FINANCIAL SERVICES INSTITUTE | VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS AND INDEPENDENT FINANCIAL ADVISORS

VIA ELECTRONIC MAIL

June 30, 2020

Lynne Egan, Chair of the State Legislation Committee (legan@mt.gov)
Faith Anderson, Chair of the Whistleblower Protections/Awards (faith.anderson@dfi.wa.gov)
NASAA Corporate Office (nasaacomments@nasaa.org)

Re: **NOTICE OF REQUEST FOR PUBLIC COMMENTS ON PROPOSED MODEL WHISTLEBLOWER AWARD AND PROTECTION ACT**

Dear Ms. Egan and Ms. Anderson:

On May 26, 2020, the North American Securities Administrators Association (NASAA) released for public comment a Notice of Request for Public Comment on Proposed Model Whistleblower Award and Protection Act, "a proposed model act to help states provide a safe environment for individuals to come forward to report suspected wrongful securities practices to state securities regulators." ("Model"). The Model was developed by NASAA's State Legislation Committee and its Whistleblower Protections/Awards Working Group.

The Financial Services Institute[1] (FSI) appreciates the opportunity to comment on this important proposal. FSI fully supports NASAA's goal of ensuring that there is safe and sufficient opportunity for individuals to report wrongdoing. We note that the Model aligns to some degree with the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and related Securities and Exchange Commission regulations. We believe the Model can provide an important avenue for individuals to report suspected abuse when other avenues are unavailable or prove inadequate.

Notably, FSI members have robust programs and processes in place to identify and address fraud, abuses and other wrongdoing. These remain the best method for flagging and promptly addressing issues early and quickly, preventing harm to investors. However, we believe the Model can provide an important backstop when a firm's process is not followed or otherwise fails.

As discussed below, FSI believes some modifications and additions to the Model can help secure the incentives to report suspected wrongdoing while minimizing any incentive and opportunity for whistleblowers to act in their own interests at the expense of investor protection.

Background on FSI Members

[1] The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the US, there are more than 160,000 independent financial advisors, which account for approximately 52.7 percent of all producing registered representatives.[2] These financial advisors are self-employed independent contractors, rather than employees of the dually registered Independent Broker-Dealers (IBD) and Registered Investment Adviser (RIA) firms through which they are licensed.[3]

FSI's member firms provide business support to independent financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners and job creators with strong ties to their communities. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans. Their services include financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide Main Street Americans with the affordable financial advice, products, and services necessary to achieve their investment goals.

Discussion

FSI appreciates the opportunity to comment on the proposed Model. Generally, our comments are focused on incentivizing the reporting of malfeasance in an effective and appropriate way and avoiding the creation of overlapping whistleblower mechanisms.

I. Adjust Scope to Fill Gaps and Avoid Duplication

FSI recommends amending the Model to minimize the opportunity for whistleblowers to arbitrage or to seek multiple whistleblower awards for reporting the same activity.

Section 21F of The Securities and Exchange Act of 1934 ("the 1934 Act")[4] and the related Securities and Exchange Commission ("SEC" or "Commission") regulations ("whistleblower rules"),[5] establish the framework for federal whistleblower protection, reporting and awards for actions relating to federal securities laws. The 1934 Act covers "any judicial or administrative action brought by the Commission under the securities laws that results in monetary sanctions exceeding $1,000,000."[6]

Similarly, Section 3 of the Model contemplates an award for information "that leads to the successful enforcement of an administrative or judicial action under [the Securities Act of this State]." The Model does not include any monetary threshold.

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[2] Cerulli Associates, Advisor Headcount 2016, on file with author.
[3] The use of the term "financial advisor" or "advisor" in this letter is a reference to an individual who is a dually registered representative of a broker-dealer and an investment adviser representative of a registered investment adviser firm. The use of the term "investment adviser" or "adviser" in this letter is a reference to a firm or individual registered with the SEC or state securities division as an investment adviser.
[4] 15 U.S.C. 78a et seq.
[5] 17 CFR § 240.21F.
[6] 15 U.S.C. 78u-6(a)(1).

To some extent, the SEC and states have overlapping oversight and enforcement authority. Thus, there are likely to be whistleblower complaints that could lead to state and/or federal actions based on the same underlying activity. Under such circumstances, a whistleblower could choose to pursue a claim – federal or state – that would be in his or her best interest, rather than investors' interests. Alternatively, neither the 1934 Act or the Model precludes the whistleblower from filing both state and federal claims, and potentially receiving two whistleblower awards based on the same underlying activity. The SEC seemingly anticipated the problems posed by multiple whistleblower awards and provided that it will not award a claim if, based on the same action, the Commodity Futures Trading Commission ("CFTC") already awarded the whistleblower under its own program or denied an award.[7]

Significantly, both the 1934 Act and the Model establish a 10% minimum for awards and a 30% maximum and set forth some criteria to be considered when determining the award amount. The award cap recognizes that the primary purpose of the award is to incentivize the reporting of wrongdoing and protect investors, not to enrich the whistleblower. Allowing a whistleblower to collect on both federal and state claims would undermine the thoughtful and specific award parameters of the 1934 Act and the Model.

