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NASAA

May 26, 2020

Ms. Petrina Thomas
U.S. House Financial Services Committee
Clerk of the Committee
2129 Rayburn House Office Building
Washington, DC 20515

Re: May 26, 2020, Bipartisan Roundtable – "Examining the Impacts of the COVID-19 Pandemic on U.S. Capital Markets"

Dear Ms. Thomas:

Enclosed please find background materials in connection with my participation in today's bipartisan roundtable, entitled "Examining the Impacts of the COVID-19 Pandemic on U.S. Capital Markets" before the House Financial Services Committee's Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets.

Should you have any questions, please contact Mike Canning, NASAA's Director of Policy & Government Affairs, at (202) 737-0900.

Sincerely,

Christopher W. Gerold
NASAA President and New Jersey Securities Commissioner

NASAA's Legislative Recommendations for COVID-19 to the House Financial Services Committee (April 16, 2020)

To: **U.S. House Committee on Financial Services**
From: **NASAA Policy & Government Affairs**
Date: **April 16, 2020**
Re: **Preliminary Recommendations for COVID-19 "Phase 4" Response Legislation**

I. Enhanced Senior Investor Protection in Response to the Pandemic:

1. ***Congress should pass legislation that would reauthorize and update the Senior Investor Protection Grant Program established by DFA Sec. 989A, clarify that the program be funded in the same manner that the CFPB funds all of its other operations and activities, and target relief specifically to threats from criminals and scam-artists seeking to capitalize on the sense of panic and uncertainty created by the COVID-19 pandemic.*** Under the reconstituted bill, certain requirements from 989(A) would be eased, and qualifying states would be able to pursue a maximum grant of $750,000 annually to combat scams of all manner that target senior and other vulnerable investors, including especially scams intended to take advantage of the Pandemic. Eligible states could pursue grant funds for up to two consecutive years, for a total of $1.5 million in grant funding per state.[1] Legislative language to effectuate this policy recommendation is available upon request.

2. ***Congress should pass the Senior Security Act to establish an interdivisional SEC Task Force that will focus on issues impacting elderly investors.*** Among other things, the mandated SEC Task Force would be required to coordinate with state securities regulators in order to maximize resources and share information. The House has already overwhelmingly voted in favor of this bipartisan bill.[2] Companion legislation has been introduced in the Senate by Sens. Sinema (D-AZ) and Collins (R-ME) and is now pending with four Republican cosponsors and four Democratic cosponsors. SEC Chairman Clayton has also endorsed the legislation.[3]

II. Enforcement Tools and Penalties Geared to the Pandemic:

1. ***Congress should promptly pass legislation authorizing disgorgement claims brought by the SEC, which the agency currently requests as an equitable remedy***. Any statute of limitations attached to disgorgement should correct the harmful impact of the U.S. Supreme Court's 2017 decision in *Kokesh v. SEC*, which bars the agency from seeking disgorgement past five years. The House has already approved bipartisan legislation addressing the implication of the *Kokesh* decision by passing H.R. 4344, The Investor Protection and Capital Markets Fairness Act.[4]

[1] On October 9, 2019, the HFSC held a hearing on draft legislation entitled "The Empowering States to Protect Seniors from Fraud Act" that would effectuate this recommendation. With minor adjustments, this provision could be incorporated into any "Phase 4" legislation and be promptly implemented to great and positive effect.
[2] See: S. 1719, the Senior Security Act (https://www.congress.gov/bill/116th-congress/senate-bill/1719)
[3] See Press Release. https://gottheimer.house.gov/news/documentsingle.aspx?DocumentID=1457
[4] Since the *Kokesh* decision in 2017, the court ruling has prevented the SEC from collecting roughly $1 billion/year. In September 2019, the HFSC voted 49-5 votes to approve a bipartisan bill – "The Investor Protection and Capital Markets Fairness Act, H.R. 4344" – which would erase the detrimental impact of *Kokesh* by extending the federal statute of limitations for disgorgement, injunctions, and officer & director bars to 14 years (from 5 years today). https://corpgov.law.harvard.edu/2019/10/17/public-enforcement-after-kokesh-evidence-from-sec-actions/

