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Panel Discussion

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Introduction and Summary of Events

Professor Elliot Spoon: Hello, my name is Elliot Spoon and I am a professor at MSU College of Law and on behalf of the MSU College of Law I want to welcome you to the 2016 edition of the Midwest Securities Law Institute. We have a wonderful, wonderful program today spreading all aspects of securities laws. We have great speakers that I think will provide you with some very, very important information. Before we begin, I'd like to ask Associate Dean of Academic Affairs, Kristi Bowman, to formally welcome you to the college.

Dean Kristi Bowman: Good morning, I am so excited to see you all here and, frankly, it is a testament to the strength of this conference and Professor Spoon's enduring efforts that it is 9:00 AM on a dreary Friday morning and this room is packed. That never happens. So I'm sure you have really, a wonderful day to look forward to. And as I understand it, this is in fact the twelfth year of this wonderful gathering and so I imagine a lot of you know each other over the course of years from interacting here and in various other instances. So I wanted to take a few minutes and give you a glimpse of a few things, few wonderful things, that are happening here at MSU Law. Often in the fall when we are talking about great things at MSU, we're able to talk about our football team, but that's not exactly the case this year so we just won't go there. But, here within the building, we really have some tremendous things happening. Well in case you don't know, we welcomed a new Dean this summer, Dean Larry Ponoroff who sends his greetings. He is in New York right now meeting with various alums and doing all sorts of interesting things there. Otherwise, he would be here to welcome you in person. But he does send his regrets and his warm greetings. And of course that also means that our Dean for the previous eight years, Joan Howarth, is spending the year in lovely Nevada, which, especially in January, when it comes to be January, I will be very jealous of that. She may be returning to the faculty or she may decide that, you know, that Nevada in January is really the way to go and formally retire. We're not sure about that yet, but it's really wonderful to be building on the strengths of the school under her leadership and now transitioning to someone else.

We are working on a number of new programs across campus. A lot of interdisciplinary opportunities, really trying to build on the strengths of MSU and of course thinking about our neighbors across the street at Broad is actually a big part of that and something that you all are more tuned in to in terms of the connections of course, between law and business than many other groups. So of course, that is certainly a high priority for us. Yesterday, we also got the bar results for our summer 2016 takers, and we were very pleased with that, so good news on that. We came in a little bit behind University of Michigan and, you know, that's a pretty good place to be. So we're pleased about that, and we were above the state average and so we're continuing to build on our success there. And, how many 3Ls in the room? Yes, okay so 3Ls, and everyone else please pardon my public service announcement, the spring we are having a new three credit bar prep course and then in summer we are going to have two courses, they're not really for credit or for a grade, but we want you to stay here and take them. They are free, they will give you a lot of feedback on your writing in preparation on the bar exam. So, there will be a lot more PR on that, so be on the lookout for that. And I'm excited about what we are building in that area.

Finally, I wanted to note that we're also really growing the opportunities for students to engage with attorneys in fields of their interest. And actually in that way, this conference is way ahead of the curve because that has been an important part of this conference for a long time. And so, first I just wanted to take a survey of the practicing attorneys. Any practicing attorneys here really not want to talk to any of the students who are in the room? Of course not, right! That is part of what makes this conference so wonderful. So, if we can get a sense of who is here from the practicing community, let's see: any MSU undergrad alums, either current students or practicing attorneys? Okay, very nice. And, MSU Law alums from among our practicing attorneys? Wonderful! So we are especially glad to see you here this morning. I think we have a couple folks from the SEC, Professor Spoon mentioned we have four folks from the SEC? Yes, so students, yes, be talking to all these people, right? And, from the Michigan Securities Bureau? And I think, wonderful, and some of you are alums as well so we're especially glad to welcome you. And, I think that pretty much takes care of it for my greeting this morning. Again we're just so thrilled to be hosting this conference and, again, it's really Professor Spoon's wonderful work that brings you all here this morning year after year and sets you up for a fantastic day. So, have a fantastic day, I'm sure it will be enlightening and I look forward to hearing much more about it. Thanks.

