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Via email: karla.black@maine.gov
Ms. Karla Black
Deputy Securities Administrator and
General Counsel
Department of Professional & Financial Regulation
Office of Securities
121 State House Station
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Chair, Restitution Assistance Working Group
North American Securities Administrators Association
750 First Street NE, Ste. 1140
Washington, DC 20002

RE: PIABA Comment Concerning NASAA's June 30, 2020 Proposed Model Act to Create a Restitution Assistance Fund for Victims of Securities Violations

Dear Ms. Black:

I write on behalf of the Public Investors Advocate Bar Association ("PIABA"), an international bar association comprised of attorneys who represent investors in securities arbitration and litigation. Since its formation in 1990, PIABA has promoted the interests of the public investor in all securities and commodities dispute resolution forums, while also advocating for public education regarding investment fraud and industry misconduct. Our members and their clients have a strong interest in the North American Securities Administrators Association's ("NASAA's") efforts relating to investor protection.

On June 30, 2020, NASAA invited public comment on a Proposed Model Act to Create A Restitution Assistance Fund For Victims of Securities Violations (the "Model Act").[1] PIABA generally supports the Model Act. Unwitting investors come to learn too late that their trusted advisors not only had defrauded them, but also that those advisors lacked the resources to pay restitution amounts ordered by a state securities regulator.[2] A state-sponsored backstop that provides victims of securities violations with at least some amount of recovery is a welcome and critical addition to available investor protection tools in this country.

PIABA applauds the flexibility built into the Model Act as well as NASAA's explanation of the thought process underlying each proposed term. However, PIABA has several concerns regarding the proposed Model Act.

[1] North American Securities Administrators Ass'n, *NASAA Seeks Public Comment on Proposed Model Act to Establish Restitution Fund for Victims of Securities Law Violations*, News Releases (July 1, 2020), https://www.nasaa.org/55241/nasaa-seeks-public-comment-on-proposed-model-act-to-establish-restitution-fund-for-victims-of-securities-law-violations/?qoid=current-headlines.

[2] While not within the scope of this Model Act, and as further discussed herein, PIABA notes the insidious problem of customer arbitration awards against advisors and firms going unpaid. Like unpaid restitution awards, unpaid arbitration awards effectively re-victimizes the investor who proves their case (in the arbitration forum selected by the advisor) that the advisor's unlawful conduct caused recoverable losses, but are left hanging dry when the advisor avoids or otherwise can't pay the award.

Specifically, our concerns relate to the fund's proposed recovery limits, Section 9's provision authorizing jurisdictions to recover from affected investors paid restitution awards that were overturned on appeal, and the Model Act's shortcomings in addressing the majority of injured investors. We urge NASAA to consider expanding the Prefatory Notes or otherwise revisiting the language of the respective sections in the Model Act, so that states or commonwealths considering adopting a version of the Model Act might weigh the following points and promote enhanced investor protections.

1. The Model Act's Proposed Recovery Limits Will Not Make Investors Whole nor Solve the Financial Distress Defrauded Investors Often Suffer.

The proposed recovery limits of $25,000 (or $50,000 for victims who are statutorily defined "vulnerable persons") are considerable sums in the abstract. But these amounts fall woefully short of making many harmed investors whole again or even helping some investors who were defrauded of all their savings. The Model Act's formula won't make even "smaller" restitution awards fully recoverable to the investor. The payments from the proposed fund would be capped at 25% of the investors' unpaid restitution award. By design, then, the fund will not make an investor whole. No explanation is given why that would be the case for restitution awards less than $25,000 (or $50,000 for vulnerable persons), or why the fund could not be designed to come much closer to ensuring the entirety of unpaid restitution awards are addressed by the fund.

Furthermore, the maximum recovery limits are too low in light of available information and what can be extrapolated regarding average customer losses resulting from securities violations. FINRA has been publishing statistical data concerning unpaid FINRA arbitration awards for some time, and the data is troubling.[3] Several important measurements – *e.g.* the absolute value of unpaid arbitration awards, the percentage of awards that go unpaid, and the minimum and median awards unpaid – all share a disturbing characteristic: they all trend upward.