2. ***Congress should enact bipartisan legislation to modernize and enhance the SEC's statutory penalty authorities.*** Federal securities laws limit the amount of civil penalties the SEC can impose on an institution or individual. Hearings in the wake of the financial crisis established that the present statutory limit on the SEC's authority to pursue civil penalties significantly "ties the hands" of the SEC in performing its enforcement duties. However, for enforcement to be effective as a deterrent, the costs to violators must be meaningful as a punishment. Therefore, as the country confronts a new economic crisis, Congress should promptly expand the SEC's enforcement toolbox to meet the challenges of the moment. As a starting point, the HFSC can look to legislation that passed the House with strong, bipartisan support in 2019.[5]

3. ***Congress should pass legislation to revise Section 922 of the Dodd-Frank Act of 2010 to clarify that the law's anti-retaliation provisions protect whistleblowers who report alleged misconduct to their employer.*** The SEC's Whistleblower Program, instituted under the Dodd-Frank Act, has proven to be an extremely effective tool for uncovering corporate wrongdoing.[6] Unfortunately, in 2018, imprecision in the drafting of Sec. 922 resulted in the U.S. Supreme Court's finding that the plain text of the section affords protection *only* to whistleblowers who report *directly* to the SEC.[7] By opening the door to corporate retaliation against whistleblowers who seek to do the right thing by reporting misconduct to their employers, the Court's decision has made the Whistleblower Program somewhat less effective. The House has already advanced legislation to address this problem, and now is the time for the full Congress to do the same.[8]

4. ***Congress should direct FinCEN to provide state securities regulators with access to SARs reports on the same terms as other state regulatory agencies tasked with enforcing BSA/AML.*** State securities regulators are currently not among the enumerated agencies with whom broker-dealers are permitted to disclose SARs. However, state securities regulators oversee broker-dealers who are required to file SARs pursuant to Chapter X, Section 1023, and conduct examinations of broker-dealers that can include inspecting their AML compliance programs for policies and procedures. SARs are highly useful because the suspicious activity is presented in a clear and concise way, and associated with one or more transactions, which enables the regulators to initiate cases, guide existing investigations, and identify trends within the industry. For that reason, many state securities regulators would benefit from having access to SARs, especially during this time when fraudulent activity is expected to increase related to the current developments and market volatility. Legislative language to effectuate this policy recommendation is available upon request.

III. Investor Support, Assistance, and Recovery:

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[5] See: The Stronger Enforcement of Civil Penalties Act of 2019 (H.R. 3691). NASAA testified in support of this bill in April 2019. The bill has previously passed the HFSC on several occasions with bipartisan support, including initially in 2017, and part of the Republican Financial CHOICE Act.

[6] The SEC received over 5,200 whistleblower tips in FY 2018, which alerted it to numerous securities frauds, supplying information and documentation that the SEC's investigators otherwise may never have uncovered.

[7] Digital Realty Trust, Inc. v. Somers, 138 S. Ct. 767 (2018)

[8] See: H.R. 2515: To amend the Securities and Exchange Act of 1934 to amend the definition of whistleblower, to extend the anti-retaliation protections provided to whistleblowers, and for other purposes. (Sponsored by Rep. Al Green, H.R. 2515 passed the full House on July 9, 2019 by a recorded vote of 420-10)

1. ***Congress should pass the Investor Justice Act (discussion draft), which would fund legal clinics to assist investors via grants administered by the SEC Office of Investor Advocate.***[9] Investor advocacy clinics, such as clinical programs within law schools, fill a crucial gap by providing legal representation to retail investors who are unable to hire counsel due to the small size of their claims or who cannot afford legal representation. Law school clinics have represented 500 retail investors and recovered an estimated $5 million for their clients. Unfortunately, many law schools are unable to fund these clinics entirely and have been forced to limit their services or close indefinitely, leaving investors without other options. The draft "Investor Justice Act" would authorize the SEC Investor Advocate to provide $5 million annually in grants to qualifying investor advocacy clinics to allow them to remain operational. Legislative language to effectuate this policy recommendation is available upon request.

2. ***Congress should take steps to reduce and eliminate unpaid judgments resulting from disputes between investors and securities firms.*** Unpaid arbitration awards were an on-going, well-documented investor protection concern prior to the COVID-19 pandemic, and with the crisis now at hand, the scope of this problem is likely to expand considerably in the coming weeks and months. There are a variety of steps Congress could take to quickly remedy this problem.[10]

3. ***Congress should explore the possibility of creating a nationwide investor restitution fund to help victims of investment fraud recover a portion of what they lost when full restitution isn't possible.***[11] In many cases of investment fraud, some or all of the money defrauded from investors may be already gone by the time a scam artist is caught and prosecuted. In many cases, the victims of these investment scams are senior citizens who don't have as much time and resources to recover from losses as do younger victims. The establishment of a restitution fund to help qualifying investors recover a portion of their losses is a common-sense tool that can provide critical assistance to harmed investors, while also contributing to investor confidence broadly. Legislative language to effectuate this recommendation is available upon request.

