



NASAA

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NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

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Washington, D.C. 20002  
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September 14, 2022

Cameron Ricker  
Chief Clerk  
U.S. Senate Committee on Banking, Housing,  
and Urban Affairs  
534 Dirksen Senate Office Building  
Washington, D.C. 20510

Re: July 28, 2022 Hearing, "Protecting Investors and Savers: Understanding Scams and Risks in  
Crypto and Securities Markets"

Dear Mr. Ricker:

Enclosed please find NASAA's responses to the two questions for the record that NASAA received in connection with the July 28, 2022 hearing. Should you or Senator Reed have any questions regarding these responses, please do not hesitate to contact Kristen Hutchens, NASAA's Director of Policy and Government Affairs, and Policy Counsel, at [khutchens@nasaa.org](mailto:khutchens@nasaa.org).

Sincerely,

Melanie Senter Lubin  
NASAA President  
Maryland Securities Commissioner

Enclosures

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President: Melanie Senter Lubin (Maryland)  
President-Elect: Andrew Hartnett (Iowa)  
Past-President: Lisa Hopkins (West Virginia)  
Executive Director: Joseph Brady

Secretary: Kevin Hoyt (New Brunswick)  
Treasurer: Claire McHenry (Nebraska)

Directors: William Beatty (Washington)  
Marni Gibson (Kentucky)  
Leslie Van Buskirk (Wisconsin)  
Diane Young-Spitzer (Massachusetts)

**Questions for Ms. Melanie Senter Lubin, President, North American Securities Administrators Association, from Senator Jack Reed:**

Earlier this year a coalition of 10 worker, consumer and investor advocates sent a letter to SEC Chair Gensler expressing concern about what they perceive to be the growing use of pre-dispute arbitration clauses by SEC-registered investment advisers (RIAs).

- 1. State securities regulators are exclusively responsible for registering and examining roughly 17,000 small and mid-sized RIAs. Have you or other state securities regulators observed a similar increase in the use of forced arbitration provisions by state registered RIAs?**

In 2021, there were approximately 17,500 state-registered investment advisers. *See [NASAA 2022 Investment Adviser Section Annual Report](#)* (April 2022) (attached hereto as Appendix A). In general, small investment advisers (less than \$25 million of regulatory assets under management (“RAUM”)) and mid-sized investment advisers (between \$25 million and \$100 million of RAUM) are registered with and primarily regulated by one or more state securities administrators. Conversely, large investment advisers (greater than \$100 million of RAUM) generally are registered with the SEC and are primarily subject to federal regulation instead of state regulation. In some cases, a small or mid-sized investment adviser may be permitted or required to register with the SEC instead of with one or more states and, in more limited circumstances, a small or mid-sized investment adviser may be registered with the SEC and one or more states.

As NASAA stated in our March 2022 letter to Congress, many investment advisers require their clients to agree to mandatory arbitration. *See [NASAA Letter Regarding Mandatory Arbitration Agreements in Our Capital Markets](#)* (March 8, 2022) (Appendix B). In this letter, we cited findings in 2013 by the Massachusetts Securities Division that many MA-registered investment advisers used a mandatory pre-dispute arbitration clause in their client contracts. *See* Massachusetts Securities Division Staff, *[Report on Massachusetts Investment Advisers’ Use of Mandatory Pre-Dispute Arbitration Clauses in Investment Advisory Contracts](#)* (Feb. 11, 2013) (Appendix C). We also would note that the Consumer Financial Protection Bureau (“CFPB”) published a study to Congress in 2015 that showed companies provide almost all consumer financial products and services subject to the terms of a written contract and pre-dispute arbitration clauses appeared to be common in those contracts. *See* CFPB, *[Arbitration Study, Report to Congress Pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act §1028\(a\)](#)* (March 2015).

As NASAA also stated in our March 2022 letter and consistent with NASAA’s long-standing policy priorities, we believe Congress should act now on a swift, bipartisan basis to ban the use of mandatory pre-dispute arbitration clauses. As stated in our letter to Congress in April 2022, we urge Congress to pass the FAIR Act of 2022 (H.R. 963 | S. 505) at the earliest opportunity. *See [NASAA Letter Regarding the Promotion of Trust in Our Capital Markets](#)*

(Apr. 5, 2022) (Appendix D). We repeated this call for action in our written testimony dated July 28, 2022, that was submitted to the U.S. Senate Committee on Banking, Housing, and Urban Affairs.

NASAA welcomes and encourages members of Congress to share information with NASAA and state securities regulators that is or may be relevant to future examinations and, if appropriate, enforcement actions against state-registered investment advisers.

- 2. Does NASAA have any information regarding the prevalence of forced arbitration contracts by state-registered investment advisers? If not, is such information something that NASAA, or individual state securities regulators, have ample tools and authority to collect?**

Please see NASAA's response to question #1.

# NASAA 2022

## Investment Adviser Section Annual Report

April 2022 | Highlighting 2021 Section Activities



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# NASAA

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NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION

# Introduction

The North American Securities Administrators Association (NASAA) is the oldest international organization devoted to investor protection. NASAA members include 67 state, provincial, and territorial securities administrators in the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, the 13 provinces and territories of Canada, and the country of Mexico.

2021 continued to provide challenges for most, and state securities regulation was no exception. The membership and industry both had to adjust to the changing landscape. With the continued shift from traditional regulatory processes to the use of virtual tools and technology, communication and flexibility were key to ensuring registrants stayed in compliance and investors were protected. Through everything, the Investment Adviser Section and Project Groups continued to work on important matters that impact state-registered investment advisers.

NASAA's 2021 Investment Adviser Section Committee Annual Report provides an updated

snapshot of the United States investment adviser population, an updated profile of the average state-registered investment adviser, and a recap of the work of NASAA's Investment Adviser Section over the year.

A highlight from the report includes the Investment Adviser Section Committee's work with members of the Broker-Dealer Section to develop and propose a new model rule addressing unpaid arbitration awards by broker-dealers, agents, investment advisers, and investment adviser representatives.

Even with the remote environment many states still found creative ways to continue important outreach and educational opportunities. The report closes by highlighting outreach programs from members in Ohio, Virginia, Nebraska, and California.

We hope NASAA members and outside stakeholders, particularly state-registered investment advisers, find this report useful and welcome suggestions on ways to improve future editions. If there is ever anything that either of us can do to help with state investment adviser regulation, please do not hesitate to contact us directly.



**William R. Carrigan, CFE**  
Chair, Investment Adviser Section



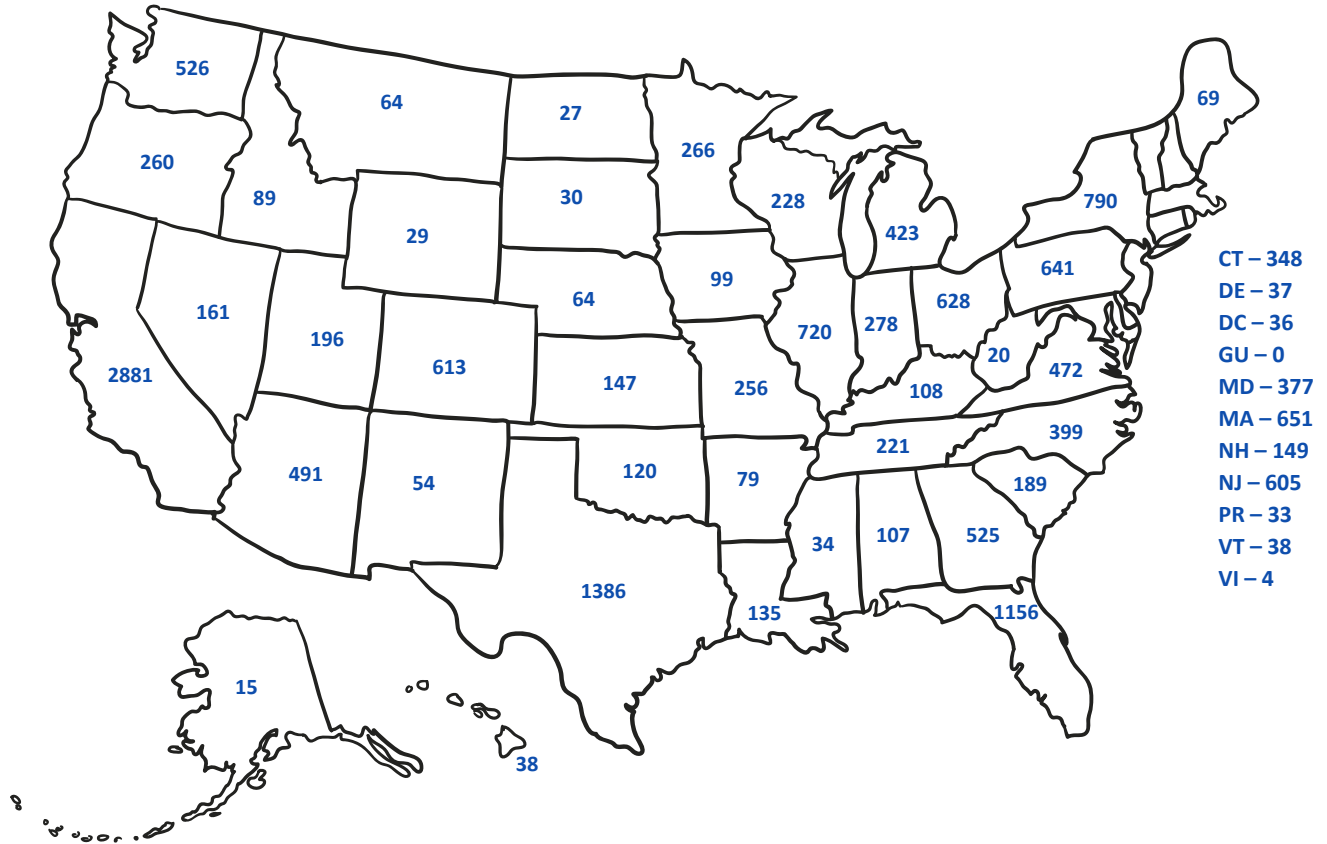
**Linda Cena**  
Vice-Chair, Investment Adviser Section

## SECTION COMMITTEE MEMBERS:

Stephen Bouchard, District of Columbia; Tung Chan, Colorado; Eric Pistilli, Pennsylvania; Scott Laskey, Ontario, Canadian Liaison; Dylan White, NASAA Staff Liaison

While statistics and information regarding the broker-dealer population have always been fairly easy to obtain, information on state-registered investment advisers has been more elusive. The following facts and figures present a snapshot of the current status of state-registered investment advisers.