FSI suggests that the Model be amended to ensure multiple awards are not made based on the same predicate activity. An award under the state whistleblower protection should be exclusive. If a whistleblower under the model has received a federal award, the state monetary award should be denied. If the whistleblower has a federal claim pending, we believe any state award should be held in abeyance until such claim is resolved. Likewise, a whistleblower should not collect multiple state awards based on the same predicate wrongdoing – a very plausible scenario as more states adopt whistleblower awards and any wrongful actions are likely to impact investors in multiple states.

Limiting the ability to collect multiple whistleblower awards is consistent with the SEC approach as reflected in its preclusions related to the CFTC. Importantly, such limits should not serve as a disincentive to whistleblowers and would not undermine investor protection.

II. Award Amount Criteria and Incentivizing Internal Reporting

As discussed above, like the whistleblower rules, the Model provides for awards in the 10% to 30% range. Section 7 of the Model draws from the 1934 Act and establishes three factors to be considered when considering the amount of a whistleblower award. Also, like the 1934 Act, the Model allows for the regulator to establish additional factors by rule or regulation.

FSI appreciates that the Model adheres to the 1934 Act provisions. Generally, we encourage uniformity and consistency in federal and state securities laws. However, we are concerned that the very limited explicit criteria in the 1934 Act and Model, coupled with the broad rulemaking authority, will result in non-uniform, inconsistent, and perhaps conflicting criteria among the states. Such inconsistencies could create more opportunity for whistleblower arbitrage which may not be consistent with investors' interests. It could also unnecessarily complicate compliance and administrative processes for broker-dealers and investment advisers.

[7] 17 CFR § 240.21F-3(b)(3).

FSI believes the federal whistleblower rules can be helpful in providing a more complete framework without unduly limiting state securities regulators' prerogatives. Most particularly, we recommend that the Model explicitly include the whistleblower rules provisions relating to participation in internal compliance systems.

Internal reporting of suspected malfeasance provides the best opportunity to promptly, effectively and comprehensively protect investors. Prompt internal reporting can prevent harm and should in no way undermine whistleblower programs. The regulatory whistleblower process serves as a crucial backstop to internal reporting, helping ensure crucial investor protection in the event internal reporting proves inadequate. FSI believes the regulatory whistleblower process should incentivize internal reporting as the preferred initial step in raising concerns.

The federal whistleblower rules provide internal reporting incentives[8] and we encourage NASAA to include similar language in the Model. Specifically, the rules provide that in determining an increase in the amount of and award, the SEC may consider "whether, and the extent to which the whistleblower…participated in the internal compliance systems." Conversely, in considering a reduction of the award, the SEC may consider whether the whistleblower "undermined the integrity" of the internal reporting system.

FSI strongly encourages NASAA to consider adding the internal reporting and other SEC award determination considerations to the Model. We recognize that the Model contemplates following federal statutory language and that state regulators would be free to follow the SEC in determining their own rules. However, with the prospect of dozens of jurisdictions potentially adopting even somewhat different regulations, we believe it would be appropriate and beneficial for the Model to include greater specificity especially where, as here with the internal reporting incentives, the policy is sound and in the interests of investor protection.

III. Provide Guidance on Funding Mechanism

Section 6 of the Model simply provides that funding for any whistleblower award shall come from a fund that the adopting state would specify. FSI appreciates that the Model cannot specify a particular fund, as the source will vary by state. However, we suggest that NASAA provide guidance to the adopting states encouraging them to ensure the source of funding comes from penalties assessed and are not borne by taxpayers or by broker-dealers or investment advisers who have not participated in any wrongdoing. Because whistleblowers are awarded a percentage of the assessed penalties, there should be no need for funding from other sources.

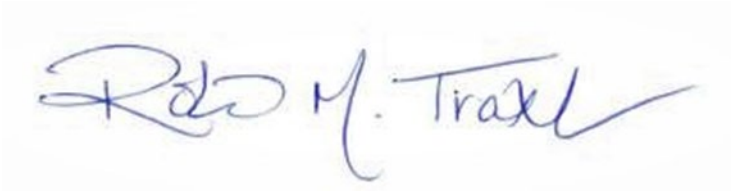
Conclusion

FSI supports NASAA's proposed model whistleblower act as it supplements federal whistleblower protections and serves as a backstop to internal reporting. FSI recommends the proposed Model be amended to better align incentives with investor protection and minimize opportunities for arbitrage or excessive awards. FSI is committed to constructive engagement with NASAA in this process and with states as they look to enact the Model.

[8] 17 CFR § 240.21F-6(a)(4) and 17 CFR § 240.21F-6(b)(3)

Thank you for considering FSI's comments. Should you have any questions, please contact my colleague Dan Barry at (202) 517-6464, or dan.barry@financialservices.org.

Respectfully submitted,



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