NASAA Insight

The Voice of State & Provincial Securities Regulation

Summer 2013

NASAA, SEC Commissioner Share Common Message: The Time Has Come to End Forced Arbitration

NASAA President Heath Abshure and SEC Commissioner Luis Aguilar delivered a common message during NASAA's 2013 Spring Conference: the time has come to end "forced" pre-dispute securities arbitration.

Abshure and Aguilar spoke about the "troubling" decrease in investor protections and civil recovery options, such as limitations on the use of class actions and the "take it or leave it" aspect of forced pre-dispute arbitration agreements.

"When it comes to addressing disputes that may arise between investors and their broker-dealers, investors should have a choice of arbitration or litigation," Abshure said during the annual NASAA/SEC 19(d) meeting. "Investors should not be forced into the 'take it or leave it' scenario they now face with mandatory pre-dispute arbitration clauses in customer agreements with their broker-dealers."

Abshure said a decision by Charles Schwab & Company to expand its forced arbitration contracts to require that investors waive their right to participate in class actions makes it essential that the SEC intervene.

He noted that Section 921 of the Dodd-Frank Act provides the SEC with rulemaking authority to prohibit or impose conditions on the use of mandatory pre-dispute arbitration agreements. "I'd like to take the opportunity to encourage you to exercise this authority," Abshure told the gathering of federal and state regulators.

Aguilar told fellow regulators he agreed that investors should have the "unencumbered right" to seek redress in all available forums.

"By providing investors with the ability to choose the forum in which to bring their legal claims and protect their legal rights, we enhance investor protection and add more teeth to our federal securities laws," Aguilar said. "My main concern with pre-dispute mandatory arbitration is the denial of investor choice; investors should not have their option of choosing between arbitration and the traditional judicial process taken away from them at the very beginning of their relationship with their brokers and advisers."

Aguilar and Abshure also noted that these infringements on investor protections are happening just as

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NASAA Policy Conference Panels Explore New Frontiers of Investor Protection

State and Canadian securities regulators gathered in Washington, D.C. on April 16 for NASAA's annual Public Policy Conference.

Rep. Jim Himes (D-CT) delivered the keynote luncheon address at this year's conference. Rep. Himes is a member of the House Financial Services Committee and its Subcommittee on Capital Markets, Insurance, and Government-Sponsored Enterprises. Currently serving his third term in Congress, Rep. Himes is Vice Chair of the moderate, pro-growth New Democrat Coalition, and Vice Chair of the coalition's Financial Services Task Force.

Rep. Jim Himes (D-CT) and Heath Abshure, NASAA President and Arkansas Securities Commissioner (right).

Other speakers included SEC Commissioner Elisse Walter and American University Professor James Thurber, an expert on campaigns, elections and presidential-congressional relations.

Chaired by Washington Securities Director William Beatty, this year's conference also featured two panel discussions: "Retail Investors and the Markets: Is the Deck Stacked?" and "Cost-Benefit Analysis: Sifting Through Fact and Fiction."

The first panel, moderated by North Carolina Deputy Securities Administrator David Massey, debated whether small retail investors can still rely on the securities markets given the growth in high-frequency trading, complex financial products and intricate trading strategies.

The second panel, moderated by Ohio Securities Commissioner Andrea Seidt, provided an in-depth examination of the advantages and disadvantages of requiring independent federal agencies to measure and compare the benefits and costs of proposed regulations.

From the Leadership

President's Message: Heath Abshure

"Action speaks louder than words but not nearly as often." | Mark Twain

Much of this edition of the *NASAA Insight* is focused for good reason on our continued call for an end to forced pre-dispute securities arbitration.

After weathering blistering criticism for its recent decision to expand its customer arbitration agreements to include a waiver of customer rights to participate in class action lawsuits against it, Charles Schwab & Co. appeared to backtrack a bit.