Professor Spoon: Thank you very much Dean. So I . . . we're going to move into our first panel momentarily, but I wanted to acknowledge the participation and importance of our students in putting on this panel and I'd like to ask two of our student leaders to come up, Mohamed . . . Pam. So I would like to introduce to you Pam Burneski who is the Editor-in-Chief of the Journal of Business and Securities Law and Mohamed Salamey who is the president of the Business Law Society. These groups have put in a lot of work to make sure that this day comes off and is a success. So please join me in congratulating these students for a job well done. [Applause]

Okay, so I want to now introduce to you my co-chair and the guy that does most of the work and that is Ray Henney from the law firm of Honigman Miller. And Ray will give you our greetings and introduce you to our first panel.

Raymond Henney: So I am Ray Henney and I am pleased to be the co-chair with Professor Elliot Spoon. And this year of a somewhat notable presidential election, Elliot and I thought it would be appropriate to remind you that this seminar is the finest seminar, this is the best, ever seminar, there has never been. This seminar is so good, it is so good that it trumps all other seminars. We have the smartest people, the most extraordinary people, they're so smart they'll solve every single concern, every single . . . there is not going to be any more securities issues after this seminar. In fact, Elliot and I are declaring, are calling for a total and complete shutdown of all other seminars. Actually we are really pleased to have you all here, and we're really excited too. We have a panel . . . as the Associate Dean was having everyone raise their hand . . . we're really thrilled to have members of the Securities and Exchange Commission here, we have members from the Office of Compliance and Compliance Inspections and Examinations. We have a member of the Office of Internal Affairs, and enforcement lawyers from, in various regions of the country, from California and from Chicago. We also have a strong supply of state regulators here, and we're very thrilled to have them here from the Department of Licensing and Regulatory Affairs, specifically the corporations, securities and commercial licensing bureau. And we have a representative from the financial industry and regulatory authority, FINRA, staff attorney in the Department of Arbitration. And we are very thrilled to have them here. This is the only seminar in our area, in the state of Michigan that has regulators here so that you can specifically talk to them, so you can specifically hear them, and we are so thrilled to have each of them here. We also have our usual supply of prominent practitioners, who will give you the benefit of their scholarship concerning various securities issues. We also are very excited to have a new panel, composed of chief compliance officers and general counsels of investment bankers and broker-dealers. It's a compliance oriented panel, it's new for us, and we're very excited about it. And in fact, we have emphasized the compliance, and you'll see this among the panels because we really have an avalanche of regulatory issues that the industry faces. Compliance is such an important aspect and the people that you'll be hearing from are the people who are really responsible in the battleground for making sure that we have fairness and integrity in the securities laws. So we're very excited about the program today and we're going to start off with our first panel and Shane Hansen is the moderator and concerning the developments of broker-dealer investments and advisors. Shane, want to introduce and take it over? Thank you.

Panel 1: Development in Broker-Dealer and Investment Advisor Regulation

Shane B. Hansen: Alright, great thank you. It's delightful to be here and very, really wonderful to have a couple of SEC speakers with us. Kris Easter Guidroz is a veteran, Kris has been with us now for several years. She is in the . . . the Assistant Director in the Office of the International Affairs, which is kind of a fun job because it means she gets a little international travel out of this. And, you might, for the students out there, if you want something to kick off a conversation, ask her about taking cooking classes in Italy. She is involved in on-site examinations of foreign firms as well as exchange of information with international firms and counter parts to the SEC operating in, of course, other countries. She was formally with the Office of Inspections and Exam Compliance, Office of Compliance and Exam Compliance, or OC as its acronym is called. Involved in special projects involving registered investment advisors in particular. And also worked in private practice. So, she has a practical side to her experience as well.

And our newbie, we'd like to welcome Carrie . . . Carrie O'Brien joins us this year. She's from the, also from OC senior special counsel responsible for giving advice to the SEC's national examination program, which is the structure around which we'll hear more about, but for examining broker-dealers and investment advisors around the country. And she has substantial experience with the SEC's net capital and customer protection rules, and I might add, has worked with Mike Macurelli. Who, if you know Mike, he's been with the SEC for forty years and is the expert, maybe even wrote the net capital rules. He is a legend in his own time and has also practical experience having practiced with Arnold Portor before joining the SEC.

So as we get started I would also like to be thankful for all the students who are here, as you'll learn in school, or hear in school, that the law is a seamless web. It may not be seamless but you sure can get tangled up in it. So we're going to talk a little bit about some of the web and try to . . . how to stay out of the web and stay out of trouble. So, first up we'll give the SEC disclaimer and if you want to repeat it, you can.