4. ***Congress should consider ways to modernize and increase the protections afforded to investors via the Securities Investor Protection Corporation (SIPC).*** SIPC serves an important role in investor protection by overseeing the liquidation of member broker-dealer firms and returning securities and cash to their customers. SIPC protects each customer up to $500,000 for securities (including cash up to $250,000). The SIPC Fund includes amounts from member assessments and interest received on U.S. Government Securities. SIPC also has a $2.5 billion line-of-credit with the Treasury. Due to the economic impacts of COVID-19, broker-dealer

[9] See IAC Recommendation: https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac030818-law-clinics-recommendation.pdf

[10] For example, the SEC's Investor Advisory Committee held a session to examine potential solutions to the problem of unpaid judgement on December 13, 2018. (See: https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac121318-agenda.htm). In addition, FINRA has proposed but not yet adopted a rule that aims to mitigate the problem. (See: https://www.nasaa.org/wp-content/uploads/2019/07/NASAA-Reg.-Notice-19-17-Comment-Letter-7-1-19.pdf). Further, relevant legislation has been introduced in Congress. For example, see S. 2499, the Compensation for Cheated Investors Act of 2018.

[11] Several states have enacted laws creating state-wide restitution funds. For example, laws in Vermont, Montana, and Indiana could serve as the basis for a federal nation-wide restitution fund. See, for example: https://csimt.gov/your-investments/restitution-assistance-fund/ and https://www.fa-mag.com/news/vermont-creates-compensation-fund-for-investment-fraud-victims-45529.html

firms may experience a greater amount of financial stress or bankruptcy, which may deplete the funds paid out to customers. Legislative language to effectuate this recommendation is available upon request.

IV. **Private Marketplace Reforms***:*

1. ***Congress should use Phase 4 legislation as an opportunity to advance reforms related to private placement offerings conducted under SEC Rule 506.*** Bad actors will use the current volatility of the public securities markets to promote private offerings related to COVID-19. Since private securities transactions sold pursuant to certain Rule 506 exemptions are not subject to review by federal or state regulators, individuals may be pitched on fraudulent offerings. Fraudulent private securities offerings, e.g. Rule 506-like exemptions, are being pitched to retail investors.[12] Indeed, opportunists are already known to be exploiting the COVID-19 pandemic and market turmoil, including the current volatility of the public securities markets to promote public and private offerings related to COVID-19.

2. ***Congress should use Phase 4 legislation to increase transparency regarding the private securities marketplace.*** Important data on private offerings are limited, thereby hampering informed policymaking in the oversight of these markets. Moreover, state securities regulators have reported late Form D filings, a number of cases involving violations of general solicitation restrictions (such as cold calls to retail investors and postings on publicly accessible websites and social media), or issuers failing to verify accredited investor status in accepting investments. Investor risk and the need for straightforward and uncontroversial improvements to the private placement marketplace are evinced in by a multitude of recent developments observed by state regulators. Legislative language to effectuate this policy recommendation is available upon request.

V. **Other Reforms**:

1. ***Congress should require the SEC to "pause" major rulemakings, particularly rulemaking related to the SEC's Concept Release on the Harmonization of Securities Offering Exemptions, for at least 90 days.*** The SEC should dedicate its regulatory resources to addressing the effects of the COVID-19 pandemic to protect investors and ensure the integrity and stability of the securities markets. The pursuit of rulemakings unrelated to this pandemic would be a misallocation of limited federal resources. Further, the SEC's Concept Release contemplates significant expansions to private securities offering exemptions that put investors, public markets, and the economy at higher risk. The SEC has moved in that direction already, with its proposed amendments to the "accredited investor" definition. While the SEC has announced that it will not move forward with any rules until after April 24, both commenters and the Commission will require more time to understand recent developments and provide meaningful feedback in light of continuing health concerns and remote working conditions.

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[12] See actions taken by state securities regulators to halt fraudulent private securities offerings seeking to capitalize on the COVID-19 pandemic. http://asc.alabama.gov/News/2020%20News/4-8-20%20Ultra-Mining-CON-WATCH.pdf. https://www.ssb.texas.gov/news-publications/forex-trader-touts-recession-proofhaven-markets-roiled-covid-19.