## STATE-REGISTERED IA STATISTICS 2021



State Registered IA Map



### Top 5 State-Registered IAs Increase from 2020 – 2021

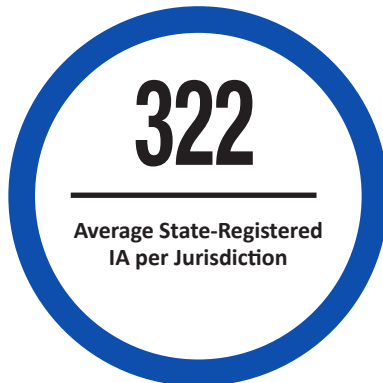
1. Florida – 53
2. Texas – 46
3. Tennessee/  
North Carolina – 14
4. Missouri – 12
5. Utah – 10

### Top 5 Most State-Registered IAs (Home State) [As of 12/31/21]

1. California – 2,881
2. Texas – 1,386
3. Florida – 1,156
4. New York – 790
5. Illinois – 720

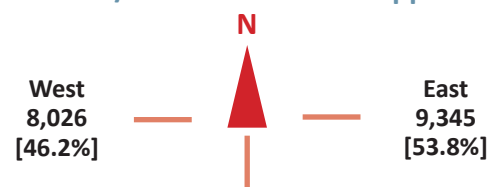
### Top 5 Most State-Registered IAs (Total) [As of 12/31/21]

1. Texas – 4,228
2. California – 3,662
3. Florida – 1,867
4. New York – 1,321
5. Illinois – 1,013

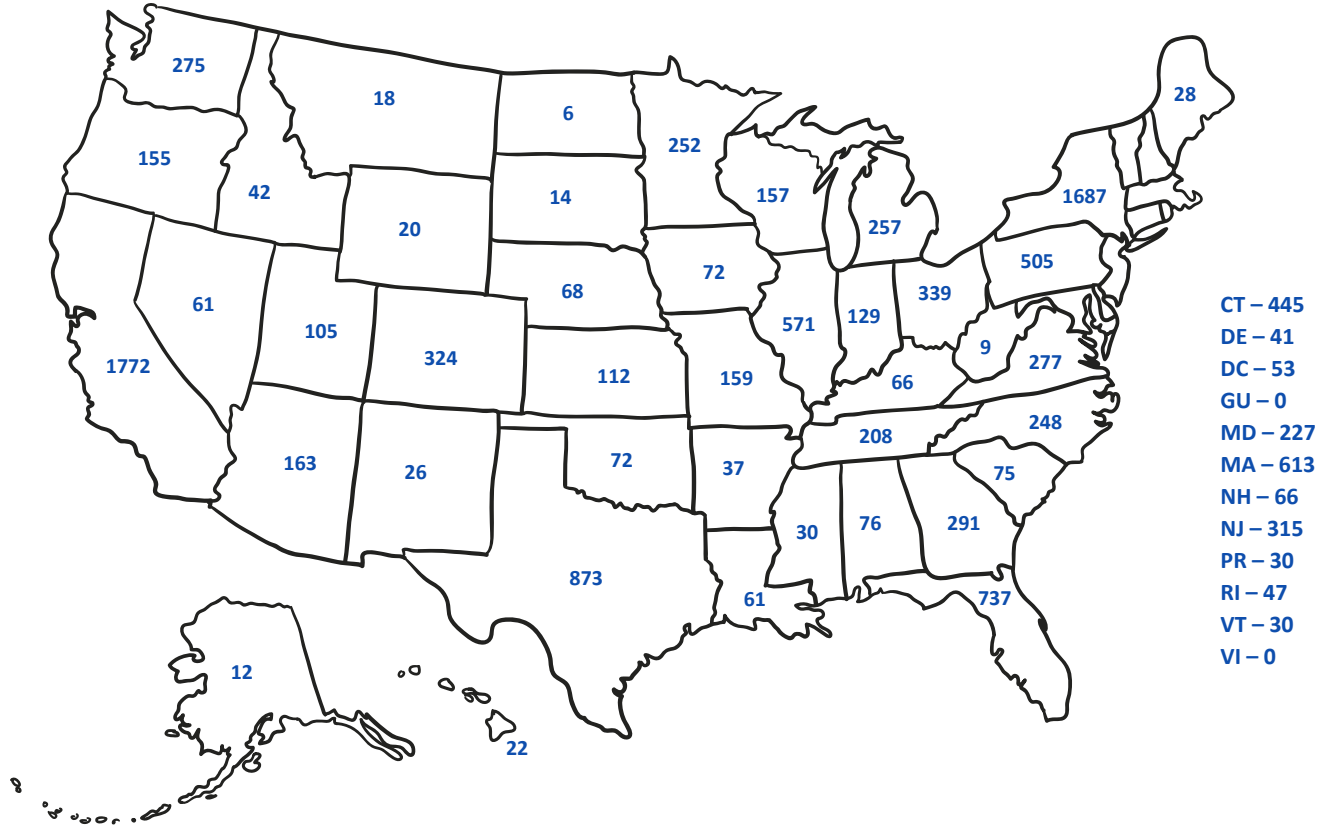


Total State-Registered IAs AUM  
**\$412,808,679,777**

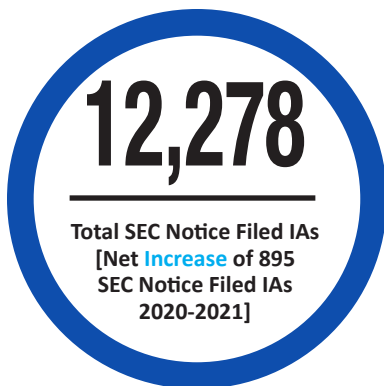
State-Registered Investment Advisers  
East/West of the Mississippi



# SEC NOTICE-FILED INVESTMENT ADVISER STATISTICS 2021



SEC Registered IA Map

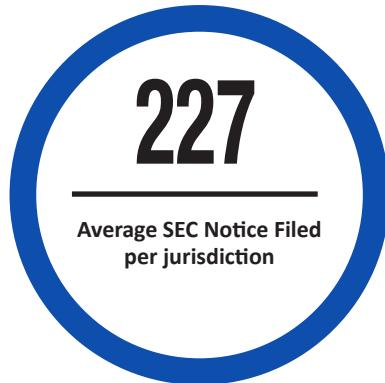
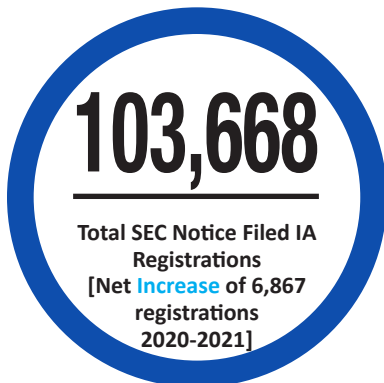


### Top 5 Most SEC Notice Filed Investment Advisers [As of 12/31/21]

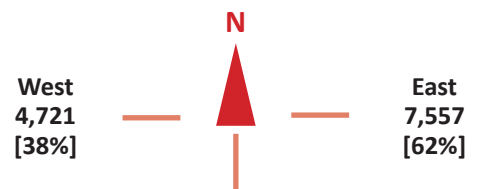
1. California – 1,772
2. New York – 1,687
3. Texas – 873
4. Florida – 737
5. Massachusetts – 613