Carrie O'Brien: Sure, basically we have to just let you know that what we say today is our opinions as staff of the SEC and we're not talking on behalf of our commissioners or any other staff that we work with. So if we make a mistake, it's all on us.

Shane B. Hansen: So the agenda, we're are about a number of things. We really want it to be a dialogue, so if you have questions as you go along don't hesitate to ask. We have a lot to cover but we will try to leave time at the end and Kris and Carrie are going to be here throughout the morning so if you have questions to ask, you'll have an opportunity to do that off-line and we've got their contact information on the screen. So if you have questions and want to follow up later that's also possible. So, in the agenda we're going to talk about the exam programs and priorities, some common examination findings, some recent enforcement cases, and some other topical issues. At the very end of the slide deck is a link to some additional materials on the SEC's website for investment advisors, for broker-dealers, really very helpful resources and what I've given you is kind of the front door to find more and drill down into lots, and lots of information there. So with that why don't we get started and turn to the exam program and overview and structure.

Carrie O'Brien: Okay, good morning. As you can see, we . . . the examination program and OC has four main goals to improve compliance, to prevent fraud, to monitor risk, and to inform policy. We have over 28,000 registrants that we examine right now, so it's quite a large population. And one of our largest areas of growth has been in the investment advisor space. We have currently about 12,000 investment advisors and 11,000 mutual funds and exchange traded funds registered with us that we examine. We've had over 2,000 investment advisors register with us in the past two years, so it's an area of big growth. And to help with that we actually decided . . . we've reorganized OC recently, this is new, this is the start of the fiscal year, October first, so we have increased our examination in the investment advisor space. We've taken some examiners from our broker-dealer program and put them into the investment advisor program. I think we've increased the staff there by 20% so that we can increase some of the investment advisor exams. To do that we also have . . . you know . . . between FINRA and the SEC, for those of you who don't know, maybe the students, FINRA is a self-regulatory agency that broker-dealers are members of and they do examinations of broker-dealers as well. So between the SEC examination and FINRA's examination we cover about 50% of the broker-dealers every year. Investment advisors, investment companies, we're currently getting about 12%, I think somewhere around there, and so we are . . . we're going to be a lot more dependent on FINRA to do the broker-dealer exams so we've also structured . . . part of our structure is that we're going to have a new group, that will oversee FINRA. So, we're going to increase our oversight of FINRA at the SEC so we're more dependent on them to do broker-dealer exams, as well as increasing our . . . so we can increase our number of investment advisor exams. So that's the exciting news for the structure of OC in the past year. I think everyone has transitioned through new roles the past few weeks, so that's something new and starting. And I think, I would also like to just reiterate what Shane said that if anyone has questions on this at any time feel free to raise your hand. I always like answering questions because a lot of what I repeat you might be able to find else . . . or say a lot of what I say you may be able to find out elsewhere on our website or anywhere else. So if there's issues that I'm talking about that you want more information on just let me know.

Shane B. Hansen: Okay, great. Next slide. Going to talk a bit about priorities and the things you guys have been looking at.

Carrie O'Brien: Yeah, we have . . . so every year we publish a priorities memo. It comes out in January of each year. It's published on our website. And we list all the areas that we are going to look at that year for examinations. We are a risk-based examination program so we . . . we, you know, we do risk based work for each registrant looking at, you know, deciding how their risk score and risk factors, but then we also decide which areas we think are very risky that we need to look at. So a lot of things we've done . . . we do a lot with cyber security, we have an initiative, we call it ReTIRE, it's to look at retirement and retirement saving and how savings and how broker-dealers and investment advisors are helping people save money for retirement. And so, all of our initiatives . . . our priorities, are listed on our website. We have the supervision practices registered investment advisors is the initiative we just started. Usually when we get ready to start our initiatives we publish a risk alert. So this one came out last month, it’s our newest one and what we’re looking at is investment advisors who are employing individuals who have a history of disciplinary actions. So we went through disciplinary records and information that people have filed on their form ADVs, we went through legal actions, civil actions, looking for people with disciplinary history, we went through SEC enforcement actions, probably FINRA enforcement actions