The Hill Opinion – “Congress should pass funding to protect seniors from financial exploitation” (Dec. 18, 2019)

Congress should pass funding protect seniors from financial exploitation

BY CHRISTOPHER W. GEROLD, OPINION CONTRIBUTOR — 12/18/19 05:00 PM EST
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Members of Congress have an opportunity to significantly help fight against senior financial exploitation in each of their respective states – and they should take it.

State securities regulators are on the front lines of the fight against elder financial exploitation. We are in every state and every community. But because of a procedural knot, states are not receiving the funds Congress authorized nearly a decade ago to help in this critical battle. Now Congress has a way to untangle it.

Nearly a decade ago, the Dodd-Frank Act included a provision that would have created a senior investor protection grant program for state regulators. The grant program, which was to be administered by the Consumer Financial Protection Bureau (CFPB), was intended to help state regulators combat misleading or fraudulent marketing of financial products to seniors.

The grants would have provided funding for technology, equipment, and training for prosecutors to increase the successful prosecution of salespersons and advisers who target seniors with the use of misleading designations. The grants would have also provided educational materials and training to seniors to increase awareness and understanding of misleading or fraudulent marketing.

This provision in the Dodd-Frank Act reflected a bipartisan concern that seniors are susceptible to fraud, and a recognition by Congress that this threat was likely to intensify with the aging of America's "baby boom" generation.

Section 989(A) of the Dodd-Frank Act directed the CFPB to establish a tailored grant program designed to bolster state efforts to protect seniors against investment scams. States meeting the program's qualifications would be eligible to receive up to $1.5 million spread over a period of three consecutive years. That may not sound like a lot of money to some. But to states used to making every dollar count, these grants would have significantly helped combat senior financial exploitation – and still could if Congress acts.

Unfortunately, Congress authorized these grants, but the CFPB's funding structure makes it unclear whether the grants require an appropriation from Congress, or whether they could be funded in the same manner as all other CFPB activities.

A draft bill, "Empowering States to Protect Seniors from Bad Actors Act," recently proffered by House Financial Services Committee Chairwoman Maxine Waters (D-Calif.), would amend Section 989(A) of the Dodd-Frank Act to clarify that the senior investor protection grant program should be funded in the same manner as all other CFPB activities, removing any purported impediments to the CFPB establishing this crucial program.

The CFPB has an obligation to implement this critical senior investor protection grant program, and it is imperative that it do so. If this grant program was implemented and funded as intended in 2010, state securities regulators could have hired more staff and funded more investor education outreach to assist in preventing and prosecuting fraud committed against senior investors.

Senior financial exploitation is a growing problem across the nation as our population ages. Last year alone state securities regulators brought 141 enforcement actions involving 758 senior victims.

NASAA and its members have been leaders in the fight against senior financial exploitation. In 2008, for example NASAA members adopted a model rule intended to protect senior investors from financial professionals passing themselves off as experts in senior financial matters without holding legitimate credentials. To date, 30 states and the District of Columbia have enacted regulations based on the NASAA model, the effectiveness of which Congress recognized by incorporating it as a qualifying eligibility requirement for the CFPB grant program.

And again in 2016, NASAA members adopted a model act to protect vulnerable adults from financial exploitation, which, among other provisions, requires financial professions to report suspected senior financial exploitation to state securities regulators. To date, 23 states have enacted laws based on, or like, this NASAA model.

In 2018, states with this law on their books received more than 400 reports of suspicious activity. Among these reports were those that led state securities regulators in six jurisdictions to act against a precious metals scheme suspected of convincing more than 750 people, mostly elderly, to collectively invest at least an estimated $100 million from their individual retirement accounts.

The threat to seniors is real, and so is the effectiveness of state securities regulators in combatting it.

But more needs to be done, especially as our senior population grows. Members of Congress have a real opportunity to protect the seniors in their jurisdictions by taking up and approving the “Empowering States to Protect Seniors from Bad Actors Act” to further strengthen enforcement and education and improve protections for all people aged 65 and older from inancial exploitation.

State securities regulators applaud the House Financial Services Committee for considering the “Empowering States to Protect Seniors from Bad Actors Act,” and we look forward to working with Congress to ensure its prompt passage.

Christopher W. Gerold is President of the North American Securities Administrators Association (NASAA), the membership organization of state and provincial securities regulators in the United States, Canada and Mexico. He also serves as Chief of the New Jersey Bureau of Securities.