### Top 5 SEC Notice Filed Investment Advisers Increase from 2020 – 2021

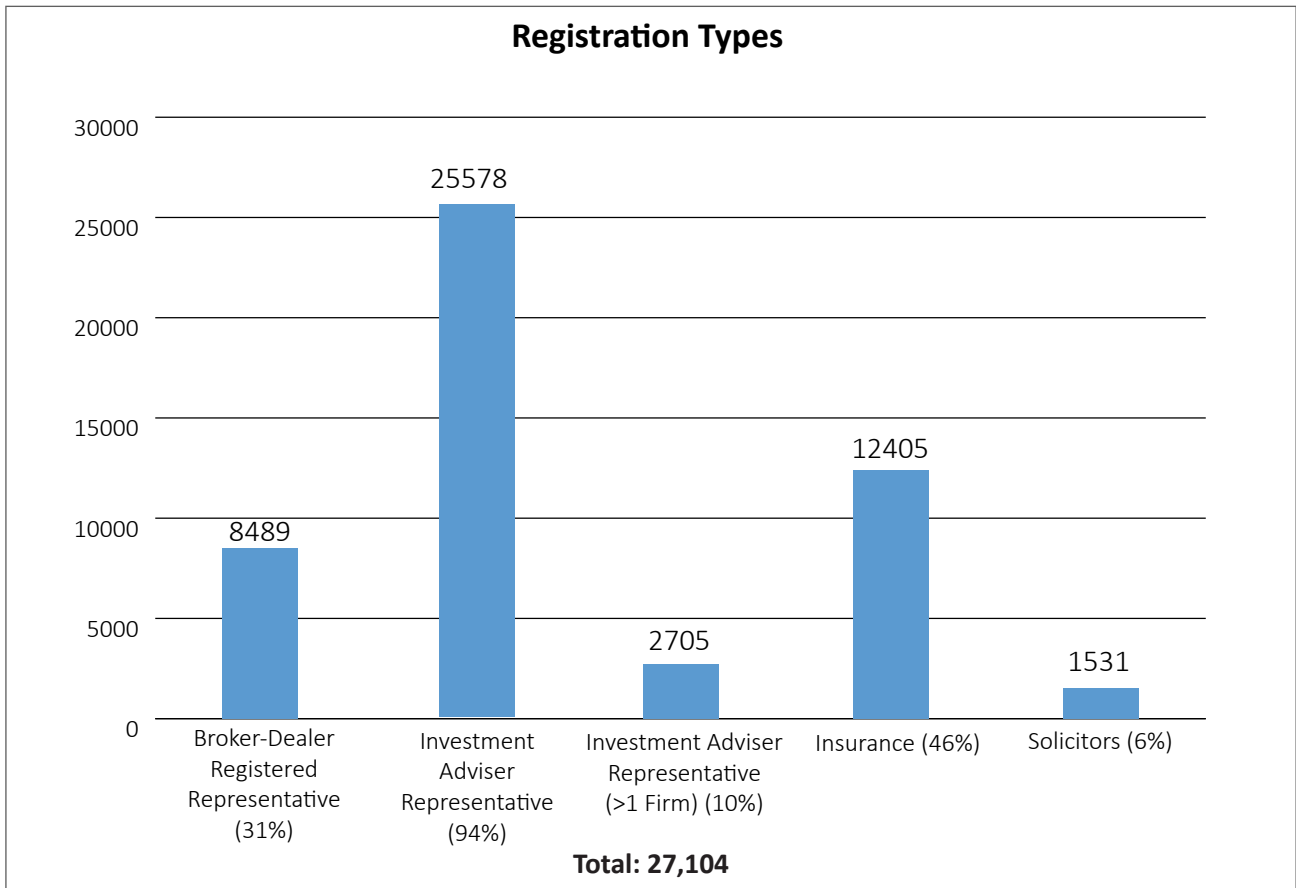
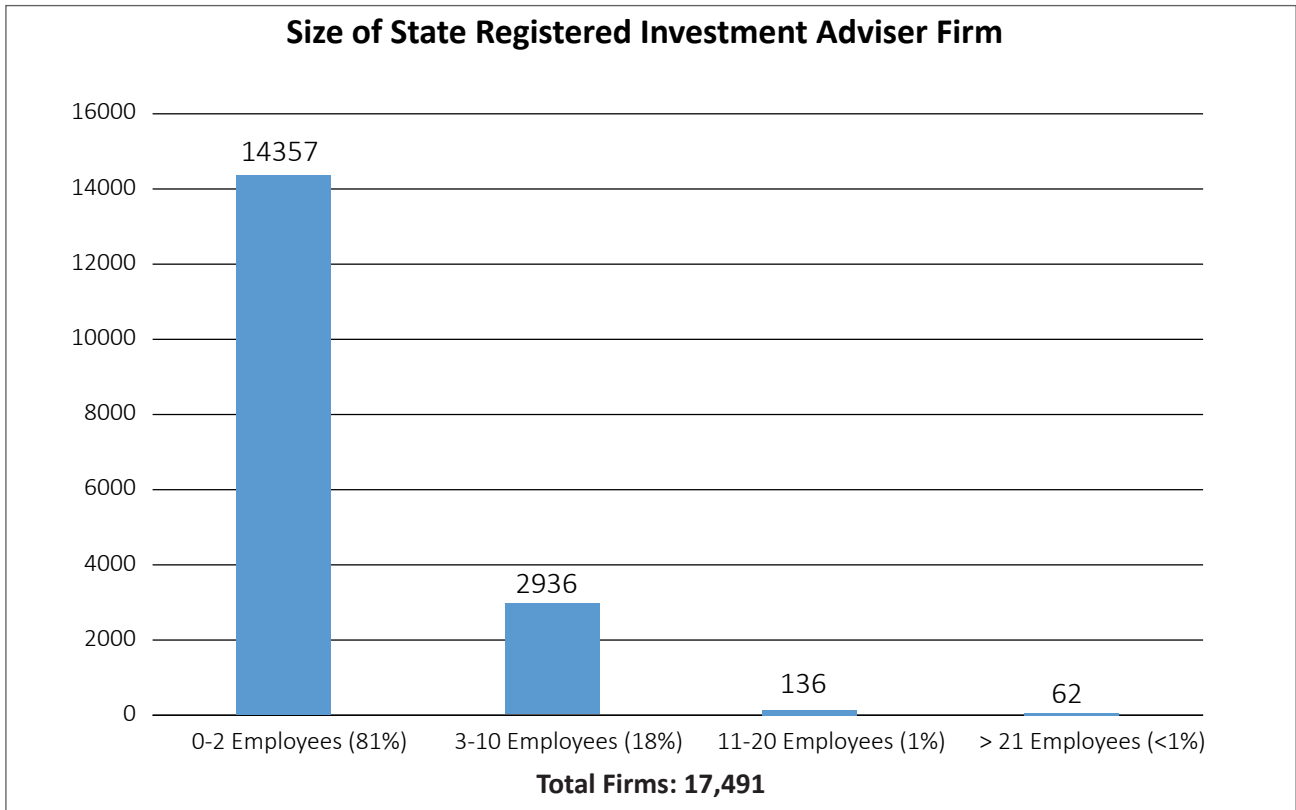
1. Florida – 130
2. California – 106
3. Texas – 94
4. Washington – 41
5. New York – 32



### SEC Notice Filed Investment Advisers



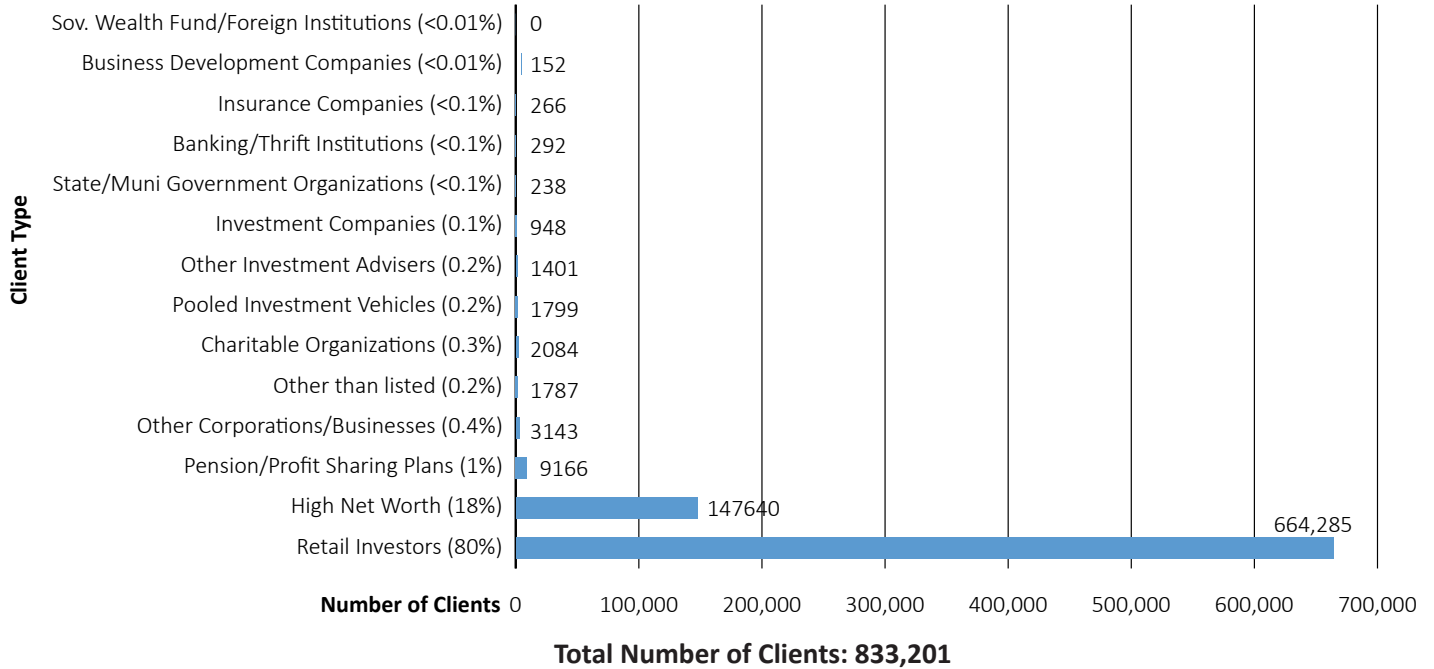
# Profile of State-Registered IAs for 2021