On May 15, the brokerage firm made the following statement about class action waivers in Schwab client account agreements:

Effective immediately, Schwab is modifying its account agreements to eliminate the existing class action lawsuit waiver for disputes related to events occurring on or after May 15, 2013, and for the foreseeable future.

While the company believes that dispute resolution is best handled via FINRA arbitration, we have chosen to voluntarily remove the waiver going forward until the issue is resolved by the appropriate regulatory and/or court decisions. Given that the process will likely take considerable time to resolve, and may leave clients with a degree of uncertainty about their dispute resolution options in the meantime, we have elected to remove that uncertainty until the legal and regulatory process is completed.

To help ensure that small investors have access to pursue any claims they consider appropriate within the arbitration forum available to them, we will continue our existing policy of paying for the arbitration fees of any investor electing to pursue an arbitration claim under $25,000 against Schwab.

This is no real victory. It is nothing more than a public relations statement; words with no real action.

Schwab has not changed its position and the matter remains before FINRA's National Adjudicatory Council. However, this public relations statement does show that Schwab has at least heard our voices. We have to remain aggressive if we want Schwab, the SEC, and Congress to heed our call. We will keep up the fight.

With regard to the last paragraph of the Schwab release, this sounds good but has no real merit. Do arbitration fees include attorney's fees? What if those fees exceed the $25,000 (which is very likely)? What happens if the investor has a $30,000 claim or even a $75,000 claim? These investors aren't likely to find an attorney willing to take their case.

While not the resolution we are striving for, Schwab's statement does show that our efforts are being noticed. This should motivate us to continue our strong efforts to end or appropriately limit mandatory arbitration clauses and class action waivers.

Executive Director's Message: Russ Iuculano

That sound you hear off in the distance is NASAA's steady drumbeat calling for the end of forced arbitration clauses. These clauses have become much more troubling in light of the further erosion of investor rights arising from the Schwab case.

On April 17, NASAA members from 18 jurisdictions went to 53 Congressional meetings on Capitol Hill to encourage their members of Congress to ask the SEC to ban or limit pre-dispute mandatory securities arbitration.

Many agreed to join Sen. Al Franken's letter to SEC Chair Mary Jo White encouraging the agency to promptly use its authority to impose limits on the use of forced arbitration agreements.

In the aftermath of Sen. Franken's (D-MN) letter, NASAA President Heath Abshure wrote to Chair White encouraging her to promptly use the authority granted to the SEC in Section 921 of the Dodd-Frank Act to ban or impose limits on the use of mandatory arbitration clauses in broker-dealer and investment adviser customer contracts.

On the congressional front, Sen. Franken and Rep. Hank Johnson on May 7 reintroduced legislation, The Arbitration Fairness Act of 2013, to eliminate forced arbitration in securities, consumer, employment, civil rights and antitrust cases. The bills, S. 878 and H.R. 1844, are co-sponsored by 17 Senators and 22 Representatives.

In other developments, NASAA on May 8 filed an amicus brief supporting FINRA's efforts to overturn a decision by a FINRA hearing panel that allowed Charles Schwab & Co. to prevent its customers from participating in class-action lawsuits. Two similiar amicus briefs were filed by other investor protection organizations that day.

So much has been accomplished, yet we have a long way to go to end this investor protection gap.

NASAA Issues **Advisory** on Private Placements

In advance of a federal rule to allow advertising of high-risk and potentially fraudulent private placement offerings, NASAA issued an advisory on April 2 cautioning investors about the risks these offerings carry.

Private placement offerings allow companies to raise money by selling stocks, bonds and other instruments.

Currently, Rule 506 of Regulation D of the Securities Act of 1933 does not permit general solicitation or advertising of private placement offerings. The JOBS Act directed the Securities and Exchange Commission (SEC) to lift this ban as long as the sales are limited to "accredited" investors – people who have sufficient wealth or access to information.