Consider, for example, FINRA arbitration award data from 2018. In that year, the *smallest* unpaid arbitration award was $25,600, with the median unpaid arbitration award set at $281,264. Understanding that losses suffered by investors pursuing FINRA claims may be different than those of eligible victims making claims on a state's restitution fund, a $25,000 cap on a restitution fund payment would almost certainly not make even the most minimally affected victim whole. When one considers the median unpaid arbitration award is in excess of $280,000, a $25,000 restitution fund payment falls far short of putting the victim back to where they should be. Similarly, a maximum $50,000 recovery from a restitution fund for victims who are "vulnerable persons" - defined by the state to be a person of a certain age, *e.g*. 60 years of age or older, or a person with a statutorily defined mental or physical condition or otherwise protected under state law – is not enough. PIABA appreciates that the Model Act doubles the proposed cap for these victims. But a harmed investor of retirement age simply does not have the time to "make up" for lost retirement savings. Many vulnerable investors are defrauded of their life savings and providing back a very small portion of those losses will not solve their incredible financial distress. That can mean the difference between a senior living independently thanks to available retirement savings, to instead becoming dependent on Social Security, SSI, Medicaid, public housing benefits, and other social welfare programs. And vulnerable persons of any age with enhanced medical or other personal care needs cannot afford to lose precious resources.

In light of these concerns, PIABA urges NASAA to consider increasing the Model Act's recovery limits, or, at a minimum, stressing in the accompanying materials that jurisdictions considering adopting a version of the Model Act perform their own analyses to determine recovery limits that more closely meet investors' actual losses.

[3] We recognize that the statistical likelihood of an arbitration award going unpaid may be different than the likelihood that a restitution order goes unpaid. But we are unaware of data reflecting what percentage of state restitution orders are paid.

2. The Model Act's Section 9 Potentially Risks Further Harm to Affected Investors.

PIABA is concerned that Section 9, which provides that a jurisdiction *may* recover payments made if the award of restitution is overturned on appeal after payment is made, leaves affected investors at risk of being victimized a second time. Any investor who received a payment while an appeal is pending would spend the money recovered at his or her own peril.

Consider, for example, an investor left destitute because of an advisor's unlawful conduct, with six figure losses of her entire savings that previously provided income to cover her cost of living expenses. A restitution order for her six figure losses goes unpaid. The investor successfully recovers the applicable maximum $25,000 from the restitution fund. The investor then spends the money over the next six months to cover living expenses since she has no other assets to be used for such a purpose. After the money is gone, she finds herself fighting a demand from her jurisdiction for the return of the money based on the results of an appeal of which she has no control. The investor then files bankruptcy thanks to her jurisdiction's prosecution of its claim under Section 9 of the Model Act. Alternatively, an investor who does not want to bear the risk of such an outcome puts the restitution fund money aside, potentially for months or years if the order is appealed to the state's highest court, until she is advised that the restitution order is truly final. There is little benefit to that investor, who has to wait until such time as she can spend the needed money without fear of reprisal.

PIABA acknowledges that this is a difficult balancing act: how to put money in investors' hands quickly at the risk of having to ask for its return, versus making the aggrieved investors wait an indeterminate amount of time to receive their restitution payments. In light of these considerations, PIABA suggests that NASAA modify the Model Act to either: (1) make the payouts only after the restitution award is truly final and non-appealable; or, (2) restrict the jurisdiction's ability to recover funds in the event the underlying restitution order is overturned on appeal.

3. The Model Act Does Not Address the Majority of Affected Investors.

Finally, while PIABA endorses the Model Act's concept, we note that it leaves many investors unprotected. Specifically, the Model Act only protects those cases NASAA members bring for a violation of the jurisdiction's law or regulation. NASAA members' restitution awards dwarf individual investor's FINRA arbitration claims every year. But NASAA members prosecute a very small number of claims identical to those brought by individual investors on their own behalf.

First, PIABA acknowledges that NASAA members do not have the resources to review and investigate every investor's individual FINRA arbitration claim to decide whether to prosecute a similar claim through state regulatory process. Second, while NASAA members prosecute violations of their state statutes and regulations, individual investors take advantage of the more liberal equitable FINRA forum, whereby a violation of a statute or common law is not required to recover.[4] [AC1] Thus, investors will benefit from the Model Act only if their particular securities'

[4] Ms. Fienberg, formerly the president of NASD Dispute Resolution, was a featured speaker and panelist at the NASAA (North American Securities Administrators Association) presentation entitled "NASAA Listens Forum," held at the National Press Club in Washington D.C. on July 20, 2004. She stated:
In arbitration, in SRO/NASD arbitration, unlike in court, you get an equitable result. *You do not have to have a claim that is cognizable under state or federal law. It can be cognizable under NASD rules.* So, for example, there's only one cause of action under the federal securities laws, that's 10(B), it's very limited, has a short statute of limitations. The rules that are applied by arbitrators looking for equitable relief are much broader than if they had to strictly follow the law.
(Emphasis added). The import of this statement by the CEO of FINRA-DR is that arbitration is an equitable proceeding, rather than an action strictly governed by law. Indeed, according to Ms. Fienberg, claimants are not even required to have a claim cognizable at law.

seller came across their regulator's radar, the regulator decided to prosecute a claim against them, and the wrongdoing ran afoul of the jurisdiction's law or regulation. The majority of investors pursuing a FINRA arbitration claim would not see any benefit since regulators might never discover their claims, or the claims cognizable in arbitration do not run afoul of the state's particular laws. The resulting pool of investors left out of a recovery in this situation is huge. Using 2018 as an example, FINRA reported that $31 million of the $92 million awarded to investors went unpaid. Only a portion of those unpaid awards would have been related to claims also prosecuted by NASAA members. Thus, only a modest subset of victimized investors stand to benefit from the Model Act's provisions.