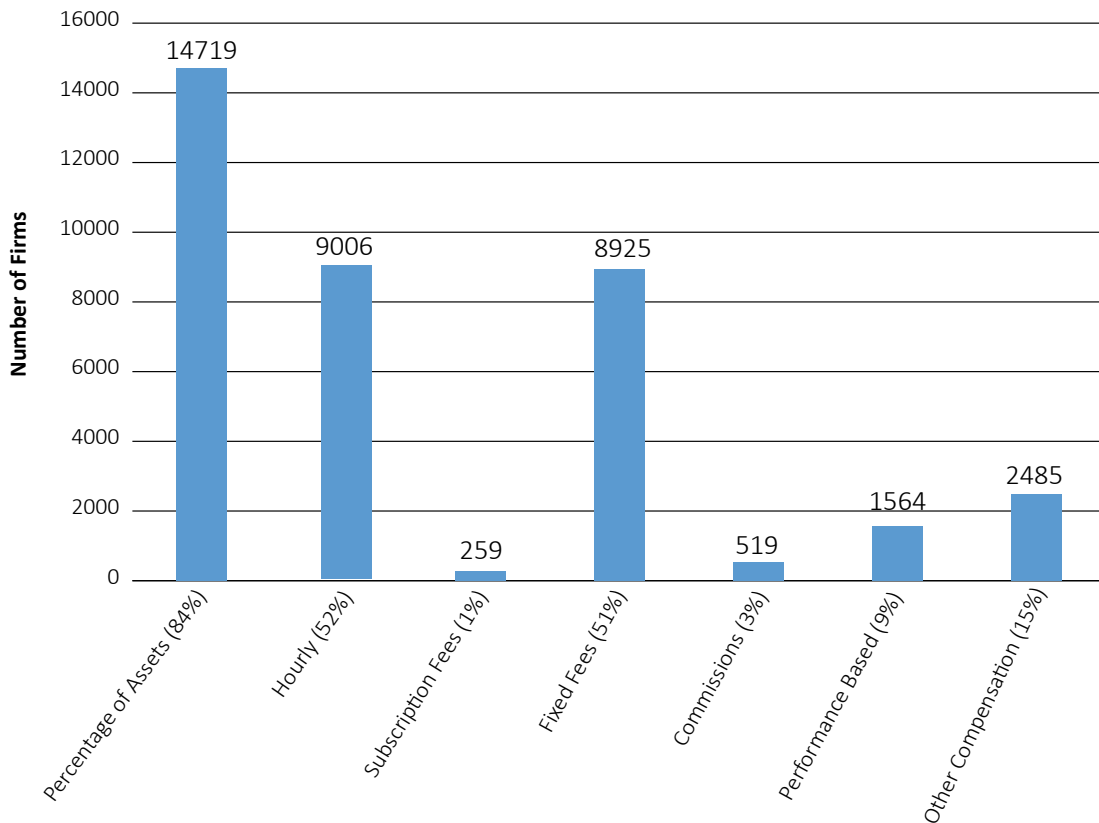


# Profile of State-Registered IAs for 2021

**Client Types**



**Types of Fees Charged**

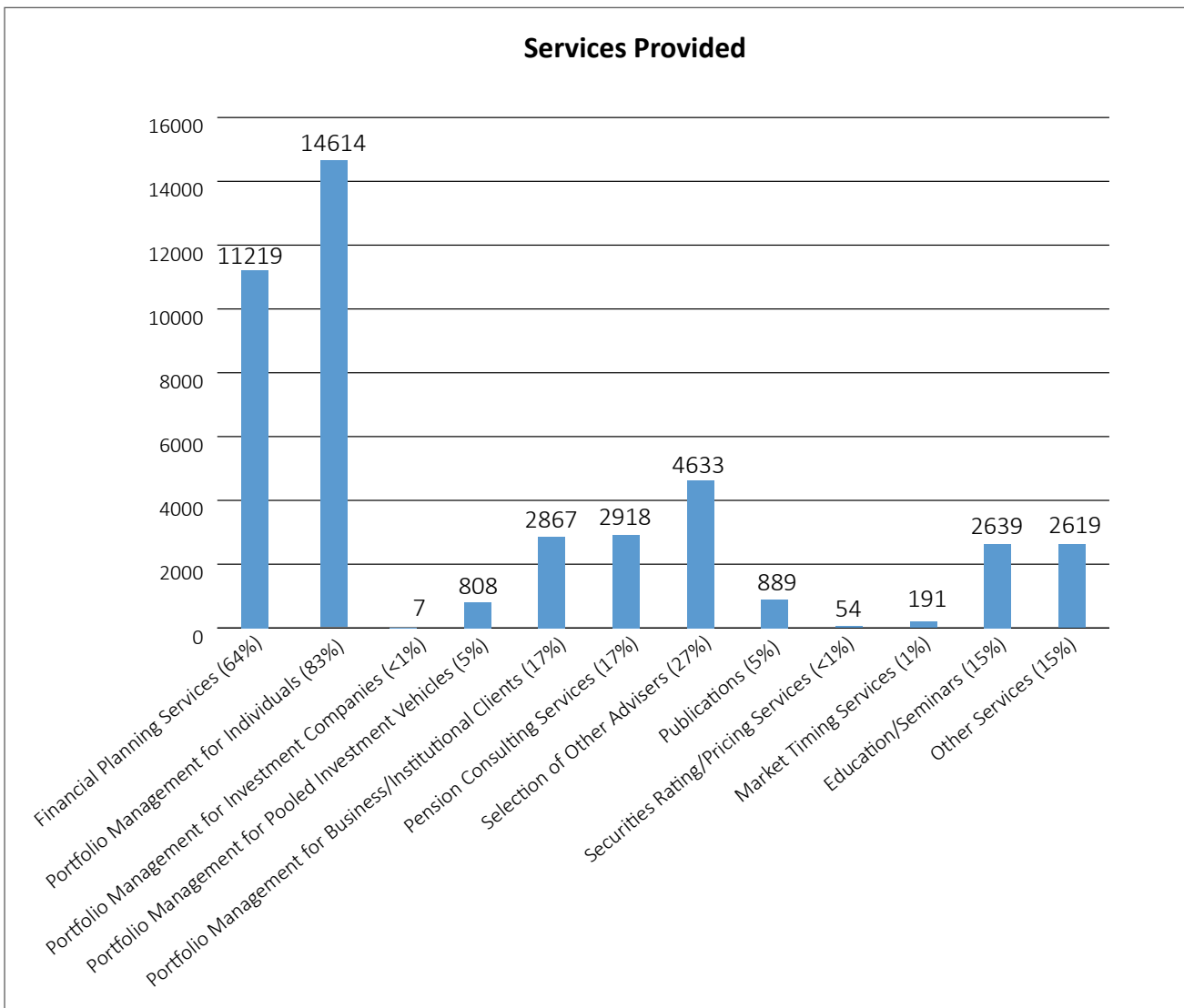


# Profile of State-Registered IAs for 2021

## Compensation

Type	Yes	No	% Yes	% No
Percentage of Assets Under Management (84%)	14,719	2,772	84%	16%
Hourly (52%)	9,006	8,485	51%	49%
Subscription Fees (1%)	259	17,232	1%	99%
Fixed Fees (51%)	8,925	8,566	51%	49%
Commissions (3%)	519	16,972	3%	97%
Performance Based (9%)	1,564	15,927	9%	91%
Other Compensation (15%)	2,485	15,006	14%	86%

## Services Provided



# Project Group Reports

## CYBERSECURITY AND TECHNOLOGY

Michelle Ray, Co-Chair (AL), Teresa Williams, Co-Chair (CT), Eric Chandra (CA), Victor Clark (DE), Rosemary Gonzalez (NJ), Clay Johnson (KS), Ryan Sullivan (MT), Patrick Willmore (CO)

During 2021, the Cybersecurity and Technology Project Group worked on the second edition of Cybersecurity and State-Registered Investment Advisers Resource Document for State Securities Regulators. It was originally drafted in July 2017 by the NASAA Investment Adviser section. This resource document is designed to assist state-registered investment advisers with the evolving cybersecurity challenges that threaten their clients and business.

The scope of cybersecurity topics is wide, even when applied to the narrow universe of state-registered investment advisers within the broader financial services industry. However, the topics covered in this resource document are likely universal in their application to the majority of state-registered investment advisers: compliance risk assessments and management, e-mail communications, cloud services, firm websites, anti-virus protection, encryption, cybersecurity insurance, custodians and third-party vendors, and robo-advisers. Each topic includes a brief description and a checklist of questions state-registered investment advisers should consider. State securities regulators can also use these checklists to

aid investment advisers with inquiries, or as part of their examinations and audits. In addition to these resources, state securities regulators can also continue to rely on regulatory frameworks already in place to provide informal guidance to state-registered investment advisers, such as the importance of due diligence.

Due to COVID-19 restrictions, the project group was unable to meet in person in 2021. Instead, the group held monthly meetings via Zoom to discuss future goals and plans to better assist NASAA, state securities regulators, and state-registered investment advisers.

In the upcoming year, the Cybersecurity and Technology Project Group will continue to work on creating, updating, and providing resource documents and presentations for state regulators and state-registered investment advisers so that it can provide the most current law, news, and articles relevant to cybersecurity and technology. It is essential that the resources the project group provides reflect the evolving and aggressive nature of cybersecurity threats.

# Project Group Reports

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## OPERATIONS

Alisa Goldberg, Chair (FL). Joanne Jones, Vice-Chair (WA), Kathleen Bowne (KS), Holly Gay Butler (VA), Elizabeth Guido (NC), Katherine Perkins (MS), Glen Sgobbo (OH), Jeffrey Teichert (UT)

The Operations Project Group compiled data from the investment adviser coordinated exam sweep, which included 1,206 examinations conducted from January 1, 2021, through July 7, 2021. The majority of the examinations were conducted remotely. The project group presented the sweep results in September 2021 at NASAA's annual conference in Chicago, Illinois.

The top three deficiencies continued to be the same as those from the two previous coordinated exam sweeps in 2019 and 2017, although the order of the top two categories changed positions. The 2021 top three deficiency categories were registration, books and records, and contracts, in that order. Overall, there was a decline in the frequency of deficiencies in each of these categories. Investment advisers improved

significantly in their cybersecurity compliance; the deficiency category dropped from fourth place in 2019 to ninth place.

The project group reviewed information about NASAA members' experiences with the various fee structures being used by investment advisers, particularly as they pertained to financial planning and asset management. Members of the project group also worked with the Senior Issues and Diminished Capacity Committee to develop questions for the NEMO Investment Adviser modules to address issues of potential diminished capacity of investment adviser representatives and broker-dealer agents. The questions will be included in both the broker-dealer and investment adviser modules.

# Project Group Reports

## REGULATORY POLICY & REVIEW

Stephen Brey, Chair (MI), Kevin Moquin, Vice-Chair (NH), Jonathan Bashi (NY), Judith Keilp (NJ), Brook Kellerman (WA), Emily Kisicki (VT), Amanda Robinson (IA)

The Investment Adviser Regulatory Policy and Review Project Group has gone through a transitional and busy year. The project group said a sad farewell to Suzanne Sarason (Washington), who passed away in December. Suzanne was a brilliant attorney and CPA who dedicated 40 years of her life to protecting Washington investors. She was a fantastic friend, teammate, source of counsel, and voice of reason for the project group, and will be dearly missed. David Smith (Arkansas) served investors in his home state for over 25 years and brought that experience and expertise to the project group for most of his illustrious career. The project group wishes David the very best that retirement has to offer, and will miss his sense of humor, expertise, wisdom, and friendship. John Harth continues to protect investors in Colorado but stepped away from the project group after serving for several years. John is a respected voice in securities regulation and proved to be a valuable contributor to the project group's review of alternative fee models. His hands-on experiences lent a unique perspective that informed the project group's work. The project group wishes John well and will miss his contributions. Blake Kennedy (South Carolina) continues to serve investors in South Carolina and provides his expertise to NASAA members in other ways. The project group valued his contributions over the last several years.

The project group met monthly by videoconference to discuss topics spanning the entire landscape of the regulation of investment advisers. The monthly

calls included discussion of emerging fee models, written policies and procedures, cybersecurity, custody, federal covered adviser notice-filing, CRD/IARD functionality, standing letters of authorization, IAR CE, investment adviser solicitors, unpaid arbitration awards, and many other topics affecting investment advisers and regulators.

The project group was fortunate to work with members of the Broker-Dealer Section to develop and propose a new model rule addressing unpaid arbitration awards by broker-dealers, agents, investment advisers, and investment adviser representatives. The project group was pleased to see the rule make its way through the internal and public comment processes and hopes to see it finalized for adoption by member jurisdictions soon.

The project group's 2022 priorities include continuing to engage with investor advocacy and industry groups to address the evolving nature of the investment advisory business, monitoring and assessing relevant developments in rulemaking by other regulators that could impact state-registered investment advisers, reviewing current and potential new model rules for investment advisers, and discussing and pushing forward on other topics of interest to the investment adviser and regulatory communities.

# Project Group Reports

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## RESOURCES & PUBLICATIONS

Lindsay M. Fedler, Chair (WI), April Odom, Vice Chair (TN), David Biemel (OH), Jeffrey Eaby (CO), Joseph Joslin (AR), Judith Keilp (NJ), Holly Mack-Kretzler, (WA), Ron Matlock (IN), Elizabeth Mullin (CT), Linda Cena (MI), Liaison

The Resources and Publications Project Group spent early 2021 working on the IA Section's Annual Report. The report highlighted the state-registered investment adviser industry, trends in registration, regulator outreach events for investment advisers and other financial professionals, and all of the work performed by the Section and its project groups in 2020. The report was distributed in an entirely electronic format due to COVID-19.