"State securities regulators are concerned that Main Street investors will be lured into high-risk or fraudulent investments when the ban on general solicitation of private placement offerings is lifted," said NASAA President and Arkansas Securities Commissioner Heath Abshure.

Once implemented, this rule will allow companies and promoters to offer securities through direct mail, cold calls, online ads, free lunch seminars and television or radio commercials.

Because private placement offerings made in reliance on Rule 506 of Regulation D are not reviewed by state regulators, they have become a haven for fraud.

Advisory Details Importance of Understanding the Types of **Financial Professionals**

NASAA released an advisory on the importance of understanding the distinctions between the different types of financial professionals.

"It pays to understand the differences between a broker-dealer agent, an investment adviser representative, and a financial planner," said Heath Abshure, NASAA president and Arkansas Securities Commissioner.

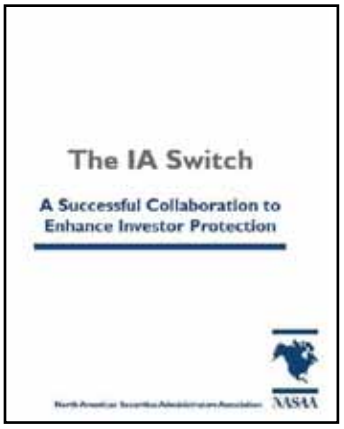
The April 30 advisory provides basic information on these types of financial services professionals and their obligations to investors.

"With so many brokers and salesmen calling themselves 'financial advisors,' or 'investment consultants,' it is easy to see how investors might assume these individuals are licensed investment advisers," Abshure said. "That's one reason why NASAA continues to call on federal securities regulators to require all financial professionals providing personalized investment advice to retail investors to be held to a high fiduciary standard."

The advisory, part of NASAA's Informed Investor series, also provides questions to ask your financial professional and warning signs to watch for.

NASAA IA Switch Report

The Largest Coordinated Regulatory Event Between State Securities Regulators, SEC



NASAA released a report on May 20 documenting the successful completion of the transfer of mid-sized investment advisers from federal to state oversight as called for by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

"This report details the history of the IA switch and the accomplishments of NASAA members and staff to ensure that the largest coordinated regulatory event between the states and the SEC was accomplished successfully," said Heath Abshure, NASAA President and Arkansas Securities Commissioner.

The Switch stemmed from Section 410 of the Dodd-Frank Act, which raised the assets under management threshold for state regulation of investment advisers from $25 million to $100 million. "The regulatory transfer of more than 2,100 IAs from federal to state oversight was one of the most significant achievements in NASAA's history," Abshure said.

Currently, states oversee approximately 17,350 investment adviser firms with assets under management of about $269 billion, while the SEC has regulatory responsibility for about 10,540 investment adviser firms.

"The Switch represents a good example of how state and federal securities regulators can and do collaborate, and I commend both state securities administrators and staff, and the staff of the SEC for working together to provide investors with stronger investment adviser oversight," Abshure said.

An Important Accouncement About Series 63, 65, and 66 Exam Fees

Enrollment fees for state Series 63, 65 and 66 exams increased June 1. Current fees are below:

- Series 63 exam: $115, previously $96;
- Series 65 exam: $155, previously $135; and
- Series 66 exam: $145, previously $128.

2013 NASAA Public Policy Conference

Arbitration, Cost Benefit Analysis in the Spotlight

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crowdfunding and the expanded use of general solicitation under Regulation D, Rule 506 are preparing to launch.

Although arbitration should remain an option for investors, Abshure noted it shouldn't be the only available civil remedy, especially concerning crowdfunding. "Arbitration doesn't make sense for a $10,000 investment, much less a $2,000 investment—which is the size contemplated by the crowdfunding provisions in the JOBS Act," he said.

"I agree with NASAA's request that Congress amend the Securities Exchange Act of 1934 to allow for a private civil action against a person that provides substantial assistance in violation of the Exchange Act," Aguilar said. "Private actions give fraud victims the ability to recover their losses."