Finally, the Model Act's definition of "claimant" and the eligibility standard to apply for and receive a restitution award ("natural person") is too limited. Advisors regularly handle securities accounts and make investment recommendations to: trustees of trusts; attorneys-in-fact under a power of attorney; personal representatives of estates; IRAs and other qualified money accounts; partnerships and other entities; and, for the benefit of protected persons under a conservatorship, guardianship, or other court-appointed fiduciary. The Prefatory Notes do mention that jurisdictions should consider expanding eligibility, but given how common these situations are among the investing public, the Model Act language itself should more clearly and expressly include eligibility for these claimants.

4. A Positive Step Forward, But Still Room for Progress.

While the Model Act is undoubtedly a positive step, and will provide some recovery to harmed investors, PIABA encourages NASAA's members to continue to explore ways to broaden recovery of losses and address unpaid arbitration awards. PIABA's previous reports on the subject have promoted a FINRA-sponsored investor recovery pool for unpaid arbitration awards.[5] PIABA asks NASAA to consider proposing a model act creating a state-sponsored investor recovery pool for unpaid arbitration awards, funded by fees paid by all registered securities sellers or advisors.

FINRA's approach to the arbitration process is not radical. Courts have long made clear that arbitrators are not bound by legal technicalities and are free to fashion results based on fairness in light of the facts. For example, as stated in 6 C.J.S. *Arbitration* §104, "Generally, arbitrators are not obliged to follow strict rules of law in the matter at hand and they are privileged to apply broad principles of justice." See also, for example, *National Iranian Oil Company v. Ashland Oil, Inc.,* (en banc) 817 F.2d 326 (5th Cir. 1987) ("[A]rbitration proceedings are by nature equitable."); *Application of Columbia Broadcasting System, Inc.,* 26 Misc.2d 972, 205 N.Y.S.2d 85 (1960) ("It is the settled policy of our courts to encourage arbitration and to enforce arbitration agreements with a complete relief from legal technicality ...[and]...proper relief is ordinarily granted when the facts warrant regardless of what may have been asked for."); *In the Matter of Arbitration Between Stanley J. Staklinski and Pyramid Electric Company*, 6 A.D.2d 565, 180 N.Y.S.2d 20 (1958) ("As already pointed out, as embodied in the arbitration statute and as recognized in our highest court, arbitration may provide relief in circumstances and on conditions which even a court has no power to grant."); *Harold Rosa v. Transport Operators Co*., 45 N.J. Super. 438, 133 A.2d 24 (1957) ("We recognize that an arbitrator does not always decide a case according to strict legal principles, but sometimes according to his own concept of what is just and right, and in such cases the courts will not disturb his decision except for very cogent reasons."); *California State Council of Carpenters v. The Superior Court of Orange County,* 11 Cal.App.3d 144, 89 Cal.Rptr. 625 (1970) ("Arbitrators may base their decisions on broad principles of justice and equity and every intendment of validity must be given the award.").

[5] PIABA's first report, *Unpaid Arbitration Awards – A Problem The Industry Created – A Problem The Industry Must Fix* was published in February 2016, and can be found: https://piaba.org/system/files/pdfs/Unpaid%20Arbitration%20Awards%20-%20A%20Problem%20The%20Industry%20Created%20-%20A%20Problem%20The%20Industry%20Must%20Fix%20%28February%2025%2C%202016%29.pdf.
PIABA's second report, *Unpaid Arbitration Awards – The Case For An Investor Recovery Pool*, can be found: https://piaba.org/system/files/2018-03/REPORT%20-%20Unpaid%20Arbitration%20Awards%20%28March%207%2C%202018%29.pdf.

PIABA again supports the concept underlying the Model Act. We urge NASAA and its members to consider exercising their considerable creative efforts to broaden the scope of any restitution assistance funds, in an effort to protect as many investors as possible.

PIABA thanks NASAA for the opportunity to offer our comments to you.

Respectfully,

Samuel B. Edwards
President, PIABA 2019-2020

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