As in the previous year, the project group did not meet in person due to COVID-19 but opted to work virtually to create compliance articles on topics of interest to state-registered investment advisers. In autumn 2021,

the group revisited the *Investment Adviser Resource Guide* project, heavily revising and updating content. The *Investment Adviser Resource Guide* will provide summarized information about registration, best practices, compliance, and examinations for state-registered investment advisers in the United States. The guide will also allow for jurisdictions to customize it with their own specific rules and regulations where appropriate.

The project group also took on the responsibility of organizing and administering the IA survey to all member jurisdictions, with the input of the IA Section.

# Project Group Reports

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## TRAINING

William Baldwin (WA), Co-Chair, Teaune Trice (IN), Co-Chair, Ryan Anderson (WY), Trisha Bernier (RI), Aaron Cooper (MS), Adam Hillier (AB), Dylan Landes (VA), Kelly Lent (CT), Veronica Rodriguez (CO), Kirsten Soltner (PA), Lindsey Stout (KY), Lindy Streit (AR), Judy Watkins (NJ), James Apistolas (NASAA), Liaison

The Training Project Group annually plans an informative, interactive program focusing on investment adviser regulation for regulators across jurisdictions. Additionally, the project group produces webinars along with training materials throughout the year.

The 2021 NASAA Investment Adviser Training was a 3-day virtual event held on April 20-22, 2021. The virtual training included sessions that focused on emerging fee models, advertising, how states treat solicitors, including proper disclosures and enforcement actions from examinations. The training group reached out and facilitated obtaining speakers on topics such as the different types of cryptocurrencies, knowing the significant cybersecurity risks, and identifying fees associated with advanced products.

Additionally, the group presented two webinars on Investment Adviser Fundamentals: Mastering the ABCs, which focused on introducing new examiners to regulatory terms and concepts found during an exam and addressed typical situations encountered during the exam, registration, or investigation. Contracts 101, the second webinar, focused on evaluating whether the agreement was adequate for the client, identifying contract deficiencies, and how to differentiate between the solicitation and asset management agreements.

The group has been working diligently towards putting on the hybrid, virtual/in-person Investment Adviser Training scheduled for April 18-21, 2022, in New Orleans, Louisiana. This hybrid training will allow for an increase in participation and engagement.

# Project Group Reports

## ZONES

Veronica Rodriguez (CO), Chair; Zone 1 (Northeast) Lauren Munschauer (MA); Zone 2 (Southeast) Matthew Alicona (VA); Zone 3 (Mid-Atlantic) Nathan Houtz (PA); Zone 4 (Central) Will Pultinas (OH); Zone 5 (South Central) Tommy Green (TX); Zone 6 (Mountain) Ryan Sullivan (MT); Zone 7 (Western) Henry Tanji (HI); Zone 8 (Canadian) Elizabeth Topp (ON)

Member jurisdictions within NASAA have been separated into 8 zones with 8 project group members each assigned to one zone. IA Zones maintains a zone communication system, including electronic communication and quarterly calls for each zone region. In addition, IA Zones coordinates information sharing among the jurisdictions and between the NASAA corporate office and the NASAA members on issues of importance regarding investment advisers, as well as identifies issues of importance in the investment adviser area, such as patterns, trends, issues, and best practices.

The project group coordinated with other project groups and committees to complete various initiatives, including the compilation of data from member surveys.

During 2021, the Zones played an important role in communication and connection among NASAA members. The project group held 10 quarterly zone

calls throughout the jurisdictions. As the pandemic continued and jurisdictions continued to work remotely, zone calls included valuable discussion of best practices, challenges, helpful resources, and efficient work processes.

Since the Investment Adviser Training was virtual this year, IA Zones hosted 3 separate webinars inviting up to three individuals from each jurisdiction to participate in these intimate video call settings. Topics discussed during each webinar ranged from compensation models, exploring unreasonable and excessive fees, examination challenges during Covid-19, and observations regarding investment products and strategies. These webinars were highly successful and received positive feedback. These calls provided groups a chance to network, discuss challenges, and share successes within a small and comfortable setting.

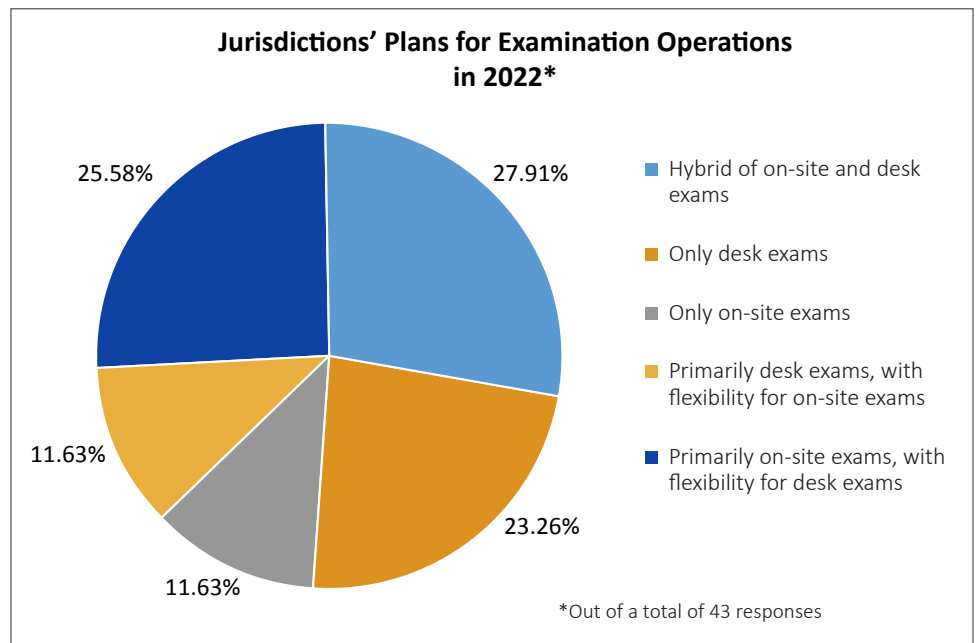


# Investment Adviser Exams and Outreach

While COVID-19 continues to shape the way that many jurisdictions carry out their regulatory responsibilities even more than two years after it began, NASAA members kept the lines of communication with registrants, particularly state-registered investment advisers, open and active in 2021. Below is a summary of exam findings from across the United States, and a few highlights from jurisdictions that were able to hold educational and training events in a safe, virtual format.

## Exams

Most jurisdictions continued to meet their examination responsibilities using a combination of remote examinations and hybrid examinations which used technology to augment the amount of review that could be done off-site. Based on feedback received from NASAA members, most intend to continue with some combination of on-site and remote examinations in 2022, as the circumstances warrant.



## Enforcement Actions Involving Investment Advisers

State securities regulators continued to resolve major deficiencies and violations of securities laws and rules uncovered during examinations in 2021. The top ten causes of enforcement actions (litigated and settled short of a hearing) were:

1. Failure to maintain adequate compliance policies and procedures;
2. Failure to register as an investment adviser representative;
3. Failure to register as an investment adviser
4. Suitability violations
5. Breach of fiduciary duty
6. Failure to disclose material information to the client
7. Violations related to Private placements
8. Failure to disclose a disciplinary action
9. Fraud
10. Senior related violations



# Investment Adviser Exams and Outreach

## NASAA Member Education, Training, and Outreach

### Ohio

On October 22, 2021, the Ohio Division of Securities hosted its 48th annual Ohio Securities Conference, continuing a tradition of providing industry stakeholders with a quality educational experience. Sessions at the full-day event covered a variety of topics, including how broker-dealer and investment adviser compliance professionals are responding to Regulation Best Interest; recent developments in the corporate finance space, including exempt offerings and crowdfunding; the financial impact of the opioid crisis; private market solicitations made via social media; and regulatory enforcement efforts involving private placement offerings. Speakers included several financial industry representatives, as well as Jennifer Zepralka, Chief of the Office of Small Business Policy and Andy Schiff, Regional Trial Counsel from the U.S. Securities and Exchange Commission, Faith Anderson from the Washington State Department of Financial Institutions—Division of Securities, and Joe Rotunda from the Texas State Securities Board. Ohio Division staff also provided updates on the work of the Division over the previous year. The keynote address was given by former Ohio congressman Steve Stivers, who provided a comprehensive overview on potential federal legislative and regulatory changes which might affect the securities industry. Approximately 160 people attended the virtual event.

### Virginia

Beginning in December of 2020, Virginia began hosting monthly investment adviser orientation and training sessions in a virtual setting for new investment adviser applicants domiciled in Virginia. To date, over sixty investment adviser representatives have attended. The training's mission is to introduce new investment advisers to the Division and set expectations on the continued regulatory relationship. The training sessions were facilitated by Principal Auditor Ashley Daniels and Principal Examiner Jonathan Hawkins.

### Nebraska

On October 19, 2021, Nebraska conducted its annual compliance webinar for 43 state-registered investment advisers and their compliance officers, compliance consultants, and legal counsel. 2021's topic was investment adviser fees, and the webinar was led by Department Counsel Mark Cameron and moderated by Administrator Claire McHenry. Administrator McHenry reported that the attendees were a very active bunch and asked a lot of questions.

### California

California utilized virtual meetings to schedule webinars on a monthly basis with registrants and Department of Financial Protection and Innovation staff. Webinar events were posted on the Department's Consumer Education and Outreach page and calendar. Registrants and the public could view the calendar and sign up to attend events where an assembly member would cover different financial education and licensing topics for financial professionals. The webinars were well received by the financial professionals who took advantage of smaller group settings to learn from Department members.

# ABOUT NASAA

Organized in 1919, the North American Securities Administrators Association (NASAA) is the oldest international organization devoted to investor protection. NASAA is a voluntary association whose membership consists of 67 state, provincial, and territorial securities administrators in the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, the 13 provinces and territories of Canada, and the country of Mexico.

In the United States, NASAA is the voice of state securities agencies responsible for efficient capital formation and grass-roots investor protection. Their fundamental mission is protecting investors who purchase securities or investment advice, and their jurisdiction extends to a wide variety of issuers and intermediaries who offer and sell securities to the public.

NASAA members license firms and their agents, investigate violations of state and provincial law, file enforcement actions when appropriate, and educate the public about investment fraud. Through the association, NASAA members also participate in multi-state enforcement actions and information sharing.

For more information, visit: [www.nasaa.org](http://www.nasaa.org).