Because crowdfunding encourages large numbers of investors to make relatively small investments, one act of fraud may affect many people at once, Abshure said. He argued that for crowdfunding to be successful, class action relief must be available to investors. Abshure said NASAA will advocate for amendments to federal law to permit private lawsuits for fraud associated with small offerings.

Abshure emphasized that, despite NASAA's concerns with crowdfunding and the increased use of Rule 506, state securities regulators want to see small businesses get the capital they need to grow. "But, investment follows trust, and the JOBS Act fails to facilitate this investor trust," he said

"While Rule 506 has allowed many legitimate companies to raised money and prosper… [it also] has resulted in significant fraudulent activities," Aguilar agreed.

In 2011, state securities regulators and the SEC, collectively, filed more than 324 enforcement actions related specifically to Rule 506 offerings, according to Aguilar.

Aguilar also said he was "disappointed" that the SEC has yet to implement the Bad Actor Rule under Dodd-Frank, which would prevent so-called "bad-actors" from using Rule 506. "The adoption of a disqualification provision would provide much needed investor protection and would not be detrimental to legitimate issuers," he said.

Rep. Jim Himes (D-CT) gives the Keynote Address during NASAA's Public Policy Conference.

SEC Commissioner Elisse Walter speaks on the need for increased examination of investment advsiers and the challenges ahead.

Bill Beatty, Washington Securities Division Director and NASAA Spring Conference Chair opens the program.

Moderator and North Carolina Deputy Securities Administrator David Massey (left) with Maureen Jensen, Executive Director of the Ontario Securities Commission, and Senate Counsel Tyler Gellasch discuss the market environment for investors.

Vanessa Countryman, Deputy Chief Counsel of the SEC's Division of Risk, Strategy and Financial Innovation, discusses cost-benefit analysis.

Vermont Securities Director and NASAA Broker-Dealer Section Chair John Cronin makes a point during a discussion of the fairness of securities markets for Main Street investors.

NASAA Executive Director Russ Iuculano (right) greets noted political expert and American University Professor James Thurber, who painted the political landscape for the remainder of the year in a panel discussion with NASAA Policy Director Mike Canning.

Panel moderator and Ohio Securities Commissioner Andrea Seidt poses a question on cost-benefit analysis to panelist Eugene Scalia.

NASAA, Others Call on SEC to Move on Fiduciary Rulemaking

A broad-based coalition, including NASAA, sent a letter to SEC Chair Mary Jo White in June urging the agency to establish a uniform fiduciary standard for broker-dealers and investment advisers that is at least as strong as the existing standard for investment advisers and pledging their vigorous opposition to any rule that would weaken investor protections.

The letter outlines the group's concerns that the SEC's March Request For Information (RFI) signals that the SEC may be backing away from requiring a fiduciary standard for broker-dealers that is "no less stringent" than the one under which registered investment advisers currently operate.

"The assumptions contained in the RFI fail to include key elements of the fiduciary standard such as the obligation to act in the best interest of the customer. If the fiduciary duty is based on the RFI assumptions, it would be weaker than that originally set forth in the Section 913 Study and far less stringent than that currently imposed under the Advisers Act," the letter said.

"If the SEC were to adopt this approach, we fear that it would significantly weaken the fiduciary standard for SEC-registered investment advisers, while adding few new protections for investors who rely on broker-dealers for investment advice. This approach would have negative consequences for investors and is one we would vigorously oppose."

Joining NASAA on the letter were the AARP, American Institute of Certified Public Accountants, Certified Financial Planner Board of Standards, Consumer Federation of America, Financial Planning Association, Fund Democracy, Investment Adviser Association, and National Association of Personal Financial Advisors.

NASAA Supports User Fees for Increased Federal Examinations

In an April 19 letter to Reps. Maxine Waters (D-CA) and John Delaney (D-MD), NASAA applauded their introduction of legislation authorizing the SEC to charge "user fees" on federally registered investment advisers.

