, Regulation S-K sets forth the information that must be disclosed about the business and its operations.¹⁴ Regulation S-X sets forth the requirements for the format and content of the company's financial statements.¹⁵ Typically, a company issuing new securities must file all of the required information in a particular format using either Form S-1 or an alternative form, and public companies are required to provide ongoing periodic disclosure using Forms 10-K, 10-Q, and others.

Given the important role of disclosure, the requirements for various types of disclosure are robust. As a result, an S-1 or 10-K can be hundreds of pages long, and the length and complexity of the disclosures has led many to question whether the disclosure requirements are properly calibrated to effectively communicate all material information to investors while eliminating immaterial, outdated, or duplicative data that may dilute the impact of the more meaningful disclosures.

This question has been an area of focus for the Commission in recent years. In December 2013, the Commission issued the Report on Review of Disclosure Requirements in Regulation S-K ("S-K Report"), a report mandated by Congress under the Jumpstart Our Business Startups Act ("JOBS

Act”).¹⁶ The S-K Report describes the evolution of the disclosure requirements within Regulation S-K and recommends a reevaluation of those disclosure requirements. On April 11, 2014, the SEC’s Division of Corporation Finance announced a disclosure reform initiative that built upon the S-K Report.¹⁷ Since then, the Commission has released two significant requests for comment. On October 1, 2015, the Commission published a Request for Comment on the Effectiveness of Financial Disclosures About Entities Other Than the Registrant, which solicited feedback about a subset of the requirements under Regulation S-X (“S-X Request for Comment”).¹⁸ Then, on April 22, 2016, the Commission published for comment a Concept Release regarding Business and Financial Disclosure Required by Regulation S-K (“S-K Concept Release”), with comments due by July 21, 2016.¹⁹

As we have in the past, the Office of the Investor Advocate will monitor the developments in this area and provide a voice for investors as potential reforms are contemplated by the Commission. There are myriad issues that we will examine in this process, but in Fiscal Year 2017 we will spend considerable time and effort in three particular areas: investor outreach, structured data, and scaled disclosure.

Investor Outreach

The S-X Request for Comment is 35 pages long, and it asks the public to answer 58 questions.²⁰ During the 60-day comment period, the Commission received 49 comment letters, but only two letters appear to be submitted by individual investors.²¹ The S-K Concept Release is 341 pages long and asks 340 questions,²² and unfortunately, we anticipate a similar response rate from actual investors.

For several reasons, it seems unrealistic to expect individual investors to participate in the “public” comment process. The average person has little or no awareness of rule proposals at the SEC, and even highly engaged investors would struggle to find the time to read 341 pages and submit meaningful comments to 340 questions. Moreover, issuers of securities and their representatives have strong incentives to comment about proposed disclosure rules that may impact them in a significant way, but individual investors have little incentive to comment because the impact on individual investors is broadly dispersed.

To counteract this structural imbalance in the public comment process, the Office of the Investor



Advocate will enhance our engagement with investors in Fiscal Year 2017. This will include individuals who invest for themselves, as well as the individuals who make the actual buy and sell decisions on behalf of institutional investors such as mutual funds and pension funds. We will attempt to determine what investment strategies are used, what sources of information and data are relied upon (including the SEC's EDGAR system), and what data points are most useful and least useful for their purposes. This outreach will inform our thinking about ways to enhance the effectiveness of disclosure for actual users of the data, and we will share our insights with policymakers. In addition, this information will help us formulate investor testing initiatives that will provide more extensive and reliable data about investor behavior.

Structured Data

In our view, while debates about the *content* of disclosure are worthwhile, a more important issue is the *delivery* of the disclosure. We believe technology is the key to enhancing the effectiveness of disclosure for investors while reducing the burdens to issuers who must provide the disclosure.²³ Thus, we will continue to encourage Commission staff to adopt user-friendly technologies that will allow for the layering of information so that investors will immediately see the most important information and have the capability to drill down for greater detail.

It is also important to keep in mind that every investor benefits from disclosure, even if the investor does not read a word of it. This is because the disclosure performs an important price-setting function in the markets, as sophisticated buyers and sellers of securities digest all material information to decide whether to buy or sell at a given price. For this price-setting mechanism to function efficiently, analysts and other market participants must have ready access to all available material information.

To improve the accessibility of disclosure for sophisticated users, the Commission has taken sig-

nificant strides to increase the use of structured data for public company filings.²⁴ However, more can be done to enhance its accuracy and give users better tools to mine the data.²⁵ Chair Mary Jo White has acknowledged this potential, and at a public meeting on April 13, 2016, she announced the creation of a dedicated working group to address the “manner of delivery” that is needed to achieve modern and efficient disclosure.²⁶ At her invitation, the Office of the Investor Advocate will participate in the working group.

Scaling of Disclosure Requirements

Frequently, lawmakers and regulators are faced with the question of whether to “scale” regulations so that smaller companies are required to satisfy fewer requirements. On its face, this appears to be an appealing way to help smaller businesses by reducing the costs and burdens of regulatory requirements.

We believe the trend toward scaling presents a significant risk to investors and deserves much closer examination. During FY 2017, we will begin to explore this issue in greater depth. For example, we will examine whether the existing disclosure requirements are already inherently less onerous for smaller companies because certain disclosures, while technically required, are not applicable to smaller companies or require less explanation. We will also consider whether smaller companies carry higher risks of default or investor losses, which would suggest that the value of disclosure is actually higher for investors in these companies. By exploring these and related questions, we will attempt to provide a more complete set of facts to policymakers who are considering whether to scale disclosure requirements.

EQUITY MARKET STRUCTURE

As noted in the last two years' Reports on Objectives, the secondary market for U.S.-listed equities has become dispersed and complex, partly as a result of the decades-long transition from a market

structure dominated by manual trading to a market structure characterized primarily by automated trading.²⁷ The evolution of technologies for generating, routing, and executing orders has enhanced the speed, capacity, and sophistication of the trading functions that are available to market participants,²⁸ and trading centers are offering a wide range of services designed to attract different types of market participants with varying trading needs.²⁹ In addition, regulatory actions have also contributed to changes in equity market structure—for example, Regulation NMS (adopted in 2005),³⁰ Regulation ATS (adopted in 1998),³¹ the Order Handling Rules (adopted in 1996),³² and certain enforcement actions.

In particular, the equity market has evolved significantly since the adoption of Regulation ATS. Regulation ATS addressed the regulatory disparity between registered national securities exchanges and non-exchange markets at the time. It sought to encourage market innovation while ensuring basic investor protections on trading venues meeting the definition of an alternative trading system (“ATS”).³³

Since the adoption of Regulation ATS, ATSS have emerged as a significant source of liquidity in national market system (“NMS”) stocks and now compete with, and operate with similar complexity and sophistication as, registered national securities exchanges. Around 35 percent of market volume in exchange-listed stocks is executed in dark ATSS and other broker-dealer platforms, rather than on lit venues like the New York Stock Exchange.³⁴

These dark venues are not currently required to disclose their rules of operation to their customers or the public, and they typically only provide limited information about how they operate.³⁵ Some recently settled enforcement actions against ATSS that trade NMS stocks highlight the lack of disclosure concerning their operation and the operators’ conflicts of interest.³⁶

On November 18, 2015, the Commission proposed amending Regulation ATS to enhance the operational transparency of venues that trade listed equity securities.³⁷ Greater information about the operation of these venues could allow sophisticated investors to better compare the trading venues and determine which venues and order routing products meet their trading needs. Our Office has monitored the public comment process and evaluated the proposal’s potential impact on investors, and we expect to make a recommendation to the Commission prior to FY 2017. We will continue to advocate for greater transparency in FY 2017 if the Commission does not finalize its proposal during the current fiscal year.

In addition to the changes brought about by Regulation ATS, the equity market has also evolved significantly in response to Regulation NMS, which was intended to modernize and strengthen the regulatory structure of the U.S. equity markets.³⁸ The Commission is evaluating Regulation NMS as part of a comprehensive review of equity market structure, and several SROs and market participants have joined the public discussion regarding reforms that might benefit investors.

The Commission’s Equity Market Structure Advisory Committee (“EMSAC”), formed in early 2015, has now met several times over the last year to discuss and debate the structure and operations of the U.S. equities market.³⁹ Under its charter, the EMSAC provides advice and recommendations to the Commission specifically related to equity market structure issues.⁴⁰ The EMSAC is currently considering various potential market structure reforms involving Regulation NMS,⁴¹ including Rule 610, which relates to the access fees that trading venues can charge to participants, and other matters concerning self-regulation, market quality, and customer issues.

Regulation NMS Rule 610— Recommendation for Access Fee Pilot

The payment model known as “maker-taker” originated with electronic trading venues in the late 1990s.⁴² As detailed in a recent Commission staff white paper, these nascent alternatives to registered exchanges competed by, among other things, charging low fees while offering fast and fully automated trading.⁴³ Paying rebates for trading on a venue provided an additional incentive for traders to use the venue—it was additional income beyond the spread between the bid and offer prices.⁴⁴

Due to competitive pressure over time, many exchanges and non-exchange markets have adopted similar fee structures to attract order flow incentivized to provide competitive prices.⁴⁵ In other words, such venues typically pay rebates to their members to encourage them to place resting, or liquidity-providing, orders on their trading systems at the best price. If an execution occurs, the liquidity-providing “maker” receives a rebate, and the “taker” that executes against that resting order pays a fee to the trading venue which is used to cover the cost of the rebate.⁴⁶

In part enshrined by Rule 610 of Regulation NMS, which sets a maximum access fee cap for “takers” on equity exchanges, this maker-taker fee model has been the subject of debate over the effects it may have on market structure, broker routing practices, and investor interests.⁴⁷ Some believe the maker-taker model is a competitive tool for exchanges and may, directly or indirectly, provide better prices for investors. Others believe that it exacerbates conflicts of interest for brokers who have a legal duty to seek best execution of their customers’ orders, contributes to market fragmentation and market complexity through the proliferation of new exchange order types, and undermines price transparency.⁴⁸

On April 26, 2016, the EMSAC discussed a framework by which the Commission could conduct a pilot program related to maker-taker access fees on

equity exchanges.⁴⁹ Following debate, the EMSAC committed to have one of its subcommittees refine the framework and, after a public meeting and vote, to likely recommend that the Commission move forward with a pilot to gather data on overall market quality and participant behavior that would result from a reduction in trading venue access fee caps for takers of liquidity and, presumably, a reduction in the corresponding rebates for makers that submit resting orders.⁵⁰

During the discussion of the proposal on April 26, representatives of national securities exchanges suggested that the access fee pilot program should also test whether a “trade-at” rule could serve investors by further encouraging the display of limit orders on exchanges.⁵¹ Generally, a “trade-at” rule would prohibit any trading center, including ATs and internalizing brokers, from executing a trade at the national best bid or offer (“NBBO”) unless that center was also displaying that price at the time.⁵² Such a rule would, in effect, require dark trading centers to either provide significant price improvement to the order or route the order to a venue that was publicly displaying the NBBO, likely a national securities exchange in today’s market.⁵³ Proponents suggest that such a rule would promote pre-trade public price discovery by preventing the diversion of a significant volume of valuable marketable order flow to undisplayed trading centers. Opponents suggest that the varying needs of investors may be better served with the current level of fragmentation, including among dark pools, rather than forcing orders to execute on the public exchanges.

Our Office will review the EMSAC recommendation, if adopted, and will likely support the implementation of a pilot program. We will carefully consider whether the proposed elements of the pilot, including a potential trade-at test, will provide the Commission with the most useful data for evaluating potential equity market structure reforms. Ultimately, we will consider whether

lowering these fees and rebates on a permanent basis will improve market quality for investors.

Regulation NMS Rules 605 and 606— Enhancements to Execution Quality and Order Routing Information

Separately from Rule 610 and access fees, recent debate over order routing between trading venues has involved a discussion of the limitations of current Rule 606 of Regulation NMS. Rule 606 requires some public disclosure of broker order routing practices, but it does not cover the large orders typically used by institutional investors.⁵⁴ One way to address this gap would be to amend the rule to require disclosure of the customer-specific information that a broker is expected to provide to each institutional customer on request. While some brokers already voluntarily provide some of this information, a rule could ensure that the disclosed information is useful, reliable, and uniformly available on request to all institutional customers.

An industry working group, including the Investment Company Institute (“ICI”), the Managed Funds Association (“MFA”), and the Securities Industry and Financial Markets Association (“SIFMA”), has developed a recommended template for the minimum disclosure of order routing and execution quality information (part of the related Rule 605 of Regulation NMS) that broker-dealers would provide, upon request, to institutional customers.⁵⁵ The disclosure template would provide a broad range of statistical data regarding the broker’s handling of a specific customer’s orders, along with the execution quality achieved by the broker at each venue.

Chair White has asked staff to prepare a recommendation to the Commission for a rule that would enhance order routing disclosures.⁵⁶ We understand that the Division of Trading and Markets is working toward that goal, and that they may soon recommend amendments to Rules 600 and 606 in order to standardize and increase transparency for

institutional customers with regard to how broker-dealers route their order flow.⁵⁷

In Fiscal Year 2017, the Office of the Investor Advocate will monitor public comments, review data, and otherwise assess the various ongoing initiatives involving equity market structure. We will evaluate how individual and institutional investors may be affected by various regulatory proposals, including any proposed changes to Rules 605 and 606 under Regulation NMS. We will consider whether disclosing trade venue routing and the quality of execution services could adequately address market complexity, or whether even more prescriptive measures are needed.

MUNICIPAL MARKET REFORM

According to Federal Reserve Board estimates, the value of outstanding municipal bonds increased from approximately \$3.65 trillion at the end of the fourth quarter of 2014 to \$3.71 trillion at the end of the fourth quarter of 2015.⁵⁸ Approximately 41 percent of outstanding municipal bonds were held *directly* by individual investors as of December 31, 2015, and another 29 percent were owned *indirectly* by retail investors through mutual funds, money market funds, or closed end funds and exchange-traded funds.⁵⁹ In its 2015 Fact Book (“MSRB Fact Book”), the Municipal Securities Rulemaking Board (“MSRB”) observed that, while the par amount of customer transactions (purchases and sales) in municipal securities has steadily decreased every year since 2011, the same is not true of the number of customer transactions.⁶⁰ Also, despite its traditional characterization as a “buy-and-hold” market, significant secondary market trading occurs in municipal securities markets.⁶¹

As these statistics indicate, municipal securities continue to be prevalent in individual investor portfolios and may constitute an increasingly important part of investors’ retirement plans. Municipal securities also provide funding for critical state and local projects. The growing size and importance of

the municipal securities market *vis-à-vis* individual investors makes investor protection and advocacy in this space necessary. The Office of the Investor Advocate highlighted municipal market reform as part of its policy agenda in fiscal years 2015 and 2016 and such reform will remain on the Office's Fiscal Year 2017 agenda.⁶²

The Commission's July 31, 2012, Report on the Municipal Securities Market ("Municipal Market Report") identified disclosure and market structure as two key areas of concern in municipal markets.⁶³ Since the Municipal Market Report was issued, some progress has been made to address certain issues in these areas.⁶⁴ For example, in the area of municipal market structure, the Municipal Market Report recommended the MSRB "consider a rule that would require municipal bond dealers to seek 'best execution' of customer orders for municipal securities."⁶⁵ The MSRB's best execution rule took effect on March 21, 2016.⁶⁶

In Fiscal Year 2017, the Office of the Investor Advocate will continue to work with Commission staff and the relevant SROs to encourage municipal securities market reforms designed to benefit investors. The Office may participate in the public comment process to help ensure that the interests of investors are given due consideration and appropriate weight as rules are being considered by both the Commission and relevant SROs.⁶⁷ In particular, we expect to advocate for markup disclosure, greater pre-trade price transparency, and for reforms to combat certain problematic practices in the municipal securities market.

Markup Disclosure

A markup is the remuneration received by a dealer when selling municipal securities as principal to a customer.⁶⁸ In general, the markup is the differential between the prevailing market price of a municipal security at the time the dealer sells it to the customer and the higher price paid by the customer to the

dealer.⁶⁹ One study estimated that between 2005 and 2013, excessive markups and markdowns paid by municipal market investors "likely substantially exceed[ed] \$10 billion."⁷⁰

Broker-dealers are required to provide retail customers with confirmation statements following fixed income transactions.⁷¹ However, under current industry practices, confirmation statements provided to retail customers typically provide no more than the price that the customer paid or received for the fixed income security. As a result, retail investors seldom receive clear disclosure of a dealer's markup or markdown.⁷² In fact, investors may not be aware that they pay a markup at all.

The Municipal Market Report recommended that bond dealers be required to disclose any markup or markdown information to customers.⁷³ In 2014, the MSRB and the Financial Industry Regulatory Authority ("FINRA") began working to require such disclosure, and in 2015, they issued for public comment a second request related to requiring markup or markdown disclosure.⁷⁴ The Municipal Market Report also suggested that the MSRB consider issuing detailed interpretive guidance to assist bond dealers in establishing the "prevailing market price."⁷⁵ On February 18, 2016, the MSRB issued a request for comment on its proposed prevailing market price guidance.

The Office of the Investor Advocate commented on several MSRB and FINRA proposals during FY 2016. In the coming year, we will continue to monitor municipal market structure initiatives such as best execution and actively participate in ongoing rulemaking proposals such as markup or markdown disclosure.

Pre-Trade Price Transparency

Municipal securities market participants have varying degrees of access to pre-trade pricing information.⁷⁶ Bond dealers and larger institutional

investors tend to have greater access while retail investors and smaller institutional investors may have access to very little pre-trade information and generally have limited knowledge or resources to obtain such information.⁷⁷ Further, the existence of so many unique bonds and the decentralized, over-the-counter dealer market inhibit pre-trade price transparency by creating an opaque secondary market and making it prohibitively difficult for retail investors to independently identify participants interested in buying or selling a municipal security and the prices they are willing to pay or receive.⁷⁸

The Municipal Market Report recommended steps that could be taken to create a level playing field between individual investors and large institutional investors and ways to disseminate pre-trade price information to individual investors. Specifically, the Municipal Market Report recommended the following:

- The Commission could consider amendments to Regulation ATS to require an ATS with material transaction or dollar volume in municipal securities to publicly disseminate its best bid and offer prices and, on a delayed and non-attributable basis, responses to “bids wanted” auctions; and
- The MSRB could consider rules requiring a brokers’ broker with material transaction or dollar volume in municipal securities to publicly disseminate the best bid and offer prices on any electronic network it operates and, on a delayed and non-attributable basis, responses to “bids wanted” auctions.⁷⁹

Problems in the municipal securities market are often complex and difficult to solve. However, the lack of pre-trade price transparency may lie at the root of many issues related to secondary trading

within the market.⁸⁰ Thus, in Fiscal Year 2017, we will monitor Commission and SRO efforts with respect to pre-trade price transparency. We will continue to explore ways to improve pre-trade transparency and make recommendations as appropriate.

Problematic Practices

In October 2015, the MSRB identified three areas of particular concern to investors in municipal securities markets—timeliness of continuing disclosures, lack of bank loan disclosures, and trades below the minimum denomination.⁸¹ The Office of the Investor Advocate briefly discussed these problematic practices within our most recent Report on Activities,⁸² and we will continue to assess potential solutions during FY 2017.

Problematic practices within each of these areas may have adverse effects on retail investors in municipal market securities. For example, a municipality’s debt-like obligations such as bank loans may be a very important factor for an investor who is deciding whether to invest in the bonds of that municipality, but bank loans are rarely disclosed to investors or the disclosure is delayed.⁸³ In addition, municipal bonds may trade below minimum denomination thresholds to the detriment of investors.⁸⁴ Minimum denominations are established to help ensure that higher risk municipal securities are sold only to those investors who are able to make larger investments and bear the associated risk. Sometimes, investors may hold below minimum denomination positions for legitimate reasons, including, for example, call provisions allowing calls in amounts below the minimum denomination, investment advisers splitting positions among several clients, death, and divorce.⁸⁵ However, some minimum denominations may be created in violation of the acceptable threshold amount, and several municipal securities dealers have been sanctioned for this practice in recent years.⁸⁶

Since identifying these potentially problematic practices, the MSRB has begun to address them. Specifically, on March 28, 2016, the MSRB published a Regulatory Notice requesting comment on a concept proposal relating to disclosure of bank loan information.⁸⁷ In addition, on April 7, 2016, the MSRB published a Regulatory Notice requesting comment on an amendment to MSRB Rule G-15(f) on minimum denominations.⁸⁸ The Office of the Investor Advocate generally supports reforms of this nature, and we will continue to participate in the public dialogue surrounding these topics.

ACCOUNTING AND AUDITING

High-quality financial reporting is critically important to investors for their investment and voting decisions. It is therefore important for the Office of the Investor Advocate to track accounting and auditing issues, to give a voice to the needs of investors in the policymaking process, and to encourage investors themselves to express their views.

In the coming fiscal year, we will be monitoring issues involving audit committee disclosures, the auditor's report, the Financial Accounting Standards Board ("FASB") approach to materiality, and the overuse of non-GAAP measures.

Audit Committee Disclosures and the Auditor's Report

On July 1, 2015, the Commission published a concept release on audit committee disclosures, focusing on the committee's oversight of independent auditors.⁸⁹ The concept release invited public comments on whether audit committee disclosures should provide more insight into the information the audit committee used and the factors it considered in overseeing the independent auditor. This includes considerations related to the process for appointing or retaining the auditor and the qualifications of the auditor and certain members of the engagement team. Commission staff is currently evaluating the comment letters received, which numbered more than 100.

On May 11, 2016, the Public Company Accounting Oversight Board ("PCAOB") voted to re-propose for public comment the audit reporting standard,⁹⁰ originally proposed in 2013.⁹¹ The PCAOB stated that its goal is to make the auditor's report more informative to investors and other financial statement users.⁹² Among other things, the proposal calls for an expansion of the auditor's report to include a discussion of critical accounting matters.

Both the audit committee report and the auditor's report are critical to the framework of financial reporting. Enhancements to either report would be of major significance to investors.

FASB and the Materiality Standard

In September 2015, FASB issued a pair of proposals related to materiality that have generated a high level of controversy among some investors.⁹³ The first of FASB's twin proposals would apply to the conceptual framework that FASB uses as a guide in its own decision-making process.⁹⁴ This proposal, according to FASB, would clarify that the concept of materiality was not intended to conflict with the legal definition.⁹⁵ The second proposal was an Accounting Standards Update that FASB said was intended to clarify how companies and not-for-profit entities consider materiality in notes to the financial statements.⁹⁶

According to FASB, the amendments are not intended to change any specific disclosure requirements, but will help entities omit non-material disclosures and focus instead on relevant, material information.⁹⁷ However, despite these assurances, several investors and interested parties have expressed concerns that the changes would allow issuers to reduce their level of financial reporting and their transparency to investors. The SEC Investor Advisory Committee weighed in with a letter to FASB expressing its concerns.⁹⁸

FASB officials have indicated that they will hold a public roundtable later this year before making any

further decisions on the twin proposals. Our Office will monitor developments closely and prepare to advocate for the best interest of investors as these proposals are considered.

Overuse of Non-GAAP Measures

In the past half-year, senior officials of the Commission have expressed concern over issuers' increasing use of non-GAAP measures. For example, in March 2016, SEC Chief Accountant James V. Schnurr stated:

The SEC staff has observed a significant and, in some respects, troubling increase over the past few years in the use of, and nature of adjustments within, non-GAAP measures by companies as well [as the] prominence that the analysts and media have accorded such measures when reporting on the results of the companies they cover.⁹⁹

The Chief Accountant urged corporate management and audit committees to increase their focus on the issue—going beyond determinations of compliance to include “probing questions on why, in contrast to the GAAP measure, the non-GAAP measure is an appropriate way to measure the company’s performance and is useful to investors.”¹⁰⁰

Chair White, in a keynote speech to the 2015 American Institute of CPAs (“AICPA”) National Conference, suggested what some of those probing questions should be:

Why are you using the non-GAAP measure, and how does it provide investors with useful information? Are you giving non-GAAP measures no greater prominence than the GAAP measures, as required under the rules? Are your explanations of how you are using the non-GAAP measures—and why they are useful for your investors—accurate and complete, drafted without boilerplate? Are there appropriate controls over the calculation of non-GAAP measures?¹⁰¹

SEC Commissioner Kara M. Stein has also called attention to the increasing use of non-GAAP measures in communications to investors, such as earnings releases and the management discussion and analysis (“MD&A”) sections of annual reports, which fall outside of the financial statements themselves. Commissioner Stein noted that the trend to make customized adjustments to GAAP financial measures has been termed “earnings before bad stuff.”¹⁰²

Commission staff have demonstrated a heightened awareness of this issue. According to Chief Accountant Schnurr, staff from the Division of Corporation Finance regularly issue comments on this issue and will be vigilant in reviewing the use of such measures going forward.¹⁰³ SEC Deputy Chief Accountant Wesley R. Bricker reiterated that point in a speech on May 5, 2016. He stated that if companies “present adjusted revenue, you will likely get a comment; moreover, you can expect the staff to look closely, and skeptically, at the explanation as to why the revenue adjustment is appropriate.”¹⁰⁴

In short, it appears that staff is prepared to address the excessive use of non-GAAP metrics through enhanced oversight. We will continue to follow this issue closely, and in particular, we will consider whether rulemaking is needed to clarify the law or enhance the Commission’s ability to deter abusive practices.

CORPORATE GOVERNANCE

In the coming year, we will consider issues involving shareholder rights and corporate governance. We will look for ways to remove any obstacles to shareholders in voting proxies and to protect shareholder rights in submitting and voting on shareholder proposals. We will also consider whether proposed changes to exchange listing standards adequately protect the interests of public shareholders, including those that require listed companies to provide shareholders a voice in corporate actions that significantly impact their interests.

Universal Ballots

In a contested board election, a slate of candidates backed by the company's current management is challenged by a slate of candidates backed by one or more shareholder proponents (sometimes called dissidents). Shareholders voting in person are able to choose from among candidates on both slates.¹⁰⁵ Shareholders voting by proxy, however, generally face a binary, either-or choice: they can vote either for the entire slate of management candidates, or for the entire slate of proponent candidates, but they cannot freely mix and match candidates from both slates.¹⁰⁶

This result flows from what Commissioner Stein has described as “the strange confluence of federal and state law.”¹⁰⁷ State law generally provides that any new proxy will revoke any previously given proxy. Thus, if a shareholder submits more than one proxy, only the last one is given effect.¹⁰⁸ This precludes a shareholder from sending in two proxies as a way of voting for a combination of management and dissident nominees.¹⁰⁹ Theoretically, if the names of nominees from the opposing slates all appeared on a single “universal” proxy ballot, shareholders could freely pick candidates from both management and proponents slates.¹¹⁰ Federal proxy rules, however, do not require the use of a universal proxy ballot.

Other rules present significant practical barriers to the use of a universal proxy ballot. Under what is called the *bona fide* nominee rule, a proxy card can list only the names of those director nominees who have consented to having their names appear on that particular proxy card and who have agreed to serve if elected.¹¹¹ Almost without exception, candidates withhold that consent for their names to appear on the opposing proxy card.¹¹²

If the proponents put forward a minority slate, or short slate, rather than seeking majority control of the board, they can round out their slate with some

of the management nominees. (The proponents' proxy card identifies the management candidates whom the proponents will not vote for, thus implying that they will vote for the rest of management's slate without actually naming them.) In this case, however, a shareholder voting for the proponents' proxy card does not freely pick which management nominees to support. Instead, it is the proponent who decides which management nominees the shareholders using the proponent card must support.¹¹³

To address this issue, some advocates have called for the Commission to engage in rulemaking to facilitate universal proxies in which all candidates from both the management and proponent sides appear on a single ballot.¹¹⁴ In 2013, for example, the Investor Advisory Committee recommended that the Commission explore changes to the proxy rules that would give proxy contestants the option, but not the obligation, to use universal ballots in connection with short slate director nominations.¹¹⁵ In January 2014, the Council of Institutional Investors submitted a rulemaking petition requesting that the Commission facilitate the use of universal proxy cards in contested elections.¹¹⁶

To explore these issues in greater depth, the Commission held a Proxy Voting Roundtable in February 2015.¹¹⁷ Then, in a speech on June 25, 2015,¹¹⁸ Chair White stated that she had asked the staff to bring appropriate rulemaking recommendations before the Commission on universal proxy ballots.¹¹⁹

In Fiscal Year 2017, we will continue to study this issue and monitor relevant developments at the Commission. We will advocate for improvements to the voting process that will more effectively serve the needs of shareholders.

Shareholder Proposals

Exchange Act Rule 14a-8 allows a shareholder who holds voting shares worth at least \$2,000 (or one percent of the voting shares, whichever is less)

to submit a proposal for a vote of the other shareholders using the company's proxy statement.¹²⁰ The proposal may recommend or require the company to take a certain course of action.¹²¹ The company is required to include such a proposal in the company's proxy materials unless the company demonstrates to the Commission that it is entitled to exclude the proposal for one of the procedural or substantive reasons set forth in the rule.¹²² Every year, Commission staff receive approximately 300 to 400 requests for assurance that the Commission will take no enforcement action against a company if the company were to exclude a shareholder proposal under one of the exceptions in Rule 14a-8.¹²³

Our Office follows developments during each proxy season, especially if issues arise that substantively affect the rights of shareholders. One such issue arose in 2014 in connection with Exchange Act Rule 14a-8(i)(9), which allows a company to exclude a shareholder proposal that "directly conflicts" with one of the company's own proposals.¹²⁴ A review of the issues surrounding the use of this exclusion eventually led the Division of Corporation Finance, on October 22, 2015, to issue Staff Legal Bulletin No. 14H,¹²⁵ and we believe the SLB has significantly enhanced shareholder rights. During FY 2017, we will continue to monitor developments in shareholder proposals and make recommendations as appropriate.

Exchange Listing Standards Regarding Shareholder Approval

The Exchange Act requires, in relevant part, that the rules of a national securities exchange be designed, in general, to protect investors and the public interest.¹²⁶ Accordingly, the original listing standards of an exchange for a public company should be designed to protect financial markets and the investing public. For a new issuer, listing on an exchange provides an environment that, in comparison to being quoted in over-the-counter markets or remaining privately held, offers the potential for

enhanced liquidity, transparency, and oversight for the issuer's equity security. These benefits also flow to investors. Thus, we generally support efforts to help companies become or remain listed on exchanges under appropriate circumstances.

The development and enforcement of adequate standards governing the initial listing and maintenance of listing of securities is an activity of critical importance to financial markets and the investing public.¹²⁷ Listing standards serve as a means for a marketplace to screen issuers and to provide listed status only to *bona fide* companies with sufficient float, investor base, and trading interest to maintain fair and orderly markets.¹²⁸ In addition to those quantitative standards, qualitative requirements, such as audit committees, independent director oversight of executive compensation, a mandatory code of conduct, shareholder meetings (including proxy solicitation and quorum), review of related party transactions, shareholder approval (including voting rights), and disclosure policies should be designed to help ensure that companies trading on a national securities exchange will adequately protect the interests of public shareholders.¹²⁹

Among the qualitative listing standards, exchange-listed companies are generally required to obtain shareholder approval prior to certain corporate actions, such as the issuance of additional shares under certain circumstances. For example, the current shareholder approval rules for the NASDAQ Stock Market ("NASDAQ") generally require companies to obtain approval from shareholders prior to issuing securities in connection with certain acquisitions, equity-based compensation plans, changes of control, and certain private placements.¹³⁰ Our Office has become concerned about a potential "race to the bottom" by the exchanges, whereby they lower either quantitative or qualitative listing standards in order to attract more companies to list with them, potentially to the detriment of the market and shareholders.

In particular, we have observed several troubling signs with respect to qualitative listing standards that would otherwise require shareholder approval for certain corporate actions. Recent proposals by the New York Stock Exchange (“NYSE”) and NASDAQ suggest that this crucial shareholder protection could be threatened.

In May 2015, the NYSE proposed to exempt certain early stage companies from a requirement to seek shareholder approval before issuing up to 20 percent of outstanding shares to certain related parties, provided that the company’s audit committee or a comparable board committee approves the transaction.¹³¹ Our Office opposed the proposed rule change because, in our view, it was yet another incremental step in a more disturbing trend.¹³² However, the Commission ultimately approved the rule in December 2015, in part because NASDAQ’s own listing standards already presented a lower standard.¹³³

In November 2015, NASDAQ issued a request for comment broadly asking whether its shareholder approval rules continue to serve their original shareholder protection purpose and otherwise still ‘make sense’ given the evolution in the capital markets and securities laws since the rules’ adoption in 1990.¹³⁴ In February 2016, our Office submitted a comment letter arguing that shareholder approval constitutes an important element in the corporate governance framework that helps protect investors and builds trust in markets and that any reduction or elimination of shareholder approval requirements could have a significant negative impact on investor protections.¹³⁵ We expressed concern that board or independent committee approval may not be an effective substitute for approval by shareholders, whose interests are directly impacted by economic and ownership dilution, and that lowering NASDAQ’s qualitative listing standards could exacerbate the “race to the bottom.”

We continue to review historical patterns in the rulemakings of the other exchanges and the behavior of market participants under those rules, but our research of NYSE rulemakings suggests that the listing standards of the NYSE have gradually deteriorated since 2005, particularly with respect to their quantitative listing standards, but also with respect to some qualitative standards.¹³⁶ In several instances where the NYSE sought to lower its qualitative standards, including the aforementioned proposal to remove the requirement for shareholder approval, the NYSE justified the change by noting the competitive advantage enjoyed by other exchanges with different standards.¹³⁷

In Fiscal Year 2017, the Office of the Investor Advocate intends to continue reviewing changes to the listing standards of the national securities exchanges, particularly those that would further deteriorate the rights of shareholders to approve corporate actions that significantly impact their financial interests.

FUND FEES AND EXPENSES

United States-registered investment companies (including open-end mutual funds, exchange-traded funds, closed-end funds, and unit investment trusts) managed more than \$18 trillion in assets at the end of calendar year 2015.¹³⁸ Those assets under management include some of the investments of more than 90 million U.S. retail investors.¹³⁹ Mutual funds remain popular among households—retail investors held approximately 89 percent of the nearly \$16 trillion of mutual fund assets at the end of 2015.¹⁴⁰ Exchange-traded funds accounted for approximately \$2.1 trillion assets under management by the end of 2015.¹⁴¹

While there are fees and expenses associated with all of these assets under management, some investors may not necessarily understand the amount they are paying, what exactly they are paying for,

nor the impact of costs on the long-term value of their investments. Some of these costs relate directly to the management and operation of the funds themselves. In addition, to the extent that investors engage financial intermediaries, there may also be layers of fees that investors pay to compensate investment advisers, brokers, or other financial professionals for the services they provide.¹⁴² We intend to take a closer look at fund fees and expenses in Fiscal Year 2017 and consider ways to improve investor understanding of those costs and their cumulative impact on fund holdings.

Fees and Expenses for Management and Operation of Funds

As an initial observation, we believe that the Commission should explore different approaches to further enhance mutual fund cost disclosures. For purposes of this discussion, several resources are particularly insightful, including the SEC's Division of Investment Management staff guidance on fund distribution and sub-accounting fees, the IAC's mutual fund cost disclosure recommendation, and recently-published research on fund fees.

Division of Investment Management Staff Guidance

In January 2016, the Division of Investment Management published a staff guidance update ("Staff Guidance") on registered open-end investment company ("mutual fund" or "fund") distribution and sub-accounting fees.¹⁴³ While the Staff Guidance is more directly geared toward mutual fund boards of directors, we believe that it is relevant to individual investors as well. For example, the Staff Guidance recognizes that "[m]utual fund fees have a direct impact on investor returns" and that "because investors may evaluate funds based on the specific level of 12b-1, management, and other fees, potential mischaracterization of fees may lead them to invest in funds that they would not otherwise have selected."¹⁴⁴ This is no less true for individual investors than it is for institutional investors.

A particular focus of the Staff Guidance is rule 12b-1 under the Investment Company Act of 1940 ("1940 Act").¹⁴⁵ Section 12(b) of the 1940 Act and rule 12b-1 thereunder limit the ability of funds to use fund assets to pay for distribution of fund shares.¹⁴⁶ Generally, rule 12b-1 prohibits mutual funds from engaging, directly or indirectly, in financing any activity which is primarily intended to result in the sale of fund shares, except pursuant to a so-called "12b-1 plan."¹⁴⁷ The Staff Guidance addresses the possibility of potential mischaracterization of 12b-1 and other fund fees, as well as the potential for the inappropriate use of fund assets to pay for distribution-related activities outside of a rule 12b-1 plan.¹⁴⁸ We share this concern and believe that investors should be able to rely on the accuracy of 12b-1 and other fund fee disclosures associated with any funds they own or are evaluating.¹⁴⁹

Investor Advisory Committee Recommendation on Mutual Fund Cost Disclosure

On April 14, 2016, the IAC recommended that the Commission "explore ways to improve mutual fund cost disclosures" with the goal of enhancing investors' understanding of the actual costs they bear when investing in mutual funds and the impact of those costs on total accumulations over the life of their investments.¹⁵⁰ In making this recommendation, the IAC suggested that, in the short-term, "the best way to make investors more conscious of costs" would be "through standardized disclosure of actual dollar amount costs on customer account statements."¹⁵¹ The IAC also encouraged the Commission, "as part of a longer term effort to improve disclosures," to "explore ways to provide context for cost information in order to improve investor understanding of the impact of those costs."¹⁵²

Among other things, the IAC mutual fund cost disclosure recommendation also encouraged the Commission "to test various approaches to deter-

mine which are the most effective in informing investors of the costs of their own funds, or funds they are considering purchasing, and the long-term impact of those costs.”¹⁵³ In his prepared remarks at that IAC meeting, SEC Commissioner Michael S. Piwowar voiced his support for a “robust investor testing program that examines the efficacy of various mutual fund cost disclosures.”¹⁵⁴ We concur. Moreover, we expect to be actively involved in such investor testing in Fiscal Year 2017.

Study on Mutual Funds and Exchange-Traded Funds

On April 26, 2016, Morningstar published research indicating that, while average fund costs continued to decline in 2015, investors were not necessarily paying less in fund fees and expenses.¹⁵⁵ This Morningstar study of open-end mutual funds and ETFs found that the asset-weighted average expense ratio across funds (excluding money market funds and funds of funds) was 0.61 percent in 2015, compared with 0.64 percent in 2014 and 0.73 percent five years ago.¹⁵⁶ Based on the research, the trend toward lower fund fees appears to be driven by investor demand for relatively cheaper passive funds (*e.g.*, index funds and ETFs) as well as strong inflows into institutional share classes, which tend to charge lower fees.¹⁵⁷

Despite this trend, the Morningstar study concluded that “lower average fund expenses do not necessarily mean investors are paying less for their investments overall.”¹⁵⁸ The reason for this, according to the study, is that the strong inflows into institutional share classes have come through retirement platforms and to ETFs via fee-only advisers.¹⁵⁹ The Morningstar study also emphasized that, because those channels “typically levy another layer of fees in addition to the cost of owning funds,” investors “need to consider their total cost of investing.”¹⁶⁰ Indeed, such adviser and retirement platform expenses have become “an increasingly important cost component” as investors “migrate toward investment services and products with these fee structures.”¹⁶¹

It would seem that, even as fund fees continue to trend downward, investors are not necessarily receiving the full benefit of lower fund expenses. This is reason for concern. At the same time, we recognize that many individual investors derive value from professional financial advice and the advisory services that financial intermediaries provide, particularly where those investors lack the time, expertise, or inclination to attempt investing on their own.

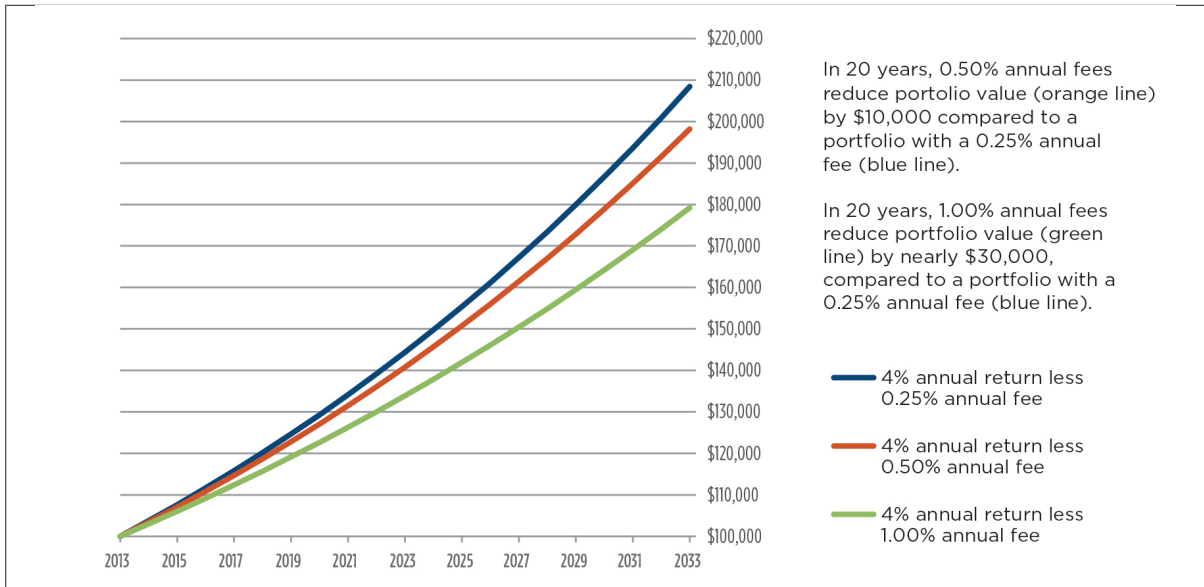
The Potential Impact of Fund Fees and Expenses on an Investment Portfolio

Not all investors are aware of how they bear the costs of running the funds in which they invest. For example, certain transactions in a fund, such as buying, selling, or exchanging mutual fund shares, involve costs commonly known as “shareholder fees.”¹⁶² In addition, a mutual fund has ongoing “operating costs” such as marketing and distribution expenses, investment advisory fees for managing the fund’s holdings, as well as custodial, transfer agency, legal, accounting, and other administrative expenses.¹⁶³ Although these fees and expenses may not be listed as specific line items on a mutual fund investor’s account statement, in reality, investors pay them indirectly because they are built into the calculation of the value of each fund share. Consequently, these fees and expenses can have a substantial impact on investment value over time.¹⁶⁴

While fees and expenses may vary depending on the nature of the fund and its investment strategy, generally, a fund with high costs must perform better than a low-cost fund to generate the same returns.¹⁶⁵ Even minor differences in fees from one fund to another can add up to substantial differences in investment returns over time.¹⁶⁶

The following graph illustrates this concept.¹⁶⁷ It shows a hypothetical investment portfolio with a 4 percent annual return over 20 years when the investment either has an ongoing fee of 0.25, 0.50 or 1 percent. Notice how the fees affect the investment portfolio over a 20-year period.

Portfolio Value From Investing \$100,000 Over 20 Years



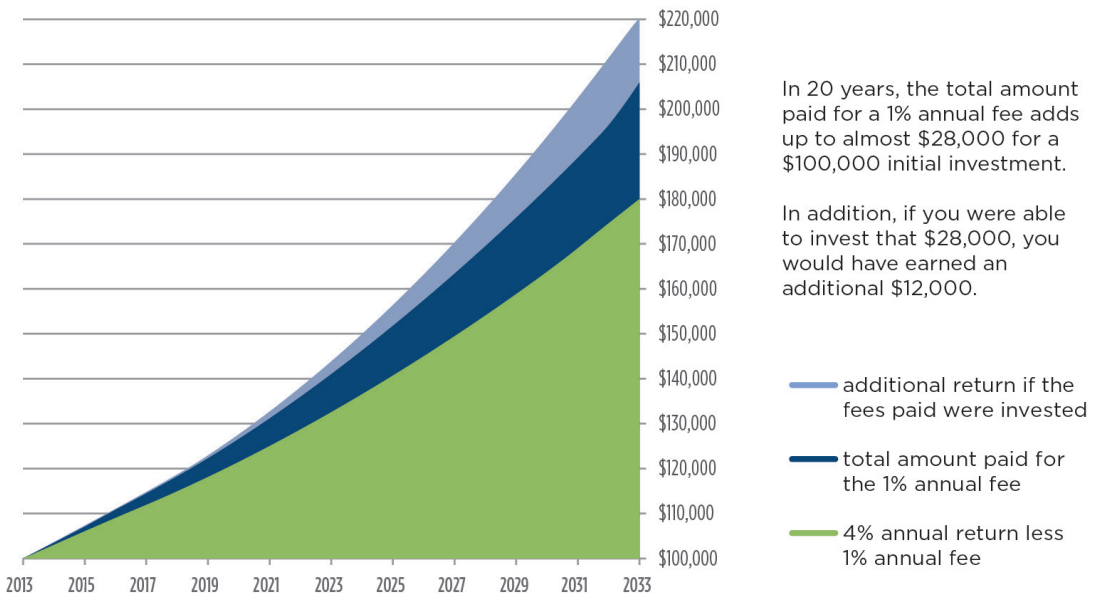
- The blue line represents the investment portfolio of a hypothetical mutual fund that does not charge shareholder fees, produces a 4 percent annual return over 20 years, and has annual operating expenses of 0.25 percent (*i.e.*, \$25 for every \$10,000 invested) during that period. If you invested \$100,000 in this fund, then after 20 years your investment portfolio would be worth approximately \$208,000.¹⁶⁸
- The orange line represents the investment portfolio of a hypothetical mutual fund that does not charge shareholder fees, produces a 4 percent return over 20 years, and has annual operating expenses of 0.50 percent (*i.e.*, \$50 for every \$10,000 invested) during that period. If you invested \$100,000 in this fund, then after 20 years your investment portfolio would be worth approximately \$198,000. The fees and expenses would have consumed about \$10,000 more of your investment portfolio over that time, compared to the hypothetical mutual fund with annual operating expenses of 0.25 percent.¹⁶⁹
- The green line represents the investment portfolio of a mutual fund that does not charge shareholder

fees, produces a 4 percent return over 20 years, and has annual operating expenses of 1.00 percent (*i.e.*, \$100 for every \$10,000 invested) during that period. If you invested \$100,000 in this fund, then after 20 years your investment portfolio would be worth approximately \$179,000. The fees and expenses would have consumed nearly \$30,000 more of your investment portfolio over that time, compared to the hypothetical mutual fund with annual operating expenses of 0.25 percent.¹⁷⁰

The more an investor pays in fees and expenses, the less money remains in the investment portfolio.¹⁷¹ Both shareholder fees and operating costs reduce the overall amount invested in a fund.¹⁷² Moreover, as the preceding chart illustrates, fund fees and expenses have a compounding effect over time and will erode the fund's investment returns.¹⁷³

Ongoing fees not only reduce the investment balance of the fund holding over time, but they also result in an indirect opportunity cost equal to what an investor *would have earned* had the investor not had to pay those fees.¹⁷⁴ The following graph illustrates the impact of a 1 percent ongoing cost

Illustration of Ongoing Fees Over 20 Years



on a hypothetical \$100,000 investment portfolio that grows 4 percent annually over a period of 20 years. The graph also shows the opportunity cost of the ongoing fee.¹⁷⁵

A mutual fund is required to disclose its shareholder fees and operating expenses in its prospectus using a standardized fee table.¹⁷⁶ The “Shareholder Fees” section of the standardized fee table lists some or all of the following items: sales loads; redemption fee; exchange fee; account fee; and purchase fee.¹⁷⁷ The “Annual Fund Operating Expenses” section of the standardized fee table lists some or all of the following items: management fees; distribution [and/or service] (12b-1) fees; other expenses; and total annual fund operating expenses.¹⁷⁸

Some mutual funds identify themselves as “no-load” funds.¹⁷⁹ However, this nomenclature can be confusing. Although a no-load fund does not charge a sales fee (commonly called a sales load), it may charge other kinds of expenses that are not designated as sales loads.¹⁸⁰ For example, a no-load fund is permitted to charge purchase fees, redemption fees, exchange fees, and account fees, none of which is considered a sales load.¹⁸¹

As the IAC noted in its recommendation on mutual fund cost disclosure, some of the labels for the sales charges disclosed in the fee table “are likely to be confusing to financially unsophisticated investors.”¹⁸² The IAC recommendation suggested that simplifying the disclosures could lead to better investor understanding—for example, definitions or brief descriptions of the fees and charges “should be provided when the label or heading itself does not clearly indicate or imply the purpose of the fees.”¹⁸³

Certain Fund-Related Financial Intermediary Fees

The Staff Guidance also addressed certain financial intermediary fees.¹⁸⁴ For example, a recent SEC sweep examination of several mutual fund complexes, investment advisers, broker-dealers, and transfer agents raised some issues with respect to certain mutual fund payments to financial intermediaries that provide shareholder and recordkeeping services for specific mutual fund shares or classes of shares held through omnibus and networked accounts.¹⁸⁵ These exams, which were a joint initiative among the SEC’s Office of Compliance Inspections and Examinations and various other Commission offices and divisions, studied, among other things, the payment of fees to

financial intermediaries characterized as non-distribution related sub-transfer agent, administrative, sub-accounting, and other shareholder servicing fees (collectively, “sub-accounting fees”). One of the concerns is that many investors do not understand fully the array of potential fees associated with their investment or retirement accounts, many of which hold funds.

We believe that individual investors should be aware—or should be made aware—of the different types and layers of intermediary fees associated with the management, operation, and custody of their investment or retirement accounts. These may include management fees, custodial fees, transaction fees, and commissions, among a whole spectrum of other potential expenses. In Fiscal Year 2017, we will explore ways to improve these disclosures.

Omnibus and Networked Accounts

The use of “omnibus” accounts by broker-dealers and other financial intermediaries has proliferated in recent years.¹⁸⁶ An omnibus account is a master account that aggregates the subaccounts of multiple investors.¹⁸⁷ There are different varieties of omnibus accounts. For example, a financial institution may establish an omnibus account to aggregate all individual investor accounts that have selected the same dividend reinvestment option;¹⁸⁸ another omnibus account may be established for a single retirement plan;¹⁸⁹ and yet another omnibus account may represent the subaccounts of a variety of investor account types, including individual investors, retirement plans, and other pooled accounts.¹⁹⁰

Generally, an omnibus account is opened on the records of the mutual fund in the name of the intermediary.¹⁹¹ The intermediary aggregates trade activity for the subaccounts in the omnibus account and usually sends a single trade (representing the net of all purchases and redemptions of the subaccounts) to the fund transfer agent each day.¹⁹² As

such, the fund complex typically does not possess any information identifying or otherwise connected to the beneficial owners of the subaccounts.¹⁹³

Given that a single omnibus account held by a fund’s transfer agent represents the share balance of multiple beneficial investors being serviced by an intermediary, an omnibus account may help reduce the administrative burdens of recordkeeping and other services that transfer agents traditionally provide to fund investors.¹⁹⁴ In this case, the financial intermediary may perform many of the usual transfer agent services for fund investors whose shares are held in an omnibus account, in addition to other services they may provide to shareholders.¹⁹⁵ It is not unusual for mutual funds or their service providers to enter into arrangements with financial intermediaries to compensate them for these services—sometimes known as “sub-accounting” arrangements.¹⁹⁶ Fee structures for the provision of these services may vary; some of these fees may be paid out of mutual fund assets (*e.g.*, pursuant to a 12b-1 plan or through non-12b-1 shareholder service fees), or by a fund’s investment adviser, by a fund’s distributor or transfer agent or other service provider, or by any combination of these.¹⁹⁷

By contrast, an individual “networked” account, which is a common type of individual account, is an account that is opened and controlled by the broker-dealer exclusively (*i.e.*, the broker-dealer generally provides all shareholder services).¹⁹⁸ An individual networked account typically is registered on the fund transfer agent’s books in the broker-dealer firm’s name FBO—“for the benefit of”—the individual broker-dealer customer.¹⁹⁹ As a result, in addition to commissions, a broker-dealer may charge a slew of other fees, for example, for account maintenance, account transfer, failure to maintain a minimum account balance, wire transfer, and other fees.²⁰⁰ These fees may not be obvious to individual investors.

Shareholder Servicing Arrangements

A financial intermediary may receive compensation for providing shareholder services such as processing purchase, redemption, or exchange orders; managing account maintenance tasks; responding to investor inquiries; furnishing investor statements and tax reporting; and delivering the required mailings.²⁰¹ These so-called “alternative shareholder servicing arrangements” may include networking agreements with broker-dealers, sub-transfer agent agreements with financial institutions and record-keepers, and third-party mutual fund supermarket arrangements.²⁰² In certain contexts such as retirement plans, these arrangements involve services that may benefit investors indirectly, but the retirement beneficiary may be unaware of the services rendered or even the reason they may be required. For example, retirement plan recordkeepers usually provide the participant level accounting of activity and positions, as well as conduct the account processing, maintenance, and servicing activities. To the extent a financial intermediary assumes responsibility for shareholder servicing activities with respect to retirement plans, the financial intermediary may be compensated in the form of a sub-transfer agent fee, networking fees paid to broker-dealers, 12b-1 fees, or as other types of fees under a separate agreement with the fund and/or its affiliates.²⁰³ It is unlikely that many individual investors are aware of these multiple layers of fees.

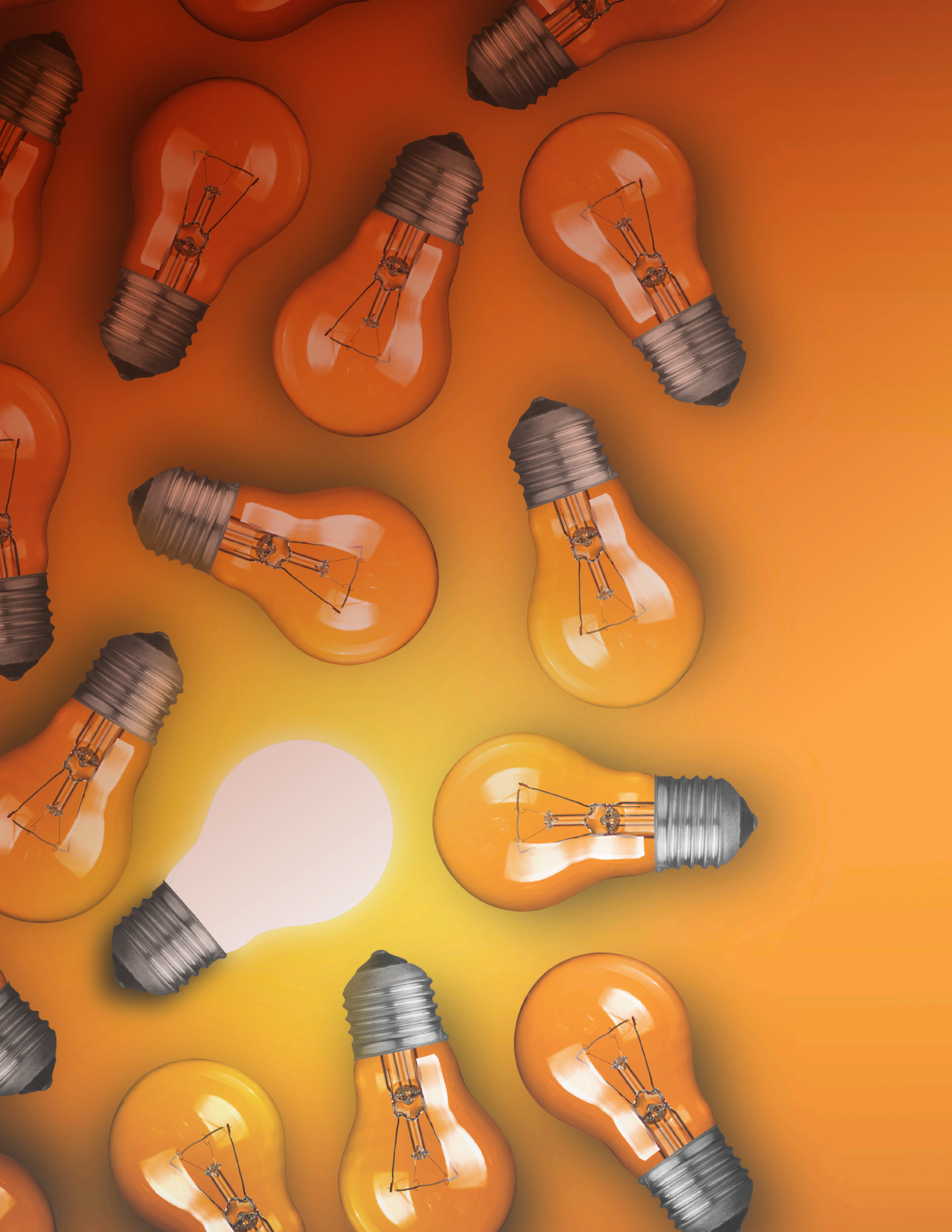
Under some circumstances, the fund distributor may pay the financial intermediary an upfront fee known as a “finder’s fee.”²⁰⁴ This may occur when all sales charges are waived for a very large order because the dollar value meets or exceeds the fund’s highest threshold amount for reducing sales charges.²⁰⁵ In such a case, where the shareholder pays no sales charge due to the large size of the order, the finder’s

fee is paid to compensate the financial intermediary for generating the large value trade.²⁰⁶

Financial intermediaries may be compensated in other ways as well. For example, some fund distributors may have incentive programs for certain of their distribution partners to compensate them for providing education to registered representatives and additional marketing to potential investors—a practice known as “revenue sharing.”²⁰⁷ Other compensation may take the form of “shelf space” or “access” fees that encourage sellers to carry the fund product as part of their product offerings to potential customers by offering these incentive fees.²⁰⁸

Moreover, for load as opposed to no-load funds, investors may pay sales charges in the form of a one-time fee at the time of purchase—known as a “front-end load”—to financial intermediaries, typically broker-dealers, as part of the purchase of fund shares.²⁰⁹ Alternatively, investors in load funds may pay sales charges in installments through 12b-1 fees (sometimes called a “contingent deferred sales charge”) that decline over time and disappear after several years.²¹⁰

Generally, it is the intermediary who determines which account structure to use to support its mutual fund-related business. Some investment advisers and broker-dealers tend to use individual networked accounts, while omnibus accounts are used by all types of intermediaries.²¹¹ Most fund complexes work with a variety of intermediaries and should be prepared to support the different types of account structures favored by their specific intermediary partners.²¹² Regardless of the type of account structure employed, we believe that financial intermediaries should disclose to the funds—and to investors—precisely how they are compensated.



OMBUDSMAN'S REPORT

ESTABLISHING A FOUNDATION FOR MEANINGFUL SERVICE

Under Section 919D of the Dodd-Frank Act, as codified in Exchange Act Section 4(g)(8), 15 U.S.C. § 78d(g)(8), the Ombudsman shall: (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.²¹³

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” (the “Ombudsman’s Report”).²¹⁴ The Ombudsman’s Report must be included in the semi-annual reports submitted by the Investor Advocate to Congress. To maintain reporting continuity going forward, the Ombudsman’s Report included in the Investor Advocate’s June 30 Report on Objectives will provide a look back on the Ombudsman’s activities during the first half of the fiscal year and discuss the objectives of the Ombudsman for the following 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 preced-

ing fiscal year. Accordingly, this report describes the Ombudsman’s activities from October 1, 2015 through March 31, 2016 (the “Reporting Period”) and provides a discussion of the Ombudsman’s primary objectives and outlook for Fiscal Year 2017, beginning October 1, 2016.



During the Reporting Period, the Ombudsman²¹⁵ continued to build the foundational infrastructure and procedures necessary to support the ombudsman function by:

- Establishing and piloting policies and procedures for staff review of and response to investor correspondence;
- Updating existing Ombudsman policies and procedures to reflect changes implemented to maximize efficient service to those seeking staff assistance, maintain and safeguard records, and minimize foreseeable challenges related to staffing limitations and reporting obligations;
- Refining issue tracking categories and recordkeeping to enhance the analysis, handling, and reporting of retail investor concerns and to formulate the basis for tailored recommendations to effectively address retail investor concerns;

- Working directly with the SEC's Office of Information Technology and a technology contractor to create an integrated electronic platform for inquiry management, data collection, reporting, and recordkeeping available only to the Ombudsman and authorized staff;
- Establishing and testing dedicated pathways for the exchange of electronic correspondence through the Ombudsman's electronic platform currently under development; and,
- Identifying specialized training opportunities for staff members to enhance their dispute resolution knowledge and expertise.

OUTREACH AND ENGAGEMENT

The Ombudsman is required to review and make recommendations regarding policies and procedures to encourage persons to present questions to the Investor Advocate regarding compliance with the securities laws. To achieve this objective, the Ombudsman must be known, approachable, and accessible to all stakeholders, including retail investors, financial services industry participants, and SEC staff at all levels. In this context, sharing information about the role within and outside the SEC is central to the Ombudsman's effectiveness.

During the Reporting Period, the Ombudsman continued to seek out opportunities to increase awareness and elevate the visibility of the position through participation in various events within the dispute resolution and securities industries, as well as leadership events targeting a broader group of business leaders and professionals. The Ombudsman also personally met with SEC division and office directors and senior staff to facilitate ongoing working relationships and enhance the Ombudsman's effectiveness as a liaison for investors raising questions or concerns about the SEC and the SROs the agency oversees.

While the day-to-day focus remained primarily on foundational policies, procedures, and systems required to meet the needs of investors and others seeking assistance, the Ombudsman identified strategies to continue and strengthen relationships with SROs, investors, and other interested persons and stakeholders. In Fiscal Year 2017, as we shift from manual recordkeeping systems to an electronic platform, the Ombudsman plans to restructure staff resources and responsibilities to accommodate additional outreach efforts, including regular in-person meetings with key SEC staff, investor-focused speaking engagements, and continued participation in securities and dispute resolution industry conferences and events.

Law School Clinic Outreach Program

In recent semesters, the Office of the Investor Advocate benefited from SEC law student externs assigned to the office who participated in investor protection, securities law, and arbitration clinics at their respective law schools. Working directly with the Investor Advocate, the Ombudsman and an Office of the Investor Advocate senior counsel began developing a framework for an outreach program to inform law schools with investor protection, securities law, and arbitration clinics of the work of the office. We plan to work directly with clinic professors and students to engage investors and offer information on policies and dispute resolution issues directly impacting investors, offer law school clinics and law student participants the opportunity to hear directly from and work with Office of the Investor Advocate staff through guest lectures, workshops, and seminars, and create an additional path for investors and law students to provide the Investor Advocate and Ombudsman with direct feedback and formal comments on Commission rulemakings and policy.

OMBUDSMAN STANDARDS OF PRACTICE

Any retail investor with an issue or concern related to the SEC or an SRO subject to SEC oversight may contact the Ombudsman. The Ombudsman is available to identify existing SEC options and resources to address issues or concerns, and to explore informal, objective steps to address issues 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

The Ombudsman has established safeguards to protect confidentiality, including a separate email address, dedicated telephone and fax lines, and secure file storage. The Ombudsman will not disclose information provided by a person in confidence, including identity, unless expressly authorized by the person to do so, or if required by law or other exigent circumstances, such as a threat of imminent risk or serious harm. At times, the Ombudsman may need to disclose information on a limited basis to other SEC staff to address inquiries and related issues. In these instances, information is only shared to the extent necessary to route and review the matter.

Impartiality

The Ombudsman does not represent or act as an advocate for any individual or entity, and does not take sides on any issues brought to her attention. The Ombudsman maintains a neutral position, considers the interests and concerns of all involved parties, and works to promote a fair process.

Independence

By statute, the Ombudsman reports directly to the Investor Advocate, who reports directly to the Chair of the SEC. However, the Office of the Investor Advocate and the Ombudsman are designed to remain somewhat independent from the rest of the SEC. Through the congressional reports filed every

six months by the Investor Advocate, the Ombudsman reports directly to Congress without any prior review or comment by the Commission or other Commission staff.

OMBUDSMAN MATTER MANAGEMENT SYSTEM

The Ombudsman maintains records of inquiries and concerns to: (i) identify and respond to problems retail investors have with the Commission or with SROs; (ii) track and analyze matter volume, responses, and resolution times; (iii) categorize and report corresponding trends and concerns; and (iv) provide data-driven support for recommendations presented by the Ombudsman to the Investor Advocate for review and consideration. During the Reporting Period, the Ombudsman continued to use several independent recordkeeping systems to collect, document, track, and respond to all forms of correspondence received from retail investors and other persons, and to ascertain issue trends and determine areas of interest or concern to investors. In the absence of an integrated matter management system, documenting and responding to a single inquiry requires the staff to enter, update, and search for related data in multiple systems. These separate systems also require independent procedures for maintaining the confidentiality of different types of information.

The Ombudsman is placing a high priority on transitioning to a fully functional, customized, electronic matter management platform in the coming fiscal year. Throughout this Reporting Period, the Ombudsman worked extensively with the SEC's Office of Information Technology and a technology contractor to establish data parameters, testing environments, and functionality requirements for the Ombudsman Matter Management System ("OMMS"), a platform for collecting, recording, and tracking matters received by the Ombudsman—including inquiries, complaints, requests, and recommendations—while ensuring necessary data management, confidentiality, and reporting require-

ments are met. The Ombudsman anticipates that OMMS will: (i) provide an efficient, user-friendly method for retail investors to submit detailed information to the Ombudsman; (ii) automate a significant portion of the existing manual intake process; (iii) reduce staff resources required to track and monitor matters and responses; (iv) increase staff resources available to interact with investors, research issues, and resolve concerns; and (v) supplement the existing safeguards used to maintain the confidentiality of communications with the Ombudsman.

When launched, OMMS will incorporate a secure communication system permitting the submission of electronic inquiries and complaints directly to the Ombudsman through the www.sec.gov/ombudsman web page. OMMS will employ a web-based form (“OMMS Form”) to guide the user through a series of questions specifically tailored to elicit information concerning matters within the scope of the Ombudsman’s function. During the Reporting Period, the technology contractor created an OMMS testing environment where the Ombudsman and Office of Information Technology staff refined the OMMS Form and functionality, and engaged in an extensive and ongoing assessment and feedback process.

The OMMS Form will encourage more retail investors and the public to contact the Ombudsman, as web-based forms are an efficient, commonly used method for submitting inquiries and complaints. Persons who choose to contact the Ombudsman via the OMMS Form will encounter user-friendly features such as radio buttons, drop-down menu responses, pop-up explanation bubbles, web page 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 informa-

tion as necessary. In addition, the OMMS Form will solicit detailed contact information to enhance efficient communication with users and will allow users to electronically upload and submit related documents for staff review.

The Ombudsman and approved staff will have the ability to review investor inquiries and complaints, including communication, handling, and resolution histories, within OMMS. OMMS will provide appropriate staff with the ability to input and access all correspondence and related supplemental documents relevant to a particular individual or entity through an automated, unified system indexed for comprehensive research and analysis. Over time, OMMS should enhance operational efficiency on multiple levels.

OMBUDSMAN SERVICE BY THE NUMBERS

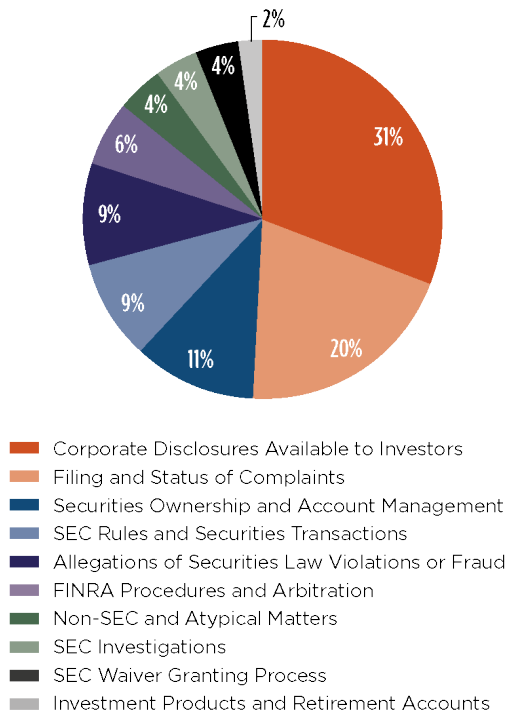
The Ombudsman assists retail investors and other individuals in a variety of ways, including, but not limited to:

- Helping persons explore available SEC options and resources;
- Listening to inquiries, concerns, complaints, and related issues;
- 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.

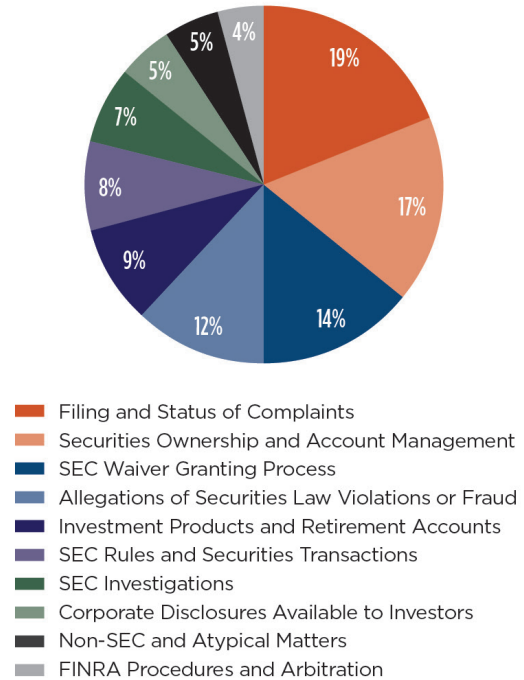
During the six-month Reporting Period, the Ombudsman fielded 509 separate contacts where

an individual contacted the Ombudsman for assistance related to a particular issue or concern. These contacts came from retail investors, industry professionals, attorneys, students, SEC staff, and other individuals. Of these 509 contacts, 71 were related to matters carried over from Fiscal Year 2015.

The Ombudsman conducts an assessment of every contact to examine the unique facts, circumstances, and concerns raised, and to make a determination of any further research and staff involvement that may be required. Unless circumstances required otherwise, the Ombudsman completed an assessment of each contact generally within five business days of receipt. During the Reporting Period, most assessments were completed less than two business days after receipt. Once the assessments were complete, the majority of these contacts required additional research and resources—including correspondence between the Ombudsman, SEC staff, SRO staff, and investors and individuals—to address the questions or concerns raised. The 509 contacts fell into 10 primary categories:



To highlight inquiry trends and evaluate recommendations, the Ombudsman also tracks contacts by matter. The 509 contacts represented 111 discrete matters. The 111 matters fell into 10 primary categories:



Within the 10 matter categories, the Ombudsman identified certain recurring themes:

- Five individuals reported conflicts between elderly investors and brokers who allegedly took advantage of their client’s physical, mental, or financial vulnerability;
- Five investors raised concerns about recovering losses in the context of Fair Funds, claim funds, or other circumstances involving court-appointed receivers;
- Seven individuals complained about inadequate investor protections in bankruptcy proceedings and/or the role of the SEC in corporate bankruptcy restructuring; and
- Twelve investors criticized the manner in which the SEC staff responded, or failed to respond, to a tip, complaint, request for investigation, inquiry, or other communication from the investor.

The Ombudsman's web presence also expanded during the Reporting Period, as the Ombudsman's external web page, accessible through the Commission's public website at www.sec.gov/ombudsman, became publicly available days before the beginning of the Reporting Period. The web page offers straightforward explanations about the Ombudsman's role and the assistance the Ombudsman provides, and describes how individuals may contact the Ombudsman and raise concerns for the Investor Advocate's consideration. The web page was viewed 595 times during this Reporting Period, with an average time spent on each view of 2 minutes and 30 seconds. A December 23, 2015 post on social media by SEC News regarding the Ombudsman²¹⁶ received 7,096 views as of the end of the Reporting Period. The Ombudsman is working with SEC staff to track these analytics on a continuing basis and to use the data to refine the web-based information offered to investors and the interested public. In anticipation of the OMMS launch, the Ombudsman also is soliciting feedback from other ombudsmen colleagues and is working with SEC staff to explore the viability of various social media platforms as additional avenues for investor outreach efforts.

OMBUDSMAN SERVICE BEHIND THE NUMBERS

While the numbers and statistics provide some insight on the Ombudsman's activity during the reporting period, they present only a partial understanding of the Ombudsman's operations and impact. The following sections provide additional context around the assistance and service the Ombudsman provides, the complexity of these matters, and the individualized strategies the Ombudsman crafts to address each situation.

Managing Expectations and Restoring Confidence

Investors frequently contact the Ombudsman when they are unable to resolve a specific investment-related problem or financial market concern in the

way they expected. The Ombudsman works with investors to clarify aspects of the resolution process, the federal securities laws, and the role of the SEC to help investors understand the reasons behind certain agency decisions and practices.

During this reporting period, the Ombudsman addressed several compelling inquiries involving elderly investors. In one instance, an elderly investor's brokerage account transaction was mistakenly identified as a suspicious activity and flagged as an identity fraud risk. When she attempted to resolve the issue directly, the firm subjected her to arduous security questions and ultimately rejected the transaction and blocked her access to her account. By the time the investor contacted the Ombudsman she was particularly distraught, as she was dependent upon the account funds to meet all of her living expenses. Within one day of her complaint, the Ombudsman responded by phone and explained the process through which the SEC contacted the brokerage firm and liaised with staff in other SEC offices to expedite a resolution of her complaint. The investor subsequently sent the Ombudsman a letter indicating she obtained access to her funds and expressing gratitude for helping restore her confidence in the SEC to protect individual investors.

In another matter, a concerned individual sought the Ombudsman's help to understand the outcome of an enforcement action in which the SEC issued a disgorgement penalty against an investment adviser. His elderly mother-in-law lost her entire life's savings due to the unscrupulous practices of her investment adviser, and he was waiting for disgorgement funds to be returned to her and the other harmed investors. From his perspective, the money the adviser paid to satisfy the SEC disgorgement penalty was money that rightfully belonged to his mother-in-law and the other harmed investors. Consequently, he argued that the SEC was perpetuating and exacerbating the harm by failing to return the disgorgement to investors via a Fair Fund. The Ombudsman proceeded carefully and respectfully and provided information backed

by research to explain how restitution and disgorgement differ, how Fair Funds are established, and how provisions for Fair Fund and disgorgement payments are determined. By listening to and thoughtfully considering his concerns, the Ombudsman helped him understand that the SEC represents the broad public interest by penalizing misconduct and cannot represent the interests of private parties, how the SEC works to protect investors through enforcement actions, and how those penalties are carefully determined.

The Ombudsman also received complaints about disappointing interactions with SEC staff. For example, an SEC job applicant contacted the Ombudsman to share a “horrible customer service experience” during the SEC job application process. She felt that the staff person she spoke with handled her call unprofessionally and inadequately, and, more importantly, that the incident reflected poorly on the SEC overall. The Ombudsman called her personally, sought clarification of her concerns about the application process, and followed up to confirm that the applicant was able to get her questions about her application process answered. In the end, the applicant shared that her subsequent interactions with the SEC and, in particular, the Ombudsman, changed her view about the SEC and the consideration given to her complaint.

This final example is provided to give a full picture of the challenges the Ombudsman encounters in responding to investors. A foreign investor copied the Ombudsman on email correspondence relating to his ongoing dispute with his brokerage firm concerning, among numerous complaints, his lack of access to hard copies of his account documents. Further frustrating his efforts were his location abroad and a seemingly slight, but very significant, language barrier. After exchanging emails explaining the role of the Ombudsman and identifying appropriate alternative SEC and FINRA dispute resolution procedures, the Ombudsman reached out to him by telephone. The conversation revealed that, although the investor had exhausted the SEC complaint process, he had

not explored any FINRA complaint options. The Ombudsman provided him with the appropriate FINRA contact information and followed the call with a summary email containing additional links to FINRA online resources available in his native language. The investor expressed his great appreciation for the phone call and the additional information, and seemed relieved that the Ombudsman spent time to help him identify resources to resolve his dispute. Acting as a liaison and leveraging the ability to address investor concerns informally, the Ombudsman demonstrated the SEC’s genuine commitment to the protection of individual investors in a meaningful way.

FINRA Dispute Resolution Reform

As discussed in the Report on Activities for Fiscal Year 2015 and the Report on Objectives for Fiscal Year 2016, several investors raised concerns to the Ombudsman about the FINRA arbitration process. The Ombudsman is empowered to act as a liaison between the Commission and any retail investor in resolving problems that retail investors may have with the Commission or with a self-regulatory organization such as FINRA.²¹⁷ Consistent with this responsibility, the Ombudsman met with SEC and FINRA staff working on FINRA arbitration and dispute resolution issues. Likewise, the Ombudsman continued the regular practice of monitoring policy, news, articles, and other activity centered on FINRA and its dispute resolution forum with a specific focus on how FINRA’s activities impact the issues and complaints raised to the Ombudsman by retail investors.

In July 2014, FINRA formed the FINRA Dispute Resolution Task Force (“Task Force”) to consider the future of FINRA’s dispute resolution forum, and to provide recommendations to FINRA’s National Arbitration and Mediation Committee (“NAMC”) to improve the forum.²¹⁸ Of interest to the Ombudsman during the Reporting Period was the final report the Task Force issued in December 2015 (“Final Report”)²¹⁹ which included 51 recommendations covering 11 thematic areas.²²⁰

The Final Report noted that although the Task Force established an email box to receive comments from the public, most of the 188 comments received came from arbitrators.²²¹ The Final Report also noted that the Task Force solicited written comments from 33 interested organizations and individuals.²²² However, in light of the lack of input from retail investors to the Task Force, coupled with the complaints about the arbitration process received by the Ombudsman from retail investors, the Ombudsman is taking a closer look at the Task Force's recommendations in two particular areas: explained awards and expungement.

Explained Awards

Explained awards—sometimes referred to as “explained decisions” or “reasoned awards”—are fact-based awards that state the general reasons for the arbitrators’ decision.²²³ Currently, explained awards are only required to be written by arbitrators upon the joint request by both parties before the first arbitration hearing.²²⁴ Arbitrators are not required to include legal authorities or damage calculations in explained awards.²²⁵

The absence of explanations in awards has been a long-standing, common complaint of non-prevailing parties in FINRA’s dispute resolution forum.²²⁶ Why do explained decisions matter to retail investors? Over the years, a wide range of commenters including industry experts, securities law practitioners, and legal scholars have noted that the inclusion of explained awards would likely increase investors’ perceptions of the fairness of the arbitration process.²²⁷ Commenters further noted that many investors want explained decisions, and the arbitrators’ decision-making process will appear more transparent and will encourage higher-quality awards for those who request and receive explained decisions.²²⁸ The Task Force agreed with this analysis, stating that expanding the use of explained decisions is one of the most important steps that FINRA can take to improve the transparency of its arbitration system, and that greater confidence in the fairness of FINRA’s arbitration system would likely

flow from that increase in transparency.²²⁹ This conclusion is consistent with the questions and feedback the Ombudsman receives from investors.

In the Final Report, the Task Force made three related recommendations to the NAMC: (1) the FINRA rule²³⁰ should be amended to require an explained decision unless a party to the arbitration notifies FINRA prior to the first hearing that it does not want an explained decision; (2) the existing fact-based format of the explanation should be retained, but the decision should include a summary explanation of the damages calculation; and (3) before expanding explained decisions, FINRA should develop and administer a training program on how to write them and should require arbitration panel chairpersons to complete the training promptly after receiving notice that an explained decision is expected in an assigned case.²³¹

The Task Force stated that “creating the presumption of an explained decision is a modest change that may or may not result in any appreciable increase in explained decisions.”²³² The Ombudsman agrees with the Task Force’s observation about the potential efficacy of its explained awards recommendations, and is further concerned that retail investors’ perceptions of unfairness in the arbitration process will persist, even with an increase in the number of explained awards.²³³ Nonetheless, the Ombudsman supports the Task Force’s recommendations and encourages FINRA’s efforts to proceed thoughtfully as changes to explained awards are considered and implemented.

Expungement

The Central Registration Depository (“CRD”) is an online registration and licensing system used by regulators, FINRA, and members of the securities industry. Investors cannot access CRD, but much of the information in CRD is available to the public through BrokerCheck, a free research tool available on FINRA’s website.²³⁴ Through BrokerCheck, investors can learn about brokers’ employment histories, certifications, licenses, regulatory actions, violations, and complaints,

as well as information about their brokerage firms.²³⁵ Regulators also rely on data in CRD for licensing and enforcement activities.

When a broker is named as a respondent in a customer-initiated arbitration proceeding, that fact is required to be reported and is subsequently added to the broker's CRD record. If the arbitration claim against the broker is denied by the arbitrators, the broker may seek to have any reference to the arbitration claim removed—or “expunged”—from his or her CRD record. As a result, if arbitrators award expungement, the customer's complaint may be permanently removed from the broker's CRD record and Broker-Check.²³⁶

To award expungement, brokers and brokerage firms (“respondents”) must follow FINRA Rule 2080. Under this rule, respondents must obtain a court order to expunge information from CRD arising from disputes with customers.²³⁷ To do this, respondents have two choices: they may seek expungement directly from a court, or they may seek to have the arbitrators award expungement and then request a court to confirm the award.

When filing with the court, FINRA must be named as a party unless FINRA waives this requirement on its finding that: (i) the claim is factually impossible or clearly erroneous; (ii) the broker was not involved in alleged sales violations, forgery, theft, misappropriation of funds, or conversion of funds; or (iii) the claim is false.²³⁸ For arbitrators to award expungement, the arbitrators must state which of these three grounds for expungement is met and provide a brief, written explanation of the reason why the grounds are satisfied when applied to the facts in the case.²³⁹

FINRA considers the expungement of customer dispute information from CRD to be an “extraordinary remedy” that should be recommended only under appropriate circumstances.²⁴⁰ Despite the narrow standard of Rule 2080 and expungement training provided to arbitrators, multiple studies have shown that

arbitrators routinely grant requests for expungement in settled and stipulated matters.²⁴¹ Thus, as a practical matter, when a matter is settled, the complaining party has little or no incentive to contest an expungement. This brings into question whether expungement really is an extraordinary remedy recommended only under appropriate circumstances.

Accurate and complete reporting in CRD is an important aspect of investor protection. When information is expunged from the CRD system, it is permanently deleted and is no longer available to the investing public, regulators, or prospective broker-dealer employers. In a recent notice, FINRA stated that “arbitrators have a unique, distinct role in ensuring that customer dispute information is expunged from the CRD system only when it has no meaningful investor protection or regulatory value.”²⁴² In March 2016, FINRA announced that it will file a rule to address the practice of brokers continually being granted expungement of their disciplinary histories from industry databases, expand upon existing guidance on expungement as an extraordinary remedy, and offer guidance on how arbitrators should weigh expungement requests.²⁴³

With the perspective that the expungement process could be improved, the Task Force raised issues and offered recommendations in its Final Report that largely correlated with comments provided by the North American Securities Administrators Association (“NASAA”)²⁴⁴ to the Task Force,²⁴⁵ including the following:

- The Task Force discussed whether a FINRA representative should participate in expungement hearings to represent the public interest.²⁴⁶
- The Task Force recommended that FINRA create a pool of specially trained arbitrators from the chairperson roster to conduct expungement hearings in settled cases and in all cases where claimants did not name the broker as a respondent.²⁴⁷

- The Task Force recommended that the panel that conducts the arbitration also conducts the expungement hearing in cases decided on the merits, provided the chairperson attends special expungement training.²⁴⁸
- The Task Force also recommended that FINRA review procedures for notifying state regulators of expungement requests,²⁴⁹ but took no position on NASAA's recommendation for a regulatory approach to expungement.
- The Task Force recommended that FINRA review its expungement training with a consultant, and that FINRA review the second Rule 2080 ground for expungement (the broker was not involved in the “alleged investment-related sales practice violation, forgery, theft, misappropriation or conversion of funds”).²⁵⁰
- The Task Force also recommended requiring greater expungement training for arbitrators, with additional training required to qualify for the special arbitration panel.²⁵¹

As the discussion above shows, the small number of FINRA arbitration complaints received by the Ombudsman during the Reporting Period was not indicative of the scope and significance of the issues presented in those complaints. The Ombudsman and staff have reviewed voluminous studies, reports, arbitration procedures, policy discussions, and commentaries relating to the investor experience in securities arbitration matters, and have spoken at length with various complainants on numerous occasions. As with explained decisions, the Ombudsman is interested in and open to hearing the perspectives of retail investors on issues relating to expungement. The Ombudsman will continue to solicit additional information and feedback from retail investors and will work with SEC staff to ensure that the views, interests, and experiences of retail investors—as important stakeholders in the arbitration process and in the outcome of

arbitration decisions—are considered as changes to the arbitration process are implemented.

OUTLOOK

During the Reporting Period, and since September 2014 when the Ombudsman began her duties, a particular refrain has been common to the majority of the inquiries and complaints received. Investors are frustrated, concerned, and disappointed that their voices are not heard or considered by brokerage or investment advisory firms, corporations, regulators, or the financial industry in general. Hearing this feedback from investors on a consistent basis, the Ombudsman realizes that investors are disenchanted with the regulatory process and disconnected from their role as important market participants. To address this issue, in Fiscal Year 2017, the Ombudsman will examine the various ways the SEC communicates with the investing public to identify areas for improvement in both practice and perception.

To focus our efforts and staff resources properly, the Ombudsman will continue to track inquiry categories, identify trends, and conduct research and analysis. With the implementation of OMMS in Fiscal Year 2017, the Ombudsman anticipates that the expanded data analysis capability will help identify additional areas of interest to investors and permit more targeted research and analysis. The Ombudsman will also continue to review and analyze the FINRA arbitration process, focusing on expungement and explained awards and reviewing any other areas raised by investors as important to the process. Finally, the Ombudsman looks to Fiscal Year 2017 as an opportunity to establish more extensive channels of communication with retail investors and to create an ongoing forum for their concerns to be heard and considered as a vital part of the work of the office.



Tracey L. McNeil
Ombudsman

SUMMARY OF IAC RECOMMENDATIONS AND SEC RESPONSES

Congress established the Investor Advisory Committee (“IAC”) 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.²⁵² 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.²⁵³

Exchange Act Section 39 authorizes the Committee to submit findings and recommendations for review and consideration by the Commission.²⁵⁴ 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.²⁵⁵ While the Commission must respond to the IAC’s recommendations, it is under no obligation to agree with or act upon the recommendations.²⁵⁶

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.²⁵⁷ This report covers all recom-

mendations the IAC has made since its inception.²⁵⁸ However, 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.²⁵⁹ Therefore, any such initiatives are not reflected in this Report.

MUTUAL FUND COST DISCLOSURE

This recommendation,²⁶⁰ adopted on April 14, 2016, consists of three parts:

- The Commission should explore ways to improve mutual fund cost disclosures, with the goal of enhancing investors’ understanding of actual costs and the impact of those costs on total accumulations over time.
- In the short term, the Commission should standardize disclosure of actual dollar amount costs on customer account statements.
- Over the longer term, the Commission should explore ways to provide context for cost information to improve investor understanding of the impact of those costs.

The Commission has not yet responded to this recommendation.

EMPOWERING ELDERS AND OTHER INVESTORS: BACKGROUND CHECKS IN THE FINANCIAL MARKETS

This recommendation,²⁶¹ adopted on July 16, 2015, asks the SEC to:

- Develop a disciplinary database for violations of the securities laws that will allow elders and other investors to conduct easy searches of any person or firm sanctioned for these violations;
- Begin to reduce the complexity of background searches by taking steps to simplify the search process, including steps to ensure comparable quality between BrokerCheck and the Investor Advisor Public Disclosure (“IAPD”) system and the development of an appropriately named site that will permit a single search through which elders and other investors can access information in all databases supervised by the SEC in whole or in part; and
- Seek to obtain the agreement from other federal regulators, self-regulatory organizations, and state regulators for the development of a single site that will permit a search of all relevant databases that provide background information on financial market professionals.

The Commission’s response to this recommendation is pending.

SHORTENING THE TRADE SETTLEMENT CYCLE IN U.S. FINANCIAL MARKETS

This recommendation,²⁶² adopted on February 12, 2015, calls for shortening the security settlement period in the U.S. financial markets from a three-day settlement cycle (“T+3”) to a one-day settlement cycle (“T+1”) for “at least” transactions in U.S. equities, corporate and municipal bonds, and unit investment trusts. The IAC acknowledged a proposal of the Depository Trust & Clearing Corporation (“DTCC”) to shorten the settlement cycle to a two-day period (“T+2”), but favored a move to

T+1 in the near term. To the extent that T+2 was nevertheless pursued, the IAC recommended that the Commission work with industry participants to create a clear plan for moving to T+1 in an expedited fashion rather than pausing at T+2 for an indeterminate period of time.

COMMISSION RESPONSE. The Chair and both current Commissioners have expressed support for shortening the settlement cycle. Since the IAC recommendation, developments have focused on moving to T+2, not T+1.

On June 29, 2015, Commissioners Piwowar and Stein issued a joint statement expressing their support for shortening the settlement cycle as soon as possible. Their statement referred specifically to the IAC recommendation.²⁶³

On September 16, 2015, Chair White expressed her strong support for efforts to shorten the settlement cycle from T+3 to T+2. In a letter to two industry leaders, she focused on the industry goal of moving to T+2 by the third quarter of 2017, while also mentioning a move from T+2 “to shorter settlement cycles potentially in the future.”²⁶⁴

The Chair noted that the most significant regulatory changes needed to move to T+2 would be amendments to the various rules of the SROs that either mandate or relate to a three-day settlement cycle. She stated that she had directed Commission staff to work closely with the SROs and, in addition, to develop a Commission proposal to amend Exchange Act Rule 15c6-1(a) to require settlement no later than T+2.

In March 2016, two SROs took steps to amend their rules to facilitate settlement in two days. The Municipal Securities Rulemaking Board (“MSRB”) filed with the Commission a proposal to amend two rules to define regular-way settlement for municipal securities transactions as occurring on a two-day settlement cycle (*i.e.*, T+2) rather than the current

three-day cycle.²⁶⁵ As part of its procedures, the Commission held a public comment period ending April 8, 2016, on the MSRB proposal.²⁶⁶

FINRA, meanwhile, proposed rule changes that would amend the definition of “regular way” settlement as occurring on T+2. FINRA held a comment period that ended April 4, 2016. The proposals would apply to U.S. secondary market transactions in equities, corporate and municipal bonds, unit investment trusts, and financial instruments composed of these products.²⁶⁷

IMPARTIALITY IN THE DISCLOSURE OF PRELIMINARY VOTING RESULTS

Exchange Act Rule 14a-2(a)(1) provides an exemption from the proxy rules for brokers that forward proxy materials to shareholders who own shares in “street name.”²⁶⁸ On October 9, 2014, the IAC adopted a recommendation that the staff of the Commission take the steps necessary to ensure that the exemption is conditioned upon the broker (and any intermediary designated by the broker) acting in an impartial and ministerial fashion throughout the proxy process, and that any broker who uses an intermediary take reasonable steps to verify that the intermediary is not subject to impermissible conflicts of interest.²⁶⁹ In adopting these recommendations, the IAC noted several concerns about current industry practices, including the disclosure of preliminary voting results to issuers while the results are withheld from exempt solicitors, as well as possible conflicts of interest between the issuer and the broker’s designated intermediary.

COMMISSION RESPONSE. The Commission response to this recommendation is pending.

THE ACCREDITED INVESTOR DEFINITION

On October 9, 2014, the IAC adopted a set of recommendations related to the Commission’s review of the accredited investor definition as required by the Dodd-Frank Act.²⁷⁰

- The Commission should seek to determine whether the current definition achieves the goal of identifying a class of individuals who do not need the protections afforded by the Securities Act of 1933 because they are sufficiently able to protect their own interests. If, as the IAC expected, the analysis were to reveal a failure to meet that goal, then the Committee recommended prompt rulemaking to revise the definition.
- The Commission should revise the definition to enable individuals to qualify as accredited investors based on their financial sophistication.
- However, if the Commission chooses to continue relying on financial thresholds, it should consider limiting investments in private offerings to a percentage of assets or income.
- The Commission should encourage development of an alternative means of verifying accredited investor status that shifts the burden away from issuers.
- In addition to any changes to the accredited investor standard, the Commission should strengthen the protections that apply when non-accredited individuals, who do not otherwise meet the sophistication test for such investors, qualify to invest solely by virtue of relying on advice from a purchaser representative.

COMMISSION RESPONSE. On December 18, 2015, the Commission issued a staff report (“Report”) analyzing various approaches for modifying the definition of an accredited investor.²⁷¹ The Report considered comments received from the Investor Advisory Committee, as well as from the Advisory Committee on Small and Emerging Companies and others. The Report remains open for comment from the public, with no set deadline for comments.

The Report found that, as a result of inflation, the number of U.S. households qualifying as accredited investors has increased from approximately 2 percent of the population to more than 10 percent.²⁷² Nonetheless, the staff found no evidence suggesting that the expanded number of qualified investors needed the protections of registration.²⁷³

The Report recommended that the Commission consider one or more of several ways to revise the financial thresholds requirements for natural persons to qualify as accredited investors. The first approach was in accord with the IAC's recommendation to limit investments in private offerings to a percentage of assets or income. The Report recommended that the Commission consider limiting investments for individuals who qualify as accredited investors solely based on those thresholds to a percentage of their income or net worth (e.g., 10 percent of prior year income or 10 percent of net worth, as applicable, per issuer, in any 12-month period).²⁷⁴ This approach would leave the current income and net worth thresholds in the accredited investor definition in place.

The Report proposed that the Commission consider two further changes to financial thresholds: first, to adjust the income and net worth thresholds for inflation (such as \$500,000 for individual income, \$750,000 for joint income, and \$2.5 million for net worth);²⁷⁵ and, second, to index financial thresholds going forward.²⁷⁶

The Report also recommended that the Commission consider revising the Accredited Investor Definition to allow individuals to qualify as accredited investors based on measures of sophistication other than financial measures. The Report offered a menu of options by which individuals would qualify as accredited investors, including by having certain investment experience or professional credentials.²⁷⁷

CROWDFUNDING

At its meeting on April 10, 2014, the IAC adopted a package of six recommendations, as described below, which were intended to strengthen the Commission's proposed rules to implement the crowdfunding provisions of the Jumpstart Our Business Startups ("JOBS") Act.²⁷⁸ The Committee stated that its recommendations would better ensure that investors understand the risks of crowdfunding and avoid unaffordable financial losses.

On October 30, 2015, the Commission adopted final rules to permit companies to offer and sell securities through crowdfunding.²⁷⁹ The Adopting Release made several references to the IAC recommendations, and the Division of Corporation Finance prepared for the IAC a chart mapping the IAC recommendations to the relevant text in the Adopting Release.

Adopt tighter limits on the amount of money that investors could invest in crowdfunding

The IAC recommended what became known as a "lesser of" approach in setting investment crowdfunding limits for all investors except accredited investors. This approach would mean that, unless both an investor's income and net worth exceeded \$100,000, the investor would only be allowed to invest up to 5 percent, and that 5 percent calculation would be applied to the lower of either their net worth or income. If both an investor's net worth and income exceeded \$100,000, then the investor could invest up to 10 percent, but that percentage would still be calculated based on the lower of either their income or net worth. In the Adopting Release, the Commission reversed its earlier proposal and adopted a "lesser of" approach, explaining that it had found the concerns of the IAC and other commenters persuasive.²⁸⁰

Strengthen the mechanisms for the enforcement of the investment limits in order to better prevent errors and evasion

The IAC recommended requiring intermediaries to create a tool that investors would use to assemble the underlying data on which investment limits are calculated and to perform the calculations electronically. In addition, the Committee urged the Commission to provide an incentive for private-sector improvements in cross-portal monitoring, such as the development of a central database. Finally, the IAC recommended that the Commission view as temporary the provision allowing portals to rely on investor representations regarding investor limits; the Commission should monitor the effectiveness of this approach to determine whether it should be continued or whether a more stringent enforcement mechanism is needed.

The Commission adopted the Final Rule as proposed, requiring intermediaries to have a reasonable basis for believing that the investor satisfies the investment limits.²⁸¹ The Commission did not require intermediaries to create software tools, as the IAC had recommended. Instead, the Commission noted that intermediaries could at their discretion take additional measures, such as creating a tool for investors to assemble the underlying data.²⁸² The Commission also asked the staff to conduct a study of the federal crowdfunding exemption, including a review of the need for a centralized database. The Commission expects the staff to undertake the study no later than three years following the May 16, 2016, effective date of Regulation Crowdfunding.²⁸³

Clarify and strengthen the obligations of crowdfunding intermediaries to ensure that issuers comply with their legal obligations

First, the IAC urged the Commission to clarify the requirements for background checks by requiring that a summary of the sources consulted as part

of the background check be posted on the website along with a description of the portal's standards for determining which offerings present a risk of fraud. Second, the IAC urged the Commission to affirm clearly the right of portals to "curate" offerings; i.e., "to reject offerings based on whatever factors the portal deems appropriate." Third, the IAC encouraged the Commission to consider a tiered approach that would impose heightened compliance obligations as the risks to investors increased. Such an approach would be based on factors such as the size of offering, investment limits, and participation by individuals with a record of securities law violations.

In the Adopting Release, the Commission chose not to require an intermediary to post to its website a summary of the sources consulted as part of the background check and a description of the intermediary's standards. Among other things, the Commission expressed concerns that the posting of such information could present a roadmap to potentially fraudulent issuers.²⁸⁴

Second, the Commission modified its rule in a manner consistent with the IAC's recommendation to allow platforms to provide curated offerings. The Final Rule expressly provides funding portals with broad discretion to determine whether and under what circumstances to allow an issuer to offer and sell securities through its platform.²⁸⁵

Third, the Commission did not adopt a specific tiered approach to compliance obligations as the IAC had recommended. Nonetheless, the Commission asserted that the Final Rule, by imposing a reasonable basis requirement on intermediaries, was "generally consistent" with a tiered approach in that it required intermediaries to have a reasonable basis that issuers using the platform complied with the crowdfunding requirements.²⁸⁶

Enhance the effectiveness of educational materials for investors

The IAC made several suggestions to strengthen the quality and delivery of educational material. The Committee suggested that the Commission consider requiring or encouraging the material to be presented in the form of participatory education, such as an interactive questionnaire that investors would be required to complete successfully before being allowed to invest through the intermediary's portal. The IAC also expressed the view that it would be appropriate for regulators (the Commission, state securities regulators, FINRA, or all three working together) to develop a sample guide designed to alert investors to the risks of crowdfunding.

In the Adopting Release, the Commission emphasizes the flexibility of intermediaries to determine the content and format of required investor education materials.²⁸⁷ The Commission chose not to require that intermediaries design an investor questionnaire, but noted that they could do so if they wished.²⁸⁸

Replace the proposed definition of electronic delivery with a stronger definition

At a minimum, the Committee recommended requiring disclosure of a specific URL where required disclosures could be found.

The Final Rule allows, but does not require, intermediaries to include specific website links in electronic messages to investors. Instead, intermediaries may choose among three options. In one option, the electronic message may provide notice of what the information is and notify investors that this information is located on the intermediary's platform or on the issuer's website.²⁸⁹

Replace the proposal to eliminate application of the integration doctrine with a narrower approach

Under certain circumstances, an offering conducted under one exemption can be "integrated" with an

offering conducted under a separate exemption, which means that the entire amount raised would count against the offering caps in either exemption. In the original crowdfunding proposal, offerings conducted under other exemptions would not be integrated with the crowdfunding offering for purposes of the offering limits in the crowdfunding exemption.

The IAC expressed concern that the Commission's proposed approach would allow issuers to circumvent certain investor protections because they would be able to conduct offerings simultaneously under multiple exemptions with potentially conflicting regulatory requirements. The Committee recommended narrowing the application of the integration doctrine rather than eliminating it entirely.

In the Adopting Release, the Commission provided guidance that a crowdfunding offering would not be integrated with other exempt offerings made by the issuer, provided that each offering complies with the requirements of the applicable exemption that is being relied upon for that particular offering. The guidance offers two examples involving concurrent offerings and rules on general solicitation. The Commission observed, "This may partly alleviate some of commenters' concerns because each offering will have the investor protections of the offering exemption upon which it relies."²⁹⁰

DECIMALIZATION AND TICK SIZES

On January 31, 2014, the IAC adopted a resolution opposing any test or pilot programs to increase the minimum quoting and trading increments ("tick sizes") in the securities markets.²⁹¹ The resolution argued that larger tick sizes would disproportionately harm retail investors by raising prices without achieving the goals of improved research coverage or liquidity of small-cap companies.

If, however, the SEC were to decide to pursue a pilot program of increasing tick sizes, the IAC made three more recommendations: to limit the pilot program's duration, with a short "sunset" on

the pilot unless benefits were proven to outweigh the costs; to conduct a careful evaluation of costs and benefits to investors, with a particular focus on retail investors; and to pilot other competition-based measures designed to encourage trading and capital formation.

COMMISSION RESPONSE. On June 24, 2014, the Commission directed the national securities exchanges and FINRA (collectively, “SROs”) to submit a plan for a pilot program to test a tick size of 5 cents per share in three groups of securities. The Commission’s release specifically referenced the IAC recommendations.²⁹²

In August 2014, the SROs submitted a plan for a two-year pilot program, and the Commission approved it with modifications on May 6, 2015.²⁹³ The Commission increased the duration of the pilot program (from one year to two) and reduced the size of companies in it (lowering the market capitalization threshold from \$5 billion to \$3 billion).

Though it did not adopt the IAC’s recommendations, the Commission stated that it had carefully considered them. The Commission also acknowledged the IAC’s “concern that a pilot would disproportionately harm retail investors because their trading costs would rise.”²⁹⁴

On November 6, 2015, the Commission delayed the implementation date by approximately five months, to October 3, 2016.²⁹⁵ The delay was intended to allow sufficient time to complete necessary preparations, including Commission approval of applicable SRO rules and development and testing by pilot participants of new compliance systems.²⁹⁶ To establish a baseline, participants began to collect data on April 4, 2016, for the six-month period prior to the implementation of the Pilot Period.²⁹⁷

LEGISLATION TO FUND INVESTMENT ADVISER EXAMINATIONS

On November 22, 2013, the IAC recommended that the SEC request legislation from Congress that would authorize the Commission to impose user fees on SEC-registered investment advisers to provide a scalable source of funding for more frequent compliance examinations of advisers.²⁹⁸ The IAC asserted that the examination cycle for SEC-registered investment advisers was “simply inadequate to detect or credibly deter fraud.”²⁹⁹

COMMISSION RESPONSE. Though it has never made a statement requesting user fees, the Commission has made funding for increased coverage of investor adviser exams a top priority every year since FY 2015. Each year, the Commission has requested funding to hire additional examiners in the SEC Office of Compliance Inspections and Examinations (“OCIE”): the FY 2015 Budget Request called for funding to support an increase of 316 OCIE examiner positions;³⁰⁰ the FY 2016 Budget Request, an increase of 225 OCIE examiners;³⁰¹ and the FY 2017 Budget Request, an increase of 127 OCIE examiners.³⁰²

In addition to adding new examiners when new resources become available, OCIE is in the process of converting some staff from its broker-dealer examination program to the investment adviser/investment company program, with the goal of increasing staff for the latter by roughly 20 percent.³⁰³

BROKER-DEALER FIDUCIARY DUTY

On November 22, 2013, the IAC adopted a set of recommendations encouraging the SEC to establish a fiduciary duty for broker-dealers when they provide personalized investment advice to retail investors.³⁰⁴ The Committee preferred to accomplish this objective by narrowing the exclusion for broker-dealers within the definition

of an “investment adviser” under the Investment Advisers Act of 1940. As an alternative, the Committee recommended the adoption of a rule under Section 913 of the Dodd-Frank Act to require broker-dealers to act in the best interests of their retail customers when providing personalized investment advice, with sufficient flexibility to permit certain sale-related conflicts of interest that are fully disclosed and appropriately managed. In addition, the Committee recommended the adoption of a uniform, plain English disclosure document to be provided to customers and potential customers of broker-dealers and investment advisers. The document would disclose information about the nature of services offered, fees and compensation, conflicts of interest, and the disciplinary record of the broker-dealer or investment adviser.

COMMISSION RESPONSE. In March 2015, Chair White announced her belief that broker-dealers and investment advisers should be subject to a uniform fiduciary standard of conduct when providing personalized securities advice to retail investors. In Congressional testimony, she stated that she would soon begin discussing the issue with fellow Commissioners, and that she had asked Commission staff to develop rulemaking recommendations for Commission consideration.³⁰⁵ She made similar remarks at a subsequent meeting of the IAC.³⁰⁶

Further Commission action is pending.

UNIVERSAL PROXY BALLOTS

On July 25, 2013, the IAC adopted a recommendation urging the SEC to explore the relaxation of the “*bona fide* nominee rule” (Rule 14a-4(d)(1)) to provide proxy contestants with the option, but not the obligation, to use Universal Ballots in connection with short slate director nominations.³⁰⁷ The IAC also encouraged the Commission to hold one or more roundtable discussions on the topic.

COMMISSION RESPONSE. On February 19, 2015, the Commission held a Proxy Voting Roundtable to explore issues related to proxy voting, including the use of a universal ballot.³⁰⁸

In June 2015 Chair White stated that she had asked Commission staff to bring appropriate rulemaking recommendations before the Commission on universal proxy ballots.³⁰⁹ She also appealed to corporations to give “meaningful consideration to using some form of a universal proxy ballot even though the proxy rules currently do not require it.”³¹⁰

Further Commission action is pending.

DATA TAGGING

At its meeting on July 25, 2013, the IAC adopted a recommendation for the SEC to promote the collection, standardization, and retrieval of data filed with the SEC using machine-readable data tagging formats.³¹¹ The Committee urged the SEC to take steps to reduce the costs of providing tagged data, particularly for smaller issuers and investors, by developing applications that allow users to enter information on forms that can be converted to machine-readable formats by the SEC. In addition, the IAC recommended that the SEC give priority to the data tagging of disclosures on corporate governance, including information about executive compensation and shareholder voting.

COMMISSION RESPONSE. *Regulation of NMS Stock Alternative Trading Systems*. On November 19, 2015, the Commission proposed rules to enhance operational transparency and regulatory oversight of alternative trading systems (ATSs) that trade stocks listed on a national securities exchange (NMS stocks), including “dark pools.”³¹² The proposal would require an NMS stock ATS to file detailed disclosures on newly proposed Form ATS-N about its operations and the activities of its broker-dealer operator and its affiliates. The Commission proposed

that the disclosures be filed in a structured format that could allow the Commission and market participants to better search and analyze information about NMS Stock ATs.³¹³

Use of Derivatives by Registered Investment Companies and Business Development Companies. In May 2015, the Commission proposed a new Form N-Port, which would require registered funds other than money market funds to provide portfolio-wide and position-level holdings data to the Commission on a monthly basis in a structured data format.³¹⁴ In December 2015, the Commission proposed enhanced reporting requirements relating to risk metrics of certain derivatives for funds that are required to have a derivatives risk management program.³¹⁵

Crowdfunding. On October 30, 2015, the Commission adopted final rules to permit companies to offer and sell securities through crowdfunding.³¹⁶ Companies that rely on the recommended rules to conduct a crowdfunding offering must file certain information on Form C, including the price of the securities, the company's financial condition, a description of the business, and the use of proceeds from the offering.³¹⁷ Unless otherwise indicated in the form, Form C must be filed in the standard format of eXtensible Markup Language (XML).³¹⁸

Swap Data of Security-Based Swap Data Repositories. On December 11, 2015, the Commission proposed amendments to specify the form and manner with which security-based swap data repositories ("SDRs") will be required to make security-based swap data available to the Commission under Exchange Act Rule 13n-4(b)(5).³¹⁹ The Commission proposed to require SDRs to make this data available according to schemas that reference the international industry standards Financial products

Markup Language ("FpML") and Financial Information eXchange Markup Language ("FIXML").³²⁰

Disclosure of Payments by Resource Extraction Issuers. On December 11, 2015, the Commission proposed rules that would require resource extraction issuers to disclose payments made to the U.S. federal government or foreign governments for the commercial development of oil, natural gas or minerals.³²¹ The proposed rules would require a resource extraction issuer to publicly disclose the information annually using Form SD. The information would be included in an exhibit and electronically tagged using the eXtensible Business Reporting Language ("XBRL") format.³²²

Earlier rulemakings. As detailed in our previous Reports to Congress,³²³ the Commission has incorporated structured data requirements in previous rulemakings, including ones related to liquidity risk of mutual funds,³²⁴ registration of security-based swap dealers,³²⁵ clawbacks of erroneously awarded executive compensation,³²⁶ investment company reporting modernization,³²⁷ executive pay versus performance,³²⁸ Regulation A,³²⁹ asset-backed securities disclosure and registration,³³⁰ and money market funds.³³¹

TARGET DATE MUTUAL FUNDS

On April 11, 2013, the IAC adopted recommendations for the Commission to revise its proposed rule regarding target date retirement fund names and marketing.³³² The package of five IAC recommendations pertained to a 2010 SEC proposal that would, among other things, require marketing materials for target date retirement funds to include a table, chart, or graph depicting the fund's asset allocation over time (*i.e.*, an "asset allocation glide path").³³³

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

COMMISSION RESPONSE. On April 3, 2014, the Commission reopened the comment period on the proposed rule in order to seek public comment on the IAC's recommendations to adopt a risk-based glide path illustration and the methodology to be used for measuring risk.³³⁴ The comment period closed on June 9, 2014, and a final rule has not yet been adopted.

GENERAL SOLICITATION AND ADVERTISING

On October 12, 2012, the IAC adopted a set of seven recommendations concerning rulemaking to lift the ban on general solicitation and advertising in offerings conducted under Rule 506.³³⁵ The IAC asserted that the recommendations would strengthen investor protections and enhance regulators' ability to police the private placement market.

COMMISSION RESPONSE. On July 10, 2013, the Commission adopted final rules permitting general solicitation and advertising in Rule 506 offerings³³⁶ and disqualifying offerings involving felons and other bad actors.³³⁷ In addition, the Commission proposed a rule to enhance the Commission's ability to evaluate the development of market practices in Rule 506 offerings and to address concerns that may arise because the ban on general solicitation was lifted.³³⁸ The majority of the IAC recommendations relate to the proposed rule, which has not yet been adopted.

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 Exchange Act § 4(g)(6)(B)(i), 15 U.S.C. § 78d(g)(6)(B)(i).
- 4 Exchange Act § 4(g)(4)(A), 15 U.S.C. § 78d(g)(4)(A).
- 5 Exchange Act § 4(g)(8)(A), 15 U.S.C. § 78d(g)(8)(A).
- 6 Exchange Act § 4(g)(8)(D), 15 U.S.C. § 78d(g)(8)(D).
- 7 *Id.*
- 8 Exchange Act § 4(g)(4)(B), 15 U.S.C. § 78d(g)(4)(B).
- 9 Exchange Act § 4(g)(4)(C), 15 U.S.C. § 78d(g)(4)(C).
- 10 Exchange Act § 4(g)(4)(D), 15 U.S.C. § 78d(g)(4)(D).
- 11 Exchange Act § 4(g)(4)(E), 15 U.S.C. § 78d(g)(4)(E).
- 12 Exchange Act § 39, 15 U.S.C. § 78pp.
- 13 Exchange Act § 39(b)(1)(A), 15 U.S.C. § 78pp(b)(1)(A).
- 14 Regulation S-K, 17 C.F.R. § 229.10 (2015).
- 15 Regulation S-X, 17 C.F.R. § 210.1-01 (2015).
- 16 Staff of the U.S. Securities and Exchange Commission, *Report on Review of Disclosure Requirements in Regulation S-K* (Dec. 20, 2013), <http://www.sec.gov/news/studies/2013/reg-sk-disclosure-requirements-review.pdf>.
- 17 Keith F. Higgins, Director, Division of Corporation Finance, SEC, Remarks Before the American Bar Association Business Law Section Spring Meeting: *Disclosure Effectiveness* (Apr. 11, 2014), <http://www.sec.gov/News/Speech/Detail/Speech/1370541479332>.
- 18 Request for Comment on the Effectiveness of Financial Disclosures About Entities Other Than the Registrant, Securities Act Release No. 9929 (Sept. 25, 2015) [80 FR 59083 (Oct. 1, 2015)] [hereinafter Regulation S-X Request for Comment], <http://www.sec.gov/rules/other/2015/33-9929.pdf>.
- 19 Concept Release, Business and Financial Disclosure Required by Regulation S-K, Securities Act Release No. 10064, (Apr. 13, 2016) [81 FR 23915 (Apr. 22, 2016)] [hereinafter Regulation S-K Concept Release], <http://www.sec.gov/rules/concept/2016/33-10064.pdf>.
- 20 Regulation S-X Request for Comment, *supra* note 18.
- 21 *See* Comment File for Regulation S-X Request for Comment, <https://www.sec.gov/comments/s7-20-15/s72015.shtml>.
- 22 Regulation S-K Concept Release, *supra* note 19.
- 23 Rick A. Fleming, Investor Advocate, SEC, Speech at SEC Speaks: *Effective Disclosure for the 21st Century Investor*, Washington, D.C. (Feb. 20, 2015), <http://www.sec.gov/news/speech/022015-spchraf.html>.
- 24 *See* SEC, Office of the Investor Advocate, *Report on Activities, Fiscal Year 2015*, at 9 (Dec. 23, 2015), <https://www.sec.gov/advocate/reportspubs/annual-reports/sec-investor-advocate-report-on-activities-2015.pdf>.
- 25 *See, e.g.*, David Trainer, *XBRL Would Be Wonderful If It Always Worked*, FORBES, Nov. 7, 2013, <http://www.forbes.com/sites/greatspeculations/2013/11/07/xbrl-would-be-wonderful-if-it-always-worked>.
- 26 Mary Jo White, Chair, SEC, Statement at an Open Meeting on Regulation S-K Concept Release (Apr. 13, 2016), <http://www.sec.gov/news/statement/white-statement-1-041316.html>.
- 27 *See generally* Concept Release on Equity Market Structure, Exchange Act Release No. 61358 (Jan. 14, 2010) [75 FR 3594 (Jan. 21, 2010)] [hereinafter Equity Market Concept Release].
- 28 *Id.*
- 29 *Id.*
- 30 Regulation NMS: Final Rules and Amendments to Joint Industry Plans, Exchange Act Release No. 51808 (June 9, 2005) [70 FR 37496 (June 29, 2005)] [hereinafter Regulation NMS] (Among other things, Regulation NMS eliminated trade-through protection for manual quotations).
- 31 Regulation of Exchanges and Alternative Trading System: Final Rule, Exchange Act Release No. 40760 (Dec. 8, 1998) [63 FR 70844 (Dec. 22, 1998)] [hereinafter Regulation ATS].
- 32 Order Execution Obligations, Exchange Act Release No. 37619A (Sept. 6, 1996) [61 FR 48290 (Sept. 12, 1996)].
- 33 *See* Regulation ATS, *supra* note 31.
- 34 *See* Mary Jo White, Chair, SEC, Speech at Sandler O'Neil & Partners, L.P. Global Exchange and Brokerage Conference, *Enhancing our Equity Market Structure*, New York, N.Y. (June 5, 2014), <https://www.sec.gov/News/Speech/Detail/Speech/1370542004312>; Equity Market Concept Release, *supra* note 27.
- 35 *See* White, *supra* note 34.
- 36 Regulation of NMS Stock Alternative Trading Systems: Proposed Rule, Exchange Act Release No. 76474 (Nov. 18, 2015) [80 FR 80998, at 81042, note 374 (Dec. 28, 2015)] (File No. S7-23-15) [hereinafter Regulation ATS-N], <https://federalregister.gov/a/2015-29890>.

- 37 Regulation ATS-N, Exchange Act Release No. 76474, *supra* note 36.
- 38 Regulation NMS, Exchange Act Release No. 51808, *supra* note 30.
- 39 See SEC, Press Release, SEC Announces Members of New Equity Market Structure Advisory Committee (Jan. 13, 2015), <http://www.sec.gov/news/pressrelease/2015-5.html>; see also <https://www.sec.gov/spotlight/equity-market-structure-advisory-committee.shtml>.
- 40 See SEC, Press Release, *supra* note 39.
- 41 See White, *supra* note 34.
- 42 See, e.g., Larry Harris, *Maker-Taker Pricing Effects on Market Quotations*, at 5 (Nov. 14, 2013), <http://bschool.huji.ac.il/upload/hujibusiness/Maker-taker.pdf>.
- 43 Memorandum on Market Taker Fees on Equity Exchanges, SEC Division of Trading and Markets, dated October 20, 2015, <https://www.sec.gov/spotlight/emsac/memo-maker-taker-fees-on-equities-exchanges.pdf> [hereinafter Staff Paper on Maker Taker].
- 44 *Id.*
- 45 *Id.*
- 46 *Id.*
- 47 *Id.*
- 48 *Id.* As noted in the white paper, former Senator Carl Levin and Senator Charles Schumer had written to the SEC Chair to urge the SEC to take action to eliminate such conflicts of interest, noting in support of their recommendation certain academic and market research into order routing decisions that suggests that the conflict may be resulting in harm to certain types of investors. See, e.g., Letter from former Sen. Carl Levin (D-MI), to Mary Jo White, Chair, SEC (July 9, 2014), https://www.hsgac.senate.gov/download/levin-letter-to-sec-chairman-mary-jo-white-re-equity-market-structure-july-15_2014. A recent academic paper analyzed selected market data and suggests that a significant number of retail firms route nonmarketable orders to the venue offering the highest rebate, and do so in a manner that the authors believe might not be consistent with the brokers' duty of best execution. See Robert Battalio, Shane A. Corwin, and Robert Jennings, *Can Brokers Have it All? On the Relation Between Make-Take Fees and Limit Order Execution Quality*, at 5 (Mar. 31, 2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2367462&download=yes.
- 49 See EMSAC Regulation NMS Subcommittee, Framework for Potential Access Fee Pilot (Apr. 19, 2016), <https://www.sec.gov/spotlight/emsac/emsac-regulation-nms-subcommittee-recommendation-041916.pdf>.
- 50 See Equity Market Structure Advisory Committee Meeting (May 13, 2016), https://www.sec.gov/video/webcast-archive-player.shtml?document_id=042616emsac.
- 51 *Id.*
- 52 See Equity Market Concept Release, *supra* note 27.
- 53 See *id.*
- 54 See White, *supra* note 34.
- 55 See Letter from ICI, MFA, and SIFMA, Customer Specific Order Routing Disclosures for Institutional Investors to Mary Jo White, Chair, SEC (Oct. 23, 2014), <https://www.managedfunds.org/wp-content/uploads/2014/10/Cover-Letter-for-Execution-Venue-Template1.pdf>; see also Broker Routing Template, <https://www.managedfunds.org/wp-content/uploads/2014/10/Standardized-Broker-Routing-Venue-Analysis.pdf>.
- 56 See White, *supra* note 34.
- 57 See Current Unified Agenda and Regulatory Plan for the SEC, Amendments to Exchange Act Rules 600 and 606: Order Routing Transparency for Institutional Customers, RIN 3235-AL67 (Fall 2015), <http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201510&RIN=3235-AL67>.
- 58 Federal Reserve Board, *Financial Accounts of the United States: Flow of Funds, Balance Sheets, and Integrated Macroeconomic Accounts, Fourth Quarter 2015*, Table L.212 (Mar. 10, 2016, 12:00 PM), <http://www.federalreserve.gov/releases/z1/current/z1.pdf>.
- 59 *Id.*
- 60 The MSRB Fact Book data suggests the par amount of customer transactions (purchases and sales) in municipal securities, as a percentage of the total par amount of municipal trades, has steadily declined to approximately 77 percent in 2015 from approximately 84 percent in 2011. The number of customer trades, as a percentage of total municipal securities trades, remains relatively stable ranging from 62 percent to 68 percent each year since 2011. In a press release, the MSRB noted that overall municipal bond market trading volume had declined by 13 percent since 2014 and the MSRB attributed a majority of this overall municipal bond trading volume decline to a "nearly 40 percent decline in trading volume in the municipal variable rate market." MSRB, *2015 Fact Book*, at 7-8 (March 2016), <http://www.msrb.org/msrb1/pdfs/MSRB-Fact-Book-2015.pdf> [hereinafter "MSRB Fact Book"]; MSRB, Press Release, MSRB Publishes Annual Fact Book of Municipal Securities Data (Mar. 3, 2016), <http://www.msrb.org/News-and-Events/Press-Releases/2016/MSRB-Publishes-Annual-Fact-Book-of-Municipal-Securities-Data.aspx>.
- 61 See, e.g., MSRB Fact Book *supra* note 60, at 37-39.
- 62 See SEC, Office of the Investor Advocate, *Report on Objectives, Fiscal Year 2015* (June 30, 2014), <http://www.sec.gov/reportspubs/annual-reports/sec-office-investor-advocate-report-on-objectives-fy2015.pdf>; see also SEC, Office of the Investor Advocate, *Report on Objectives, Fiscal Year 2016* (June 30, 2015), <http://wcm.sec.gov/advocate/reportspubs/annual-reports/sec-office-investor-advocate-report-on-objectives-fy2016.pdf>.

- 63 SEC, *Report on Municipal Securities Market* (July 31, 2012) [hereinafter *Report on Municipal Securities Market*], <https://www.sec.gov/news/studies/2012/munireport073112.pdf>.
- 64 *Id.*
- 65 *Id.* at 149-50.
- 66 On August 6, 2013, the MSRB issued a concept release seeking comments on this recommendation, and the MSRB subsequently proposed a best execution rule. On December 5, 2014, the SEC issued an order approving the proposed amendments, and the rule changes are set to become effective on December 7, 2015. On November 20, 2015, the MSRB published implementation guidance to assist bond dealers in complying with the MSRB's best execution rule. The MSRB subsequently announced it would provide additional guidance about the new best execution rule and delayed the effectiveness of the rule until 120 days after publication of the interpretive guidance. The MSRB's best execution rule requires municipal securities dealers to use "reasonable diligence" in seeking to obtain for their retail customers the most favorable terms reasonably available under prevailing market conditions. *See* MSRB, Comment Letters, Request for Comment on Whether to Require Dealers to Adopt a "Best Execution" Standard for Municipal Securities Transactions, <http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2013/2013-16.aspx?c=1>; MSRB, Regulatory Notice 2014-22, SEC Approves MSRB Rule G-18 on Best Execution of Transactions in Municipal Securities and Related Amendments to Exempt Transactions with Sophisticated Municipal Market Professionals (Dec. 8, 2014), <http://www.msrb.org/~media/Files/Regulatory-Notices/Announcements/2014-22.ashx?n=1>; Order Granting Approval of a Proposed Rule Change Consisting of Rule G-18, on Best Execution of Transactions in Municipal Securities, and Amendments to Rule G-48, on Transactions with Sophisticated Municipal Market Professionals ("SMMP"), and Rule D-15, on the Definition of SMMP, Exchange Act Release No. 73764 (Dec. 5, 2014) [79 FR 53236 (Sept 8, 2014)]; MSRB, Press Release, MSRB Provides Implementation Guidance on Best-Execution Rule (Nov. 20, 2015), <http://www.msrb.org/News-and-Events/Press-Releases/2015/MSRB-Provides-Implementation-Guidance-on-Best-Execution-Rule.aspx>.
- 67 *See, e.g.*, Comment Letter, Rick A. Fleming, Investor Advocate, SEC, RE: MSRB Regulatory Notice 2014-20, Request for Comment on Draft Rule Amendments to Require Dealers to Provide Pricing Reference Information on Retail Customer Confirmations (Jan. 20, 2015), <http://www.msrb.org/RFC/2014-20/USSEC.pdf>; Comment Letter, Rick A. Fleming, Investor Advocate, SEC, RE: FINRA Regulatory Notice 14-52, Request for Comment on Pricing Disclosure in the Fixed Income Markets (Jan. 20, 2015), http://www.finra.org/sites/default/files/notice_comment_file_ref/SEC.pdf; Comment Letter, Rick A. Fleming, Investor Advocate, SEC, RE: MSRB Regulatory Notice 2015-16, Request for Comment on Draft Rule Amendments to Require Confirmation Disclosure of Mark-ups for Specified Principal Transactions with Retail Customers (Dec. 11, 2015), <http://www.msrb.org/RFC/2015-16/Fleming.pdf>; Comment Letter, Rick A. Fleming, Investor Advocate, SEC, RE: Regulatory Notice 2016-07, Request for Comment on Draft Amendments to MSRB Rule G-30 to Provide Guidance on Prevailing Market Price (Mar. 31, 2016), <http://www.msrb.org/RFC/2016-07/Fleming.pdf>.
- 68 MSRB, Glossary of Municipal Securities Terms, *Mark-up*, <http://www.msrb.org/Glossary/Definition/MARK-UP.aspx> (last visited May 11, 2016).
- 69 *Id.*
- 70 Luis A. Aguilar, Comm'r, SEC, Statement on Making the Municipal Securities Market More Transparent, Liquid, and Fair (Feb. 13, 2015), <https://www.sec.gov/news/statement/making-municipal-securities-market-more-transparent-liquid-fair.html>.
- 71 *See* MSRB Rule G-15, Confirmation, Clearance, Settlement and Other Uniform Practice Requirements with Respect to Transactions with Customers, <http://www.msrb.org/pdf.aspx?url=http%3A%2F%2Fwww.msrb.org%2FRules-and-Interpretations%2FMSRB-Rules%2FGeneral%2FRule-G-15.aspx>.
- 72 *See Report on Municipal Securities Market, supra* note 63, at 148.
- 73 MSRB rules already require municipal bond dealers acting as agents to disclose on the transaction confirmation the amount of any remuneration received from the customer. However, there is no comparable requirement if the municipal securities dealer is acting as a principal (by selling securities out of its own inventory). The Municipal Market Report concluded that because municipal bond dealers execute almost all customer transactions in a principal capacity, customers receive very little confirmation disclosure of their dealer's compensation. Thus, the Municipal Market Report recommended the MSRB "consider requiring municipal bond dealers to disclose to customers, on confirmations for riskless principal transactions, the amount of any markup or markdown." *See Municipal Market Report, supra* note 63, at 147-50.
- 74 In 2014, the MSRB announced that it would develop a proposal regarding disclosure of information by dealers to retail customers to help them independently assess the prices they were receiving. On November 17, 2014, the MSRB and FINRA released companion proposals to require disclosure of pricing reference information on customer confirmations for transactions in fixed income securities. Under both proposals, dealers in retail-sized fixed income transactions would be required

to disclose on a customer confirmation the price of certain same-day principal trades in the same security and the difference between that price and the customer's price. The Comment period for the MSRB's and FINRA's second request for comment closed on December 11, 2015. MSRB, Regulatory Notice 2014-20, Request for Comment on Draft Rule Amendments to Require Dealers to Provide Pricing Reference Information on Retail Customer Confirmations (Nov. 17, 2014), <http://www.msrb.org/~media/Files/Regulatory-Notices/RFCs/2014-20.ashx?n=1>; MSRB, Press Release, MSRB Holds Quarterly Meeting (May 6, 2014), <http://www.msrb.org/News-and-Events/Press-Releases/2014/MSRB-Holds-Quarterly-Meeting-April-2014.aspx>; MSRB, Press Release, MSRB Holds Quarterly Meeting (Aug. 5, 2014), <http://www.msrb.org/News-and-Events/Press-Releases/2014/MSRB-Holds-Quarterly-Meeting-July-2014.aspx>; MSRB, Press Release, FINRA and MSRB Release Proposals to Provide Pricing Reference Information to Investors in Fixed Income Markets (Nov. 17, 2014), <http://www.msrb.org/News-and-Events/Press-Releases/2014/FINRA-and-MSRB-Release-Proposals-to-Provide-Pricing-Reference-Information-for-Investors.aspx>; see also FINRA, Regulatory Notice 14-52, Pricing Disclosure in the Fixed Income Markets (Nov. 2014), http://www.finra.org/sites/default/files/notice_doc_file_ref/Notice_Regulatory_14-52.pdf; MSRB, Regulatory Notice 2015-16, Request for Comment on Draft Rule Amendments to Require Confirmation Disclosure of Mark-ups for Specified Principal Transactions with Retail Customers (Sept. 24, 2015), <http://www.msrb.org/~media/Files/Regulatory-Notices/RFCs/2015-16.ashx?n=1>; FINRA, Regulatory Notice 15-36, Request for Comment on Revised Proposal Requiring Confirmation Disclosure of Pricing Information in Corporate and Agency Debt Securities Transactions (Oct. 2015), http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-15-36.pdf.

75 *Report on Municipal Securities Market*, *supra* note 63, at x, 148.

76 *See id.* at vi, 118-33, 143-44.

77 *See id.*

78 *See id.* at ix.

79 *Id.*

80 In a speech, Commissioner Aguilar stated that the lack of pre-trade price transparency in the secondary market for municipal securities “perpetuates the high level of markups and other transaction costs that individual investors incur, and it prevents individual investors from assessing the fairness of the prices they are quoted by their dealers. It also complicates broker-dealers’ efforts to comply with their fair pricing and best execution obligations.” Aguilar, *supra* note 70.

81 Letter from Lynnette Kelly, Exec. Dir., MSRB, to Rick

A. Fleming, Investor Advocate, SEC, *Response to SEC Request Highlighting Municipal Market Practices* (Oct. 30, 2015) (on file with the Office of the Investor Advocate, SEC). The Office of the Investor Advocate highlighted and briefly discussed each area of concern in its Report on Activities for fiscal year 2015. See SEC, Office of the Investor Advocate, *Report on Activities, Fiscal Year 2015* (Dec. 23, 2015), <http://www.sec.gov/advocate/reportspubs/annual-reports/sec-investor-advocate-report-on-activities-2015.pdf>.

82 *See* SEC, Office of the Investor Advocate, *Report on Activities, Fiscal Year 2015* (Dec. 23, 2015), <http://www.sec.gov/advocate/reportspubs/annual-reports/sec-investor-advocate-report-on-activities-2015.pdf>.

83 Debt-like obligations include bank loans, direct-purchase debt, and privately placed debt. As of March 28, 2016, a search of the Electronic Municipal Market Access (“EMMA”) system for the term “bank loan” produced 143 results: 79 documents including the words “bank loan” and were filed under the subcategory suggested by the MSRB; 23 submissions included the words “bank loan” but the document reported under a subcategory other than that suggested by the MSRB may not be related to a bank loan; and the remaining 41 results included the words “bank loan” in a document, did not include any document under the subcategory suggested by the MSRB. MSRB, Regulatory Notice 2016-11, Request for Comment on a Concept Proposal to Improve Disclosure of Direct Purchases and Bank Loans (Mar. 28, 2016), at 3 n.8, <http://www.msrb.org/~media/Files/Regulatory-Notices/RFCs/2016-11.ashx?n=1>; see MSRB, Regulatory Notice 2015-03, Bank Loan Disclosure Market Advisory (Jan. 29, 2015), <http://www.msrb.org/~media/Files/Regulatory-Notices/Announcements/2015-03.ashx>; Kelly, *supra* note 81.

84 A minimum denomination is the smallest dollar amount of bonds authorized by the issuer to be sold by a dealer to an investor in a single transaction. Typically, municipal bonds have a minimum denomination of \$5,000, but some issuers may impose a higher minimum denomination threshold, most commonly in the amount of \$100,000. For a variety of legitimate reasons, issuers may structure certain municipal securities with higher minimum denominations (e.g., \$100,000 or higher), making them unlikely to be purchased by retail investors in the primary market. MSRB, Glossary of Municipal Securities Terms, *Minimum Denomination*, <http://www.msrb.org/glossary/definition/minimum-denomination.aspx> (last visited May 3, 2016); see also Kelly, *supra* note 81.

85 *See* Jack Casey, *MSRB Proposes Clarifying Minimum Denomination Rule Exceptions*, THE BOND BUYER, (Apr. 7, 2016), <http://www.bondbuyer.com/news/washington-securities-law/msrb-proposes-clarifying-minimum-denomination-rule-exceptions-1100814-1.html>; Chapman and Cutler LLP, Client Alert, *MSRB Proposes*

- Additional Exceptions for Trading Municipal Bonds Below Stated Minimum Denominations*, (Apr. 8, 2016), http://www.chapman.com/insights-publications-MSRB_Municipal_Bonds_Minimum_Denomination.html (last visited Apr. 27, 2016).
- 86 Minimum denomination represents the smallest dollar amount of bonds to be sold by a municipal bond dealer to an investor in a single transaction. Kelly, *supra* note 81. *See, e.g.*, SEC, Press Release 2014-246, SEC Sanctions 13 Firms for Improper Sales of Puerto Rico Junk Bonds (Nov. 3, 2014), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543350368> (on November 3, 2014, the Commission sanctioned thirteen firms for violating MSRB Rule G-15(f)); Jack Casey, *Oppenheimer One of 7 Firms FINRA Fines Over Minimum Denominations*, THE BOND BUYER (Feb. 16, 2016), <http://www.bondbuyer.com/news/washington-enforcement/oppenheimer-one-of-7-firms-finra-fines-over-minimum-denominations-1096687-1.html> (in February 2016, FINRA fined seven firms for trading municipal securities below the minimum denomination).
- 87 Regulatory Notice 2016-11 requested comment on whether the MSRB should propose a rule requiring municipal advisors to disclose information relating to the direct purchases and bank loans of their municipal clients. In the Regulatory Notice, the MSRB noted that it would publish a second request for comment outlining a specific proposal if it determines to proceed with imposing such a requirement. Comments were due no later than May 27, 2016. MSRB, Regulatory Notice 2016-11, *supra* note 83.
- 88 Regulatory Notice 2016-13 seeking comment on whether to amend MSRB Rule G-15(f) to exclude two additional trading scenarios from the prohibition on sales to customers below the minimum denomination. Comments were due no later than May 25, 2016. MSRB, Regulatory Notice 2016-13, Request for Comment on Draft Amendments to MSRB Rule G-15(f) on Minimum Denominations (Apr. 7, 2016), <http://www.msrb.org/~media/Files/Regulatory-Notices/RFCs/2016-13.ashx?n=1>.
- 89 Concept Release, Possible Revisions to Audit Committee Disclosures, Securities Act Release No. 9862 (July 1, 2015) [80 FR 38995 (July 8, 2015)], <https://federalregister.gov/a/2015-16639>.
- 90 Proposed Auditing Standard, The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion, PCAOB Release No. 2016-003 (May 11, 2016), <http://pcaobus.org/Rules/Rulemaking/Docket034/Release-2016-003-ARM.pdf>. *See* PCAOB, News Release, PCAOB Reproposes Standard to Enhance the Auditor's Report for Investors with Refined Requirements for Critical Audit Matters (May 11, 2016), <http://pcaobus.org/News/Releases/Pages/PCAOB-Reproposes-Auditors-Report-051116.aspx>.
- 91 Proposed Auditing Standards, PCAOB Release No. 2013-005 (Aug. 13, 2013), http://pcaobus.org/Rules/Rulemaking/Docket034/Release_2013-005_ARM.pdf.
- 92 *See supra* note 90.
- 93 *See, e.g.*, comment letters submitted to FASB by the California Public Employees' Retirement System ("CalPERS") (Dec. 8, 2015); the CFA Institute (Jan. 21, 2016); the Council of Institutional Investors (CII), (Dec. 3, 2015); and Jack Ciesielski, R.G. Associates, Inc. (Dec. 7, 2015), http://www.fasb.org/jsp/FASB/CommentLetter_C/CommentLetterPage&cid=1218220137090&project_id=2015-310. For a summary of comment letters submitted to FASB, *see* FASB, Board Meeting Handout: Disclosure Framework, dated March 2, 2016, http://www.fasb.org/jsp/FASB/Document_C/DocumentPage&cid=1176167952679.
- 94 FASB, Exposure Draft: Proposed Amendments to Statement of Financial Accounting Concepts, Conceptual Framework for Financial Reporting—Chapter 3, Qualitative Characteristics of Useful Financial Information, http://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176166402450&acceptedDisclaimer=true.
- 95 For a FASB member's explanation of how the materiality proposals fit in with FASB's overall Disclosure Framework project, *see* Marc Siegel, For The Investor: Disclosure Effectiveness—How Materiality Fits In, FASB, 2016 Q1, <http://www.fasb.org/cs/ContentServer?c=Page&pagename=FASB%2FPage%2FSectionPage&cid=1176167771326>.
- 96 FASB, Exposure Draft: Proposed Accounting Standards Update (ASU), Notes to Financial Statements (Topic 235): Assessing Whether Disclosures Are Material, http://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176166402325&acceptedDisclaimer=true.
- 97 *See, e.g.*, FASB in Focus: FASB Disclosure Framework Exposure Drafts on Materiality, September 2015, http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176166402203.
- 98 SEC, Investor Advisory Committee, Letter to Technical Director, FASB (Jan. 21, 2016), <http://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-letter-fasb-materiality-012116.pdf>.
- 99 James V. Schnurr, Chief Accountant, Office of the Chief Accountant, SEC, Remarks before the 12th Annual Life Sciences Accounting and Reporting Congress, Philadelphia, PA (Mar. 22, 2016), <http://www.sec.gov/news/speech/schnurr-remarks-12th-life-sciences-accounting-congress.html>.
- 100 *Id.*
- 101 Mary Jo White, Chair, SEC, *Maintaining High-Quality, Reliable Financial Reporting: A Shared and Weighty Responsibility*, Keynote Address at the 2015 AICPA-

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- 102 Kara M. Stein, Comm’r, SEC, Statement on the Commission’s Consideration of the Public Company Accounting Oversight Board’s Proposed 2016 Budget and Accounting Support Fee (Mar. 14, 2016), <http://www.sec.gov/news/statement/stein-remarks-open-meeting-pcaob-031416.html>.
- 103 Schnurr, *supra* note 99.
- 104 Wesley R. Bricker, Deputy Chief Accountant, SEC, Remarks before the 2016 Baruch College Financial Reporting Conference, New York, NY (May 5, 2016), http://www.sec.gov/news/speech/speech-bricker-05-05-16.html#_ftn20.
- 105 Kara M. Stein, Comm’r, SEC, Remarks to the U.S. Treasury Department’s Corporate Women in Finance Symposium: *Toward Healthy Companies and a Stronger Economy*, Washington D.C. (Apr. 30, 2015), http://www.sec.gov/news/speech/stein-toward-healthy-companies.html#_ftn19.
- 106 Mary Jo White, Chair, SEC, *Building Meaningful Communication and Engagement with Shareholders*, Society of Corporate Secretaries and Governance Professionals, 69th National Conference, Chicago, IL (June 25, 2015), <http://www.sec.gov/news/speech/building-meaningful-communication-and-engagement-with-shareholde.html>.
- 107 Stein, *supra* note 105.
- 108 White, *supra* note 106.
- 109 White, *supra* note 106.
- 110 White, *supra* note 106.
- 111 White, *supra* note 106.
- 112 White, *supra* note 106.
- 113 See Exchange Act Rule 14a-4(d)(4), 17 C.F.R. § 240.14a-4(d)(4) (2015). For an explanation of the short slate rule, see White, *supra* note 106, at n.16.
- 114 See, e.g., SEC Proxy Voting Roundtable (Feb.19, 2015), <http://www.sec.gov/news/otherwebcasts/2015/proxy-roundtable-021915.shtml> (in which advocates and opponents of universal proxies expressed their views).
- 115 SEC, *Recommendations of the Investor Advisory Committee Regarding SEC Rulemaking to Explore Universal Proxy Ballots* (July 25, 2013), <http://www.sec.gov/spotlight/investor-advisory-committee-2012/universal-proxy-recommendation-072613.pdf>.
- 116 Letter from Glenn Davis, Director of Research, Council of Institutional Investors, Request For Rulemaking to Amend Section 14 of the Securities Exchange Act of 1934 to Facilitate the Use of Universal Proxy Cards in Contested Elections (Jan. 8, 2014), <https://www.sec.gov/rules/petitions/2014/petn4-672.pdf>.
- 117 SEC Proxy Voting Roundtable, *supra* note 114.
- 118 White, *supra* note 106.
- 119 White, *supra* note 106.
- 120 Exchange Act Rule 14a-8, 17 C.F.R. § 240.14a-8 (2015).
- 121 *Id.*
- 122 *Id.*
- 123 Mary Jo White, Chair, SEC, Speech at Tulane University Law School 27th Annual Corporate Law Institute: *A Few Observations on Shareholders in 2015*, New Orleans, LA (Mar. 19, 2015), <http://www.sec.gov/news/speech/observations-on-shareholders-2015.html>.
- 124 Exchange Act Rule 14a-9, 17 C.F.R. § 240.14a-9 (2015).
- 125 SEC, Division of Corporation Finance, Staff Legal Bulletin No. 14H (CF), October 22, 2015, <https://www.sec.gov/interp/legals/cfslb14h.htm>.
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- 127 See, e.g., Exchange Act Release No. 65225 (Aug. 30, 2011) [76 FR 55148 (Sept. 6, 2011)] (File No. SR-BATS-2011-018), <http://www.gpo.gov/fdsys/pkg/FR-2011-09-06/pdf/2011-22627.pdf> [hereinafter BATS Listing Approval Order].
- 128 See *id.* at 55152 n.30.
- 129 See *id.* at 55152.
- 130 See NASDAQ Stock Market Rule 5635, Shareholder Approval (2016), http://nasdaq.cchwallstreet.com/NASDAQTools/bookmark.asp?id=nasdaq-rule_5635&manual=/nasdaq/main/nasdaq-equityrules/.
- 131 See Exchange Act Release No. 74849 (April 30, 2015) [80 FR 26118 (May 6, 2015)] (File No. SR-NYSE-2015-02), <https://federalregister.gov/a/2015-10503>.
- 132 See Memorandum to the Commission from Rick. A. Fleming, Investor Advocate, SEC, dated October 16, 2015, <https://www.sec.gov/about/offices/investorad/comment-letter-sec-investor-advocate-101615.pdf>.
- 133 See Exchange Act Release No. 76814 (Dec. 31, 2015) [81 FR 820 (Jan. 7, 2016)] (File No. SR-NYSE-2015-02), <https://federalregister.gov/a/2015-33313>.
- 134 See NASDAQ, Solicitation of Comments by the NASDAQ Listing and Hearing Review Council about Shareholder Approval Rules (Nov. 18, 2015), <https://listingcenter.nasdaq.com/assets/Shareholder%20Approval%20Comment%20Solicitation.pdf>. See also Press Release, NASDAQ, Nasdaq Requests Comments for Shareholder Approval Rules (Nov. 18, 2015), <http://ir.nasdaq.com/releasedetail.cfm?releaseid=943415>.
- 135 See Letter to Stanley Higgins, Senior Director, Listing Qualifications, NASDAQ, from Rick. A. Fleming, Investor Advocate, SEC (Feb. 12, 2016), <https://www.sec.gov/about/offices/investorad/comment-letter-investor-advocate-nasdaq-021216.pdf>.

- 136 See Rick A. Fleming, Investor Advocate, SEC, *The Falling Leaves of the Buttonwood Tree*, The SEC Speaks in 2016, Washington D.C. (Feb. 19, 2016), <https://www.sec.gov/news/speech/falling-leaves-buttonwood-tree.html>.
- 137 See *id.* See also Appendix, *The Falling Leaves of the Buttonwood Tree* (Feb. 19, 2016), <https://www.sec.gov/about/offices/investorad/investor-advocate-sec-speaks-appendix-021916.pdf>.
- 138 See INVESTMENT COMPANY INSTITUTE, 2016 INVESTMENT COMPANY FACT BOOK 8 (56th ed., 2016), www.ici.org/research/stats/factbook.
- 139 See *id.* at 6.
- 140 See *id.* at 29.
- 141 See *id.*
- 142 See *id.* at 102.
- 143 SEC, *Mutual Fund Distribution and Sub-Accounting Fees*, IM Guidance Update No. 2016-01 (Jan. 2016) [hereinafter Staff Guidance]. We recognize and support the Division of Investment Management’s continuing efforts and significant contributions toward enhancing fee disclosure.
- 144 See Staff Guidance, *supra* note 143.
- 145 Investment Company Act, 15 U.S.C. § 80a-1 *et seq.* (2015).
- 146 See Mutual Funds and Exchange Traded Funds Regulation (Clifford E. Kirsch, ed., 3d ed. 2014).
- 147 Investment Company Act Rule 12b-1(a)(2), 17 C.F.R. § 270.12b-1(a)(2) (2015); Staff Guidance, *supra* note 143.
- 148 Staff Guidance, *supra* note 143.
- 149 While a discussion of 12b-1 fees is beyond the scope of this Report, we take notice that the SEC’s Office of Compliance Inspections and Examinations plans to launch a “Share Class Initiative” to examine commissions in connection with recommending share classes that charge 12b-1 fees. See, e.g., Melanie Waddell, *SEC to Launch 12b-1 Fee Share Class Initiative*, THINKADVISOR (Apr. 19, 2016).
- 150 See 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>.
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- 152 See *id.*
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- 155 See MORNINGSTAR MANAGER RESEARCH, *Average Fund Costs Continued to Decline in 2015* (Apr. 26, 2016), at 1.
- 156 See *id.*
- 157 See *id.*
- 158 See *id.*
- 159 See *id.* See also Anne Tergesen, *Fees on 401(k)s Head Lower*, WALL ST. J., May 16, 2016, at A1.
- 160 See MORNINGSTAR, *supra* note 155.
- 161 See *id.*
- 162 See SEC Investor Bulletin, *Mutual Fund Fees and Expenses* (May 2014), https://www.sec.gov/oiea/investor-alerts-bulletins/ib_mutualfundfees.pdf.
- 163 See *id.*
- 164 See *id.*
- 165 See *id.*
- 166 See *id.*
- 167 See *id.*
- 168 See *id.*
- 169 See *id.*
- 170 See *id.*
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- 172 See *id.*
- 173 See *id.*
- 174 See SEC Investor Bulletin, *How Fees and Expenses Affect Your Investment Portfolio* (Feb. 2014), www.sec.gov/oiea/Article/ib_fees_expenses.pdf.
- 175 See *id.*
- 176 See *Mutual Fund Fees and Expenses*, *supra* note 162.
- 177 *Id.*
- 178 *Id.*
- 179 *Id.*
- 180 *Id.*
- 181 *Id.*
- 182 See *supra* note 150.
- 183 See *id.*
- 184 Staff Guidance, *supra* note 143.
- 185 See *id.*
- 186 See *id.*
- 187 See, e.g., Navigating Intermediary Relationships, JOINT REPORT OF THE INVESTMENT COMPANY INSTITUTE AND THE INDEPENDENT DIRECTORS COUNCIL, Sept. 2009, at 8.
- 188 See *id.*

- 189 *See id.*
- 190 *See id.*
- 191 *See id.*
- 192 *See id.*
- 193 *See id.*
- 194 Staff Guidance, *supra* note 143.
- 195 *See id.*
- 196 *See id.*
- 197 *See id.*
- 198 *See, e.g.*, Navigating Intermediary Relationships, *supra* note 187.
- 199 *See id.*
- 200 *See id.*
- 201 *See id.*
- 202 *See id.*
- 203 *See id.*
- 204 *See id.*
- 205 *See id.*
- 206 *See id.*
- 207 *See id.*
- 208 *See id.*
- 209 *See id.*
- 210 *See id.*
- 211 *See id.*
- 212 *See id.*
- 213 Exchange Act § 4(g)(8)(B), 15 U.S.C. § 78d(g)(8)(B).
- 214 Exchange Act § 4(g)(8)(D), 15 U.S.C. § 78d(g)(8)(D).
- 215 As used in this report, the term “Ombudsman” may refer to the Ombudsman, or to the Ombudsman and Office of the Investor Advocate staff directly supporting the ombudsman function.
- 216 @SEC_News, TWITTER (Dec. 23, 2015, 10:45 AM), https://twitter.com/SEC_News/status/679734537115549697.
- 217 Exchange Act § 4(g)(8)(B)(i), 15 U.S.C. § 78d(g)(8)(B)(i).
- 218 *See* Final Report, *infra* note 219, at 1, 4. The NAMC is FINRA’s Standing Board Advisory Committee on dispute resolution that meets to discuss the Final Report and recommend items to implement immediately, items to discuss further, and identify items that may not be feasible. *See* FINRA, *FINRA Arbitration Task Force Issues Final Report* (Dec. 16, 2015), <https://www.finra.org/newsroom/2015/finra-arbitration-task-force-issues-final-report>.
- 219 *See* FINRA, FINAL REPORT AND RECOMMENDATIONS OF THE FINRA DISPUTE RESOLUTION TASK FORCE (Dec. 16, 2015) [hereinafter Final Report], <https://www.finra.org/sites/default/files/Final-DR-task-force-report.pdf>.
- 220 The 11 thematic areas are: Arbitrators; Explained Awards; Expungement; Small Claims; Mediation; Motions to Dismiss; Case Management – Procedural Issues; Transparency; Frivolous Motions to Vacate; Professionalism; and Funding to Law School Arbitration Clinics.
- 221 Final Report, *supra* note 219, at 4-5.
- 222 *Id.* at 5. The Task Force solicited written comments from the American Arbitration Association, Consumers Union, Public Investors Arbitration Bar Association (“PIABA”), Securities Industry and Financial Markets Association, and other organizations. *See* Final Report, *supra* note 219, Appendix III.
- 223 *See* FINRA, *FINRA Dispute Resolution Arbitrator Training, Explained Decisions*, Mar. 2010, at 4, <https://www.finra.org/sites/default/files/ArbMed/p121132.pdf>.
- 224 FINRA, RULE 12904(g) (2009).
- 225 *Id.* Even if the parties do not jointly request an explained decision before the first arbitration hearing, the arbitrators may still provide one, but the arbitrators are not obligated to do so.
- 226 *See, e.g.*, Exchange Act Release No. 34-52009 (July 11, 2005) [70 FR 41065, 41065 (July 15, 2005)] (proposed rule to require explained decisions upon request by investors in FINRA arbitrations).
- 227 *See, e.g.*, Comment Letter, Barbara Black, Jill I. Gross & Deborah Summers, RE: Release No. 34-58862, File No. SR-FINRA-2008-051, Notice of Filing of Proposed Rule Change Relating to Amendments to the Codes of Arbitration Procedure to Require Arbitrators to Provide an Explained Decision upon the Joint Request of the Parties (Nov. 20, 2008) [hereinafter Black-Gross letter], at 6, <http://www.sec.gov/comments/sr-finra-2008-051/finra2008051-1.pdf>.
- 228 *Id.*
- 229 Final Report, *supra* note 219, at 21.
- 230 FINRA Rule 12904(g) requires arbitrators to provide a brief, fact-based explanation of their award when requested by both parties to the dispute.
- 231 Final Report, *supra* note 219, at 23.
- 232 *Id.* at 22.
- 233 The Black-Gross letter provides an interesting discussion of the effects of continuing to frustrate retail investors, in the context of FINRA’s explained decision rule proposal in 2008: “Although this revision respects arbitration as a process valuing all parties’ consent, we have concerns

- that this change does not adequately address the apprehension investors have over the fairness of the process. Securities arbitration is, as a practical matter, mandatory. . . . As a consequence, investors who request a written explanation in a case where brokers and/or firms decline to request one may believe they have little control over the process. If those investors are unhappy with the outcome of the hearing, their perceptions of unfairness will only increase.” Black-Gross letter, *supra* note 227, at 5. This analysis is equally relevant to the Task Force’s explained decisions recommendations.
- 234 FINRA BrokerCheck, <http://brokercheck.finra.org> (last visited May 11, 2016).
- 235 *Id.*
- 236 *See Expungement Training (Part II)*, FINRA, <https://www.finra.org/arbitration-and-mediation/expungement-training-part-ii> (last visited May 11, 2016); *see also*, Expanded Expungement Guidance, *infra* note 240.
- 237 FINRA, RULE 2080(a) (2004).
- 238 FINRA, RULE 2080(b)(1) (2004).
- 239 FINRA, RULE 12805(c) (2009).
- 240 *Notice to Arbitrators and Parties on Expanded Expungement Guidance*, FINRA, <https://www.finra.org/arbitration-and-mediation/notice-arbitrators-and-parties-expanded-expungement-guidance> (last updated Sept. 2015) [hereinafter Expanded Expungement Guidance].
- 241 PIABA published studies in 2007, 2013, and 2015, and Seth E. Lipner, Professor of Law, Zicklin School of Business, Baruch College, published a study in 2013. All four studies show alarmingly high percentages of expungements granted in settled and stipulated matters. *See* PIABA, PIABA 2007 EXPUNGEMENT STUDY (Sept. 24, 2007), <https://piaba.org/system/files/pdfs/September%2024,%202007%20including%20Expungement%20Study.pdf>; PIABA, EXPUNGEMENT STUDY OF THE PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION (Oct. 16, 2013), <https://piaba.org/system/files/pdfs/PIABA%20Expungement%20Study.pdf>; PIABA, UPDATE TO THE 2013 EXPUNGEMENT STUDY OF PIABA (Oct. 20, 2015), <https://piaba.org/system/files/pdfs/Update%20on%20the%202013%20Expungement%20Study%20of%20PIABA%20%28October%2020%2C%202015%29.pdf>; Seth E. Lipner, ANALYSIS OF EXPUNGEMENT AWARDS IN SETTLED FINRA CUSTOMER ARBITRATIONS JANUARY 1, 2013 - JUNE 30, 2013 (2013) (on file with the Ombudsman).
- 242 Expanded Expungement Guidance, *supra* note 240.
- 243 Antoinette Gartrell, *FINRA to Address Expungement Issues, Arbitration Chief Says*, BNA (Mar. 21, 2016), <http://www.bna.com/finra-address-expungement-n57982068766>; *see also*, *Update: FINRA Board of Governors Meeting* (Sept. 17, 2015), FINRA, <http://www.finra.org/industry/update-finra-board-governors-meeting-14> (announcement of FINRA’s intended rulemaking codifying best practices).
- 244 NASAA is an organization that represents states securities regulators. *See Our Role*, NASAA, <http://www.nasaa.org/about-us/our-role> (last visited May 12, 2016).
- 245 *See* Comment Letter from William Beatty, President, NASAA, to FINRA Dispute Resolution Task Force (Aug. 31, 2015), <http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2011/07/NASAA-Expungement-Letter-enclosure.pdf>. NASAA provided two comment letters to the Task Force. The above NASAA letter focused exclusively on expungement. CRD is maintained by FINRA on behalf of both FINRA and NASAA.
- 246 Final Report, *supra* note 219, at 28.
- 247 *Id.* at 55 (Expungement, item 1).
- 248 *Id.* at 27.
- 249 *Id.* at 55 (Expungement, item 3).
- 250 *Id.* at 28.
- 251 *See id.* *See also, id.* at 55 (Expungement, item 2). In October 2013, FINRA published its Expanded Expungement Guidance. In February 2014, FINRA revised its training for all arbitrators. *See* Exchange Act Release No. 34-72649 (July 22, 2014) [79 FR 43809, 43811 (July 28, 2014)] (order approving FINRA Rule 2081). The Task Force’s recommendation for additional training would presumably expand on the pre-existing training already available to arbitrators although the Task Force does not specify what areas are insufficiently covered by the existing training program.
- 252 Exchange Act § 39(a), 15 U.S.C. § 78pp(a).
- 253 *Id.*
- 254 Exchange Act § 39(a)(2)(B), 15 U.S.C. § 78pp(a)(2)(B).
- 255 Exchange Act § 39(g), 15 U.S.C. § 78pp(g).
- 256 Exchange Act § 39(h), 15 U.S.C. § 78pp(h).
- 257 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.”
- 258 For the full versions of the recommendations, *see* SEC, <http://www.sec.gov/spotlight/investor-advisory-committee-2012.shtml> (last visited May 12, 2016).
- 259 17 C.F.R. §§ 200.735-3(b)(2)(i), 230.122 (2014); Exchange Act § 24(b), 15 U.S.C. § 78x; 5 U.S.C. § 552a(i)(1); SEC18-2, Section 8.5 (Nonpublic Information) (July 31, 2005).
- 260 *Supra* note 150.

- 261 SEC, *Recommendation of the Investor Advisory Committee: Empowering Elders and Other Investors: Background Checks in the Financial Markets* (July 16, 2015), http://www.sec.gov/spotlight/investor-advisory-committee-2012/final_iac_backgroundcheck_recommendation_071615.pdf.
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- 263 Michael S. Piwowar & Kara M. Stein, Comm’rs, SEC, Statement Regarding Proposals to Shorten the Trade Settlement Cycle (June 29, 2015), <http://www.sec.gov/news/statement/statement-on-proposals-to-shorten-the-trade-settlement-cycle.html>.
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- 265 SEC, Notice of Filing of Proposed Rule Change Consisting of Proposed Amendments to Rules G-12 and G-15 to Define Regular-Way Settlement for Municipal Securities Transactions as Occurring on a Two-Day Settlement Cycle and Technical Conforming Amendments, Exchange Act Release No. 77364 (Mar. 14, 2016) [81 FR 14906 (Mar. 18, 2016)], <http://www.sec.gov/rules/sro/msrb/2016/34-77364.pdf>.
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- 267 FINRA, Regulatory Notice 16-09, Shortening the Settlement Cycle for Securities to T+2 (Mar. 2016), https://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-16-09.pdf.
- 268 Exchange Act Rule 14a-2(a)(1), 17 C.F.R. § 240.14a-2(a)(1) (2015).
- 269 SEC, *Recommendations of the Investor Advisory Committee: Impartiality in the Disclosure of Preliminary Voting Results* (October 9, 2014) <http://www.sec.gov/spotlight/investor-advisory-committee-2012/impartiality-disclosure-prelim-voting-results.pdf>.
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- 271 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>.
- 272 *Id.* at 89.
- 273 *Id.*
- 274 *Id.* at 90-91.
- 275 *Id.*
- 276 *Id.* at 91.
- 277 *Id.* at 94-96.
- 278 SEC, *Recommendation of the Investor Advisory Committee: Crowdfunding Regulations* (Apr. 10, 2014), <http://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-adviser-crowdfunding-recommendation.pdf>.
- 279 SEC, Final Rule, Crowdfunding, Securities Act Release No. 9974 (Oct. 30, 2015) [80 FR 71387 (Nov. 16, 2015)] [hereinafter Crowdfunding Final Rule], <http://www.sec.gov/rules/final/2015/33-9974.pdf>.
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- 287 *Id.* at 191-95.
- 288 *Id.* at 193.
- 289 *Id.* at 186-87.
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- 291 SEC, *Recommendation of Investor Advisory Committee: Decimalization and Tick Sizes* (Jan. 31, 2014), <http://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-adviser-decimalization-recommendation.pdf>.
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- 303 Mark Wyatt, OCIE Director, SEC, Remarks before the IAC (April 14, 2016), video replay available at http://www.sec.gov/video/webcast-archive-player.shtml?document_id=041416iac.
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OFFICE OF THE
INVESTOR ADVOCATE

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