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 NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

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March 8, 2022

The Honorable Sherrod Brown  
 Chairman  
 Senate Committee on Banking, Housing,  
 and Urban Affairs  
 534 Dirksen Senate Office Building  
 Washington, D.C. 20510

The Honorable Patrick J. Toomey  
 Ranking Member  
 Senate Committee on Banking, Housing,  
 and Urban Affairs  
 534 Dirksen Senate Office Building  
 Washington, D.C. 20510

Re: Mandatory Arbitration Agreements in Our Capital Markets

Dear Chairman Brown and Ranking Member Toomey:

On behalf of the North American Securities Administrators Association, Inc. (“NASAA”),<sup>1</sup> I am writing to commend the U.S. Senate Committee on Banking, Housing, and Urban Affairs for scheduling a hearing to examine mandatory arbitration in financial services products. In addition, I am writing to urge you and your colleagues to consider certain key points that have emerged from NASAA’s study of mandatory arbitration agreements and then act on a swift, bipartisan basis to ban these anti-investor choice instruments.<sup>2</sup>

At NASAA, we believe in prioritizing investor protection, encouraging responsible capital formation, and supporting inclusion and innovation in our capital markets. We have ample experience and expertise in the difficult work of maintaining an even playing field in our capital markets for investors and all types of investment products, professionals, practices, and technologies, new and old. During the last 35 years, we have witnessed the proliferation of mandatory arbitration agreements. At each juncture, we have grown more concerned and outspoken about the fact that these agreements are a net-negative for investor protection and responsible capital formation.

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<sup>1</sup> Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA’s membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grassroots investor protection and responsible capital formation.

<sup>2</sup> State securities regulators have testified numerous times, engaged with peers at the SEC, FINRA, and the CFPB, and continued to advocate for legislative action that returns investor choice to dispute resolution. *See, e.g.,* [NASAA Letter to HFSC Leadership Regarding the Investor Choice Act of 2021](#) (Nov. 15, 2021); [Putting Investors First: Reviewing Proposals to Hold Executives Accountable](#), Written Testimony of Melanie Senter Lubin Board Member, NASAA and Maryland Commissioner of Securities (Apr. 3, 2019); [The Federal Arbitration Act and Access to Justice: Will Recent Supreme Court Decisions Undermine the Rights of Consumers, Workers, and Small Businesses?](#), Written Statement of Mike Rothman, Commissioner of the Minnesota Department of Commerce on behalf of NASAA (Dec. 17, 2013); [Mandatory Binding Arbitration: Is It Fair and Voluntary?](#), Written Statement of the NASAA (Sept. 15, 2009); [NASAA Voices Support for Arbitration Fairness Act of 2009 \(S. 931, H.R. 1020\)](#) (May 21, 2009); [NASAA Statement on FINRA Arbitration Pilot Program](#) (July 24, 2008).

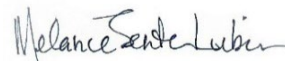
As you know, broker-dealers, investment advisers, and securities issuers use mandatory arbitration as part of their business models. Nearly all FINRA members, as well as many investment advisers, now require their clients to agree to mandatory arbitration. In addition, it appears that many securities issuers use mandatory arbitration clauses in their governance documents and offering documents, thereby eliminating or complicating the ability of investors to bring securities class actions.<sup>3</sup> As a practical matter, mandatory arbitration requirements have reduced the extent of investor choice in dispute resolution significantly.

Meanwhile, investors continue to want choice. According to a 2019 national poll, 83% of investor-respondents said they want the choice to pursue a dispute in court or in arbitration.<sup>4</sup> Put differently, they oppose a system that expects them to make time that they do not have to review copious, lengthy documents for the possible inclusion of a mandatory arbitration provision. Instead, they want an easy system that gives them a choice in the unlikely event a dispute arises.

NASAA believes Congress should act now on a swift, bipartisan basis to empower investors and give them a choice when it comes to resolving disputes with securities firms and professionals. Unfortunately, the SEC has failed to use the rulemaking authority that Congress gave it in 2010 to prohibit, condition, or limit the use of mandatory arbitration agreements by broker-dealers and investment advisers. This failure has occurred notwithstanding efforts by state securities regulators and many others to urge action.<sup>5</sup> Moreover, the authority that Congress gave the SEC in 2010 would not prohibit or restrict mandatory arbitration provisions in the governing documents and offering documents of securities issuers.<sup>6</sup>

Thank you for your consideration of NASAA's comments. Should you have any questions, please do not hesitate to contact Kristen Hutchens, NASAA's Director of Policy and Government Affairs, and Policy Counsel, at [khutchens@nasaa.org](mailto:khutchens@nasaa.org).

Sincerely,



Melanie Senter Lubin  
NASAA President  
Maryland Securities Commissioner

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<sup>3</sup> Securities class actions are necessary to ensure that investors continue to view our capital markets as fair and equitable. Presently, they are the primary means in the United States of upholding securities disclosure standards. While the SEC and state securities regulators make significant contributions to these efforts, the government lacks the resources to pursue every alleged violation of federal and state securities laws.

<sup>4</sup> In early 2019, Engine, a national opinion firm based in New York, conducted a national opinion poll of investors that included 1,000 investors.

<sup>5</sup> See, e.g., [Letter from NASAA President Heath Abshire of Arkansas to the SEC](#) (May 3, 2013); [Letter from the Massachusetts Securities Division to the SEC](#) (Feb. 12, 2013) (urging the SEC to use its authority under Section 921 of the Dodd-Frank Act); Massachusetts Securities Division, [Report on Massachusetts Investment Advisers' Use of Mandatory Pre-Dispute Arbitration Clauses in Investment Advisory Contracts](#) (Feb. 11, 2013).

<sup>6</sup> See, e.g., [NASAA Letter to HFSC Leadership Regarding the Investor Choice Act of 2021](#) (Nov. 15, 2021); SEC Commissioner Rob Jackson, [Keeping Shareholders on the Beat: A Call for a Considered Conversation About Mandatory Arbitration](#) (Feb. 26, 2018); SEC Investor Advocate Rick Fleming, [Mandatory Arbitration: An Illusory Remedy for Public Company Shareholders](#) (Feb. 24, 2018).

## REPORT ON MASSACHUSETTS INVESTMENT ADVISERS' USE OF MANDATORY PRE-DISPUTE ARBITRATION CLAUSES IN INVESTMENT ADVISORY CONTRACTS

*By the Massachusetts Securities Division Staff  
February 11, 2013*

### Introduction

Under the Federal Arbitration Act (the “FAA”), American courts have historically favored the use of pre-dispute arbitration clauses to compel arbitration as an alternative dispute resolution mechanism. In the context of securities law, the U.S. Supreme Court extended the favorable treatment of pre-dispute arbitration clauses in Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987). In McMahon, the Court explained that the FAA generally mandates enforcement of agreements to arbitrate statutory claims in the context of the Securities Exchange Act of 1934, but also explained that, as with any statutory directive, the FAA’s mandate may be overridden by a contrary congressional command.<sup>1</sup>

Since McMahon, the use of arbitration has continued to govern a variety of securities-related disputes. A recent development along these lines occurred in October 2012, when the Financial Industry Regulatory Authority (“FINRA”) announced that it had opened its dispute resolution process to investment advisers not registered with FINRA or subject to FINRA jurisdiction.<sup>2</sup> Significantly, to use FINRA’s arbitration forum, the investment adviser and investor must reach a *post-dispute* agreement to use the forum and must also agree that they will be subject to FINRA’s arbitration rules.

Congress has recently recognized that pre-dispute arbitration clauses may not be in investors’ best interests in some contexts. Section 921(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) amended the Investment Advisers Act of 1940 to provide the U. S. Securities and Exchange Commission (the “SEC”) with rulemaking authority to prohibit or impose conditions upon the use of mandatory pre-dispute arbitration clauses in investment advisory contracts.<sup>3</sup> In a study of investment advisers and broker-dealers

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<sup>1</sup> “The [FAA]...mandates enforcement of agreements to arbitrate statutory claims. Like any statutory directive, the [FAA’s] mandate may be overridden by a contrary congressional command. The burden is on the party opposing arbitration, however, to show that Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue. If Congress did intend to limit or prohibit waiver of a judicial forum for a particular claim, such an intent will be deducible from the statute’s text or legislative history...or from an inherent conflict between arbitration and the statute’s underlying purposes.” McMahon, 482 U.S. at 226-27 (internal citations and quotations omitted).

<sup>2</sup> Bruce Kelly, *FINRA Opens Arb System to RIAs*, Investment News, October 25, 2012, <http://www.investmentnews.com/article/20121025/FREE/121029965>.

<sup>3</sup> The entire text of Section 921(b) of the Dodd-Frank Act is as follows:

(b) AMENDMENT TO INVESTMENT ADVISERS ACT OF 1940.—Section 205 of the Investment Advisers Act of 1940 (15 U.S.C. 80b—5) is amended by adding at the end the following new subsection:

“(f) AUTHORITY TO RESTRICT MANDATORY PRE-DISPUTE ARBITRATION.—The Commission, by rule, may prohibit, or impose conditions or limitations on the use of, agreements that require customers or clients of any investment adviser to arbitrate any future dispute between them arising

pursuant to Section 913 of the Dodd-Frank Act, the SEC touched upon mandatory pre-dispute arbitration clauses in investment advisory contracts.<sup>4</sup> The study noted that “...during the Dodd-Frank Act legislative process, concerns were raised regarding mandatory-pre-dispute arbitration, including costs and limited grounds for appeal, among others,” but concluded that “...it [did] not recommend that the [SEC] take any action relating arbitration as part of these recommendations, because Section 921 provides the [SEC] the opportunity to review this issue in greater detail.”<sup>5</sup>

Given these developments, the Massachusetts Securities Division (the “Division”) of the Office of the Secretary of the Commonwealth William Francis Galvin recently conducted a voluntary and anonymous survey of investment advisers registered with and operating in the Commonwealth. Among other things, the purpose of the “Survey Regarding Content of Investment Advisory Contracts” (the “Survey”) was to gather information on investment advisers’ use of pre-dispute arbitration clauses in their client contracts. The Division mailed the Survey to 710 state-registered investment advisers on Wednesday, January 2, 2013. Responses were requested by Friday, January 18, 2013.

### Findings

The Division has received 370 returned surveys as of February 11, 2013, representing 52.11% of all state-registered investment advisers located in Massachusetts. Of those 370 responses, 87.3% (323) of investment advisers indicated that they use standardized written contracts pertaining to their investment advisory services.<sup>6</sup> Copies of the Survey results for questions pertaining to the use of mandatory pre-dispute arbitration clauses are attached hereto at Exhibit 1.