The Investment Adviser Examination Act of 2013 (H.R. 1627) would amend the Investment Advisers Act of 1940 to provide the SEC with the authority to impose and collect user fees on investment advisers for the purpose of increasing the number and frequency of SEC examinations at no additional expense to taxpayers. The legislation will not impose additional costs and added regulation on the thousands of small and mid-size investment adviser firms that are registered with and regulated by the states.

"State securities regulators strongly support Congressional efforts to improve the oversight of federally registered investment advisers by acting on a recommendation of the Dodd-Frank Act and establishing a dedicated funding mechanism to ensure that the SEC's Office of Compliance, Inspections, and Examination's resources are aligned with its examination responsibilities," Heath Abshure, NASAA President and Arkansas Securities Commissioner, said in a statement.

"State securities regulators and the investment adviser industry agree that authorizing the SEC to collect 'user fees' from the investment advisers it examines is the most effective and efficient way to provide for more robust oversight of federally registered investment advisers.

"NASAA commends Representatives Waters and Delaney for their leadership in this area, and hopes that other members of Congress who have been vocal in their support of policies to strengthen investor protection will lend their support to the Waters-Delaney bill," Abshure said.

Since the bill's introduction, four House memebrs have joined as co-sponsors, including Reps. Ellison, Capuano, Markey and Moore.

NASAA Opposes Bill Imposing More Cost-Benefit Analysis on SEC

NASAA has voiced strong opposition to a bill that would establish "a significant number" of additional cost benefit analyses that the SEC would be required to complete when issuing a new regulation.

The SEC Regulatory Accountability Act (H.R. 1062) would impose new requirements that would "substantially impede the ability of the SEC to conduct rulemaking, but will also create standards that could conflict with the SEC's investor protection mission," NASAA wrote in letters to House Financial Services Committee Chair Rep. Jeb Hensarling (R-TX) and Ranking Member Rep. Maxine Waters (D-CA).

"State securities regulators appreciate the importance of the rigorous regulatory cost-benefit and cost-effectiveness analyses to which independent agency rules are subjected," NASAA wrote. "The SEC is already subject to extensive and exacting cost-benefit analysis standards, and the new analytical hurdles imposed by H.R. 1062 could have a detrimental effect on the SEC's ability to meet its regulatory mandate. Moreover, the costs of such additional hurdles (i.e., rulemaking delays, increased staffing demands, and additional taxpayer dollars) will likely outweigh the intended benefit that the expanded analyses are intended to provide.

"The unintended consequence of H.R. 1062, if enacted, would be the derailment of important investor protections that are essential to a robust and stable capital marketplace," NASAA wrote.

NASAA Joins Call to Reverse Ruling Allowing Schwab to Deny Rights

NASAA filed an amicus brief May 8 supporting FINRA's efforts to overturn a decision by a FINRA hearing panel that allowed Charles Schwab & Co. to prevent its customers from participating in class-action lawsuits.

"Schwab's attempt to unilaterally alter its account agreements to include the class action waiver is an obvious attempt by the firm to insulate itself from liability to its own clients," said Heath Abshure, NASAA President and Arkansas Securities Commissioner. "This ruling would essentially allow broker-dealers to prohibit participation in class actions against them by their customers. That's wrong on the merits and bad public policy."

NASAA's amicus brief was filed with FINRA's National Adjudicatory Council (NAC), the national committee that reviews initial decisions rendered in FINRA disciplinary and membership proceedings. The Public Investors Arbitration Bar Association (PIABA) filed a related amicus. A similar brief was filed jointly by AARP, the National Consumer Law Center and Public Justice supporting FINRA's efforts to overturn the hearing panel's decision.

"Our interest in this case stems from our strong belief that investors should be free to join with other investors through the representative class action process to resolve claims that are too costly to bring independently," Abshure said. "The hearing panel's decision deprives investors of this choice through an erroneous application of the Federal Arbitration Act and should therefore be reversed."