Of the 323 investment advisory firms that indicated they had written contracts, nearly half confirmed that those contracts contained a mandatory pre-dispute arbitration clause. Of those advisers that have a pre-dispute arbitration clause in their contracts, 62.59% indicated that their clauses designate a specific arbitrator to hear the dispute,<sup>7</sup> and 53.06% (78) of those with clauses confirmed that their clauses designate a specific location or jurisdiction in which the arbitration must take place.<sup>8</sup>

The 92 investment advisory firms whose contracts designate a specific arbitrator identified that arbitrator as follows:

- 65.22% (60) designate the American Arbitration Association (“AAA”);
- 16.3% (15) designate FINRA;

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under the Federal securities laws, the rules and regulations thereunder, or the rules of a self-regulatory organization if it finds that such prohibition, imposition of conditions, or limitations are in the public interest and for the protection of investors.”

<sup>4</sup> The full text of the SEC Study can be found at <http://www.sec.gov/news/studies/2011/913studyfinal.pdf>.

<sup>5</sup> SEC Study, pp. 134-35.

<sup>6</sup> Based on the written explanations provided by a number of respondents, the Division believes that a significant number of the 12.7% (47) of investment advisers who indicated that they did not use standardized written contracts did so because they act only as firms that solicit business for other investment advisory firms and do not provide any other investment advisory services.

<sup>7</sup> Alternatively, 37.41% (55) of investment advisory firms have clauses that do not designate a specific arbitrator.

<sup>8</sup> Similarly, 45.58% (67) of investment advisory firms with arbitration clauses in their contracts explained that their clauses do not specify a required location or jurisdiction for the arbitration.



- 15.22% (14) stated that their contracts designated an arbitrator, but did not specifically identify the arbitrator;
- 1.09% (1) designate FINRA and/or AAA;
- 1.09% (1) designate Endispute; and
- 1.09% (1) designate the Massachusetts Securities Division.

The 78 investment advisory firms whose contracts designate a specific location or jurisdiction in which the arbitration must take place identified the arbitration's location as follows:

- 47.44% (37) stated Massachusetts as the specific location or jurisdiction;
- 24.36% (19) stated Boston, Massachusetts;
- 15.38% (12) confirmed that their arbitration clause designated a location, but did not specifically identify the location;
- 7.69% (6) stated another location in Massachusetts; and
- 5.13% (4) stated other non-Massachusetts locations.

### Conclusion

As demonstrated by the Division survey, nearly half of investment advisers have pre-dispute mandatory arbitration clauses in their advisory contracts. The SEC has not taken a position on pre-dispute arbitration clauses since the enactment of Dodd-Frank. Meanwhile, FINRA has opened its arbitration forum to investment advisers – a forum that a significant number of advisers have already chosen to designate.<sup>9</sup>

While the Division recognizes that arbitration may be appropriate in selected situations, a clause binding an investor to arbitrate a dispute before its circumstances are established may not be in that client's best interests, nor may such a requirement be consistent with the fiduciary duty owed to the client by the investment adviser. Accordingly, the Division urges that the SEC conduct an in-depth review of the use of these clauses in the advisory context and enact such rules as are necessary and appropriate for the protection of investors.

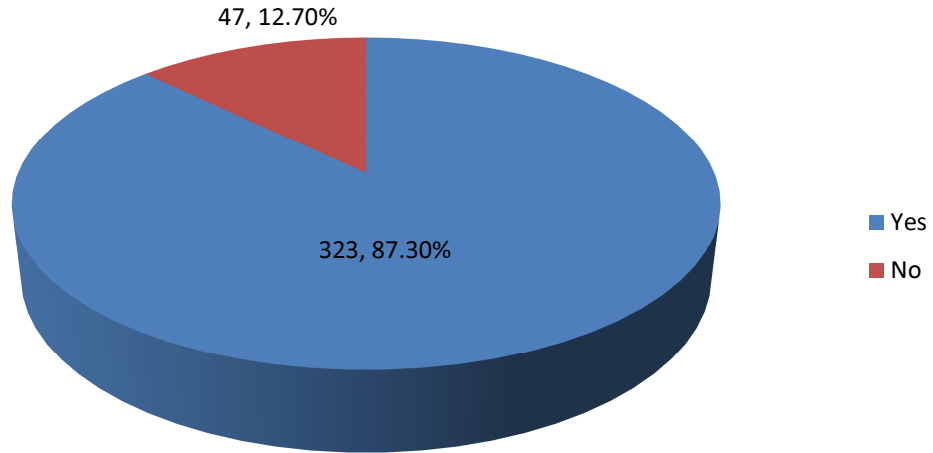
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<sup>9</sup> Interestingly, although FINRA requires an agreement between the parties to arbitrate *post-dispute*, a significant number of Massachusetts investment advisers maintain *pre-dispute* arbitration clauses in their contracts designating FINRA as the arbitrator.

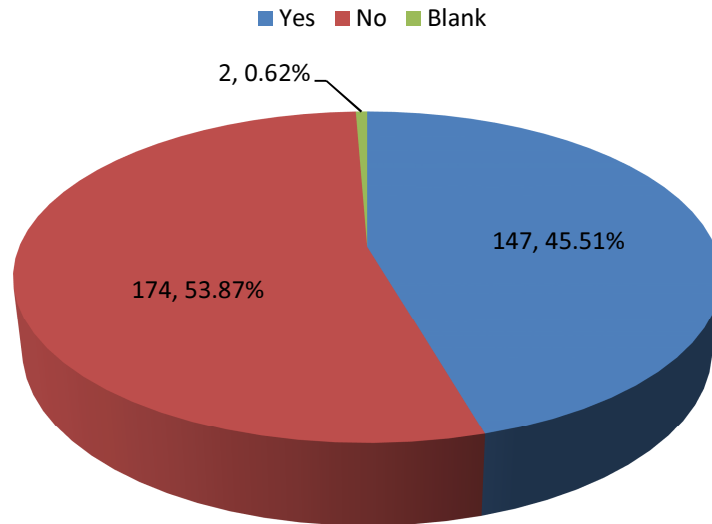


Exhibit 1

**Does your investment advisory firm use a standard written contract?**

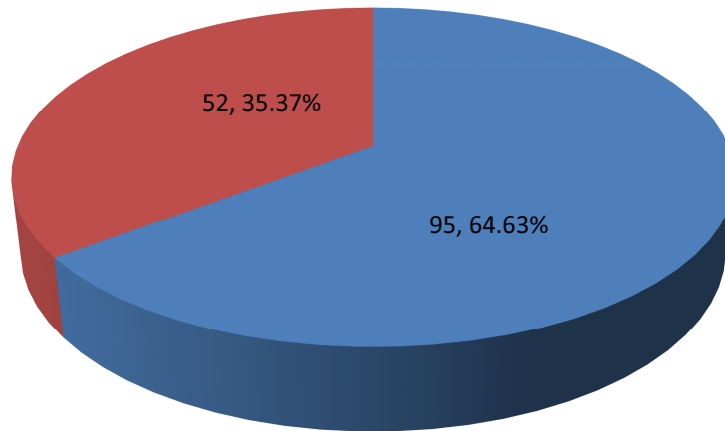


**Does your investment advisory firm's contract contain a mandatory pre-dispute arbitration clause?**

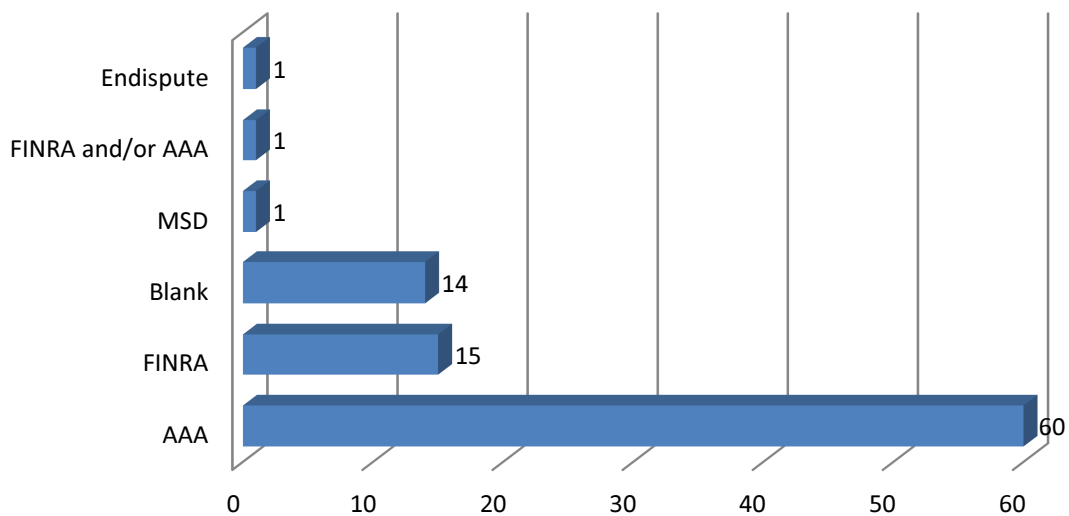


## Does the mandatory pre-dispute arbitration clause designate a particular arbitrator?

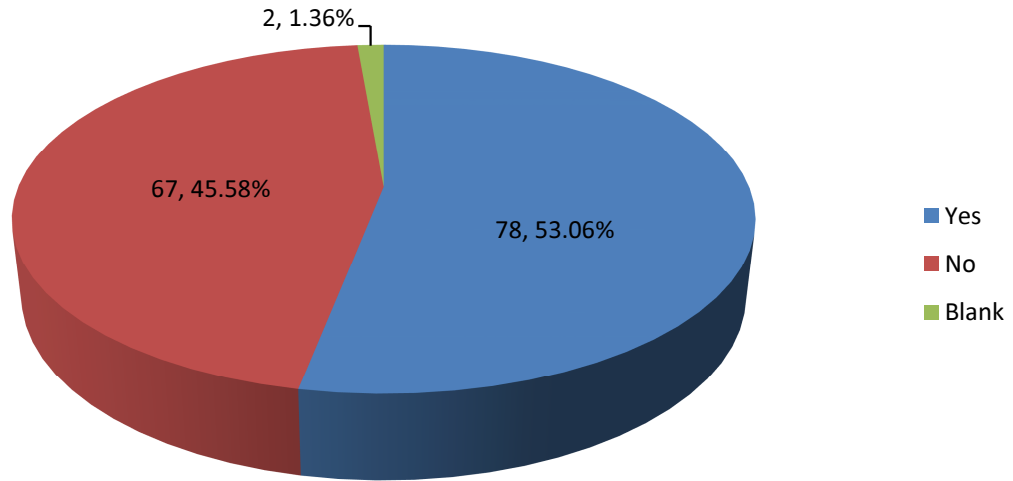
■ Yes ■ No



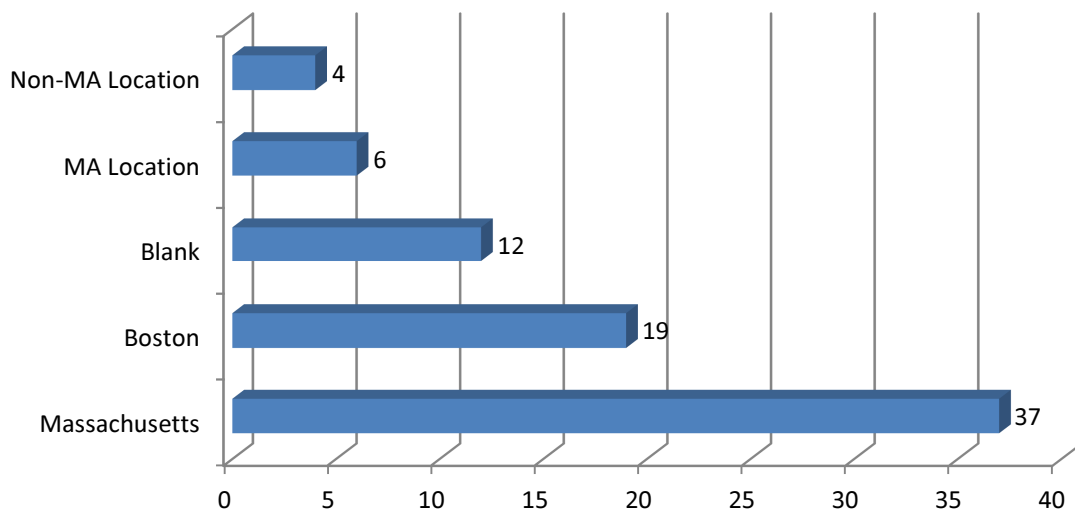
## Which organization does the mandatory pre-dispute arbitration clause designate as the arbitrator?



### Does the mandatory pre-dispute arbitration clause designate a particular location or jurisdiction for the arbitration?



### Which location or jurisdiction does the mandatory pre-dispute arbitration clause designate?






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 NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

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 Washington, D.C. 20002  
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April 5, 2022

The Honorable Sherrod Brown  
 Chairman  
 Senate Committee on Banking, Housing,  
 and Urban Affairs  
 534 Dirksen Senate Office Building  
 Washington, D.C. 20510

The Honorable Patrick J. Toomey  
 Ranking Member  
 Senate Committee on Banking, Housing,  
 and Urban Affairs  
 534 Dirksen Senate Office Building  
 Washington, D.C. 20510

Re: Promoting Trust in Our Capital Markets

Dear Chairman Brown and Ranking Member Toomey:

On behalf of the North American Securities Administrators Association, Inc. (“NASAA”),<sup>1</sup> I am writing to commend the U.S. Senate Committee on Banking, Housing, and Urban Affairs for holding a hearing to examine illegal insider trading legislation. As explained below, while NASAA supports swift passage of legislation to combat illegal insider trading, we also urge Congress to pass a package of reforms that will foster greater trust in our capital markets.

At NASAA, we work independently and collaboratively with many external partners such as academics, consumer advocates, legislators, regulators, and trade associations to help ensure that entrepreneurs, investors, and others trust our capital markets and will continue to use them for generations to come. To encourage the trust of America’s hard-working entrepreneurs and investors in our capital markets, we protect investors, promote responsible capital formation, and support inclusion and innovation. Yet, nearly 15 years after the 2008-2009 Financial Crisis, a concerning amount of distrust in our capital markets persists. Indeed, large numbers of U.S. adults across all age demographics remain skeptical of Wall Street’s institutions, professionals, and products.<sup>2</sup>

As stated above, Congress should act on a swift, bipartisan basis to pass legislation, including insider trading legislation, that will help to foster trust and participation in the regulated markets. In doing so, Congress should prioritize proposals that strengthen accountability, compliance, investor education, registration, regulatory coordination, and transparency. The following is a representative list of proposals to approve:

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<sup>1</sup> Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA’s membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grassroots investor protection and responsible capital formation.

<sup>2</sup> For various reasons, we know that many U.S. adults do not trust our capital markets. For example, in a survey conducted in March 2022, the percentages of Gen Z, Millennial, Gen X, and Baby Boomer respondents who expressed trust in Wall Street were 20%, 39%, 31%, and 40%, respectively. *See* Morning Consult, [Tracking Trust in U.S. Institutions](#) (Mar. 2022). *See also* Bankrate, [Survey: More than half of investors think the stock market is rigged against individuals](#) (Mar. 2021) and P. Sapienza and L. Zingales, [Financial Trust Index](#) (Feb. 5, 2020).

1. [\*\*The Empowering States to Protect Seniors from Bad Actors Act\*\*](#) (H.R. 5914 | S. 3529): This bicameral, bipartisan bill, which the House Financial Services Committee approved by a voice vote in November 2021, would establish a grant program that would enhance existing efforts by state securities and insurance regulators to protect senior investors and policyholders from financial fraud. Importantly, with respect to the grant program, the bill would: (A) make the U.S. Securities and Exchange Commission (“SEC”) the program administrator; (B) give the SEC the authority and tools necessary to operate a data-driven grant program; (C) empower the SEC to make grants to state regulators from across the United States; (D) authorize an appropriation of \$10,000,000 to the SEC for each of the fiscal years 2023 through 2028 to make such grants; (E) require the SEC to cap each grant at \$500,000; and (F) effectively create more opportunities for federal and state securities regulators to communicate and coordinate in their efforts to protect senior investors.<sup>3</sup>

2. [\*\*The Insider Trading Prohibition Act\*\*](#) (H.R. 2655 | S. 3990): S. 3990 would make it easier for market participants, courts, and other stakeholders to identify, follow, and enforce the law by creating a codified definition of illegal insider trading. In short, the bill would make it unlawful for a person to trade while aware of material, non-public information if that person knows, or has reason to know, that the information was obtained wrongfully. In addition, the bill would prohibit a person with material, nonpublic information from wrongfully passing along that information to others, or tipping them, if the person is aware that the communication would result in trading and the recipient in fact trades based on that communication. In May 2021, the U.S. House of Representatives (“House”) passed H.R. 2655 by a vote of 350 to 75.<sup>4</sup>

3. [\*\*The 8-K Trading Gap Act of 2021\*\*](#) (H.R. 4467 | S. 2360): This bicameral legislation, which received bipartisan support last Congress, would close a loophole by requiring the SEC to prohibit corporate insiders from making trades during the four-day period they have between the occurrence of a significant event – such as bankruptcy or an acquisition – and the public company’s legally-mandated disclosure. The SEC requires public companies to file an 8-K to announce significant events relevant to shareholders. Companies have four business days to file an 8-K for most specified items.<sup>5</sup>

4. [\*\*The FAIR Act of 2022\*\*](#) (H.R. 963 | S. 505): Last month, the House approved this bicameral, bipartisan legislation by a vote of 222 to 209. The bill was referred to the Senate Committee on the Judiciary. Among other things, this legislation would prohibit broker-dealers and registered investment advisers from including pre-dispute arbitration clauses in customer

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<sup>3</sup> See NASAA, [Letter to SBC Leadership Regarding S. 3529, the Empowering States to Protect Seniors from Bad Actors Act](#) (Jan. 25, 2022); NASAA, [Letter to HFSC Leadership Regarding H.R. 5914, the Empowering States to Protect Seniors from Bad Actors Act](#) (Nov. 15, 2021).

<sup>4</sup> See generally NASAA, [Letter to Rep. Himes Regarding H.R. 2655](#) (May 17, 2021); Written testimony of Melanie Senter Lubin, [Putting Investors First: Reviewing Proposals to Hold Executives Accountable](#) (Apr. 3, 2019).

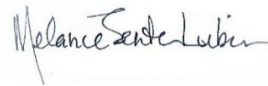
<sup>5</sup> The House passed [The 8-K Trading Gap Act of 2019](#) by a vote of 384 to 7. See [Van Hollen, Maloney Introduce Bicameral Legislation to Help Eliminate Corporate Insiders’ Unfair Advantage in Stock Sales](#) (July 15, 2021).

contracts as well as invalidate any standing mandatory pre-dispute arbitration clauses in current employment and customer agreements.<sup>6</sup>

Notably, at this time, we are not recommending that Congress pass the [Promoting Transparent Standards for Corporate Insiders Act](#) (H.R. 1528 | S. 2211). In short, this bill would direct the SEC to study and report on possible revisions to regulations regarding Rule 10b5-1 trading plans and to revise regulations consistent with the results of the study. Though NASAA called on Congress to conduct oversight with respect to Rule 10b5-1 plans and expressed support for this bill in early 2021,<sup>7</sup> the SEC has since published a proposed rule relating to Rule 10b5-1 plans and insider trading. On April 1, 2022, NASAA submitted a comment letter stating that we generally support the proposal. Our comment letter suggested ways in which the SEC could improve the proposal to make it a more meaningful enhancement of the insider trading laws.<sup>8</sup>

Thank you for your consideration of NASAA's comments. Should you have any questions, please do not hesitate to contact Kristen Hutchens, NASAA's Director of Policy and Government Affairs, and Policy Counsel, at [khutchens@nasaa.org](mailto:khutchens@nasaa.org).

Sincerely,



Melanie Senter Lubin  
NASAA President  
Maryland Securities Commissioner

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<sup>6</sup> See generally NASAA, [Letter to SBC Leadership Regarding Mandatory Arbitration Agreements in Our Capital Markets](#) (Mar. 12, 2022) (explaining that NASAA believes Congress should act now on a swift, bipartisan basis to empower investors and give them a choice when it comes to resolving disputes with securities firms and professionals).

<sup>7</sup> See NASAA, [Legislative Agenda for the 117<sup>th</sup> Congress](#), at p. 14; NASAA, [Letter to HFSC Leadership Regarding the Promoting Transparent Standards for Corporate Insiders Act](#) (Mar. 8, 2021).

<sup>8</sup> NASAA, [Comment Letter Regarding SEC Rule 10b5-1 and Insider Trading Proposal](#) (Apr. 1, 2022).