Read NASAA's New Issue Focus: Forced Arbitration www.nasaa.org

NASAA Urges SEC to Use Section 921 Authority to Protect Investors' Rights in Light of Schwab Class-Action Waiver

NASAA leveraged Charles Schwab & Co.'s demand for its customers to waive their right to participate in class actions by calling upon the SEC to use the authority granted to the agency in Section 921 of the Dodd-Frank Act to prohibit or impose limits on the use of mandatory arbitration clauses in broker-dealer and investment adviser customer contracts.

In a May 3 letter to SEC Chair Mary Jo White, NASAA President and Arkansas Securities Commissioner Heath Abshure said "it is essential" for the SEC to act given Schwab's action.

"The decision by Charles Schwab & Co. to include class action waivers in the arbitration provisions of its customer contracts is yet another example of the pernicious effects of mandatory arbitration clauses," Abshure wrote.

"Schwab's decision to flaunt FINRA rules prohibiting the use of such clauses coupled with the decision by a FINRA Hearing Panel not to enforce those rules highlights the importance of Section 921. Now, more than ever, it is essential that the SEC use its authority to insure that investors have meaningful remedies and a choice of forums in which to resolve disputes with broker-dealers and investment advisers," Abshure wrote.

Similar concerns were raised on April 26 by Sen. Al Franken (D-MN) and 36 Congressional colleagues expressing deep concern "that the Commission's failure to respond to the dangers posed by widespread forced arbitration will weaken existing investor protections," wrote Sen. Franken and his colleagues in their letter. "We urge the Commission to act quickly to exercise its authority...to prevent this practice and protect investor rights."

In a speech to FINRA on May 21, SEC Commissioner Elisse Walter said the SEC is unlikely to focus on arbitration "in the next few months or this year" because of backlogged Dodd-Frank and JOBS Act rulemakings.

NASAA Applauds Bill Upholding Investors' Arbitration Rights

NASAA strongly supports the Arbitration Fairness Act of 2013, recently introduced in the Senate (S. 878) by Sen. Al Franken (D-MN) and House (H.R. 1844) by Rep. Hank Johnson (D-GA) that would prohibit mandatory, pre-dispute arbitration clauses.

"As the closest regulators to Main Street investors, state securities regulators commend Sen. Franken and Rep. Johnson for their leadership and shared belief that investors should not be forced into the 'take it or leave it' scenario they now face with mandatory pre-dispute arbitration clauses in customer agreements with their broker-dealers," said NASAA President Heath Abshure.

By prohibiting mandatory, pre-dispute arbitration clauses, the AFA restores investors' access to the courts and upholds the original intent of the Federal Arbitration Act, which was enacted in 1925 to honor agreements to arbitrate between mutually consenting parties.

"The Arbitration Fairness Act of 2013 reaches beyond the securities regime and eliminates mandatory, pre-dispute arbitration clauses in a wide range of consumer contracts. It restores investors' access to the courts, and allows them to determine, after a dispute arises, if arbitration is the appropriate and desired forum," Abshure said. "This legislation is consistent with the intent and spirit of Section 921 of the Dodd-Frank Act, and it removes the ability of any brokerage firm to unilaterally restrict an investor's ability to seek judicial relief."

NASAA: Because Every Investor Deserves Protection

About Us

The North American Securities Administrators Association (NASAA) is a voluntary association of securities administrators in the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada and Mexico.

Organized in 1919, NASAA is the oldest international organization devoted to investor protection.

As the preeminent organization of securities regulators, NASAA is committed to protecting investors from fraud and abuse, educating investors, supporting capital formation and helping ensure the integrity and efficiency of financial markets.

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NASAA Annual Conference

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Upcoming Events:

NASAA Annual Conference
Salt Lake City, Utah
October 6-8, 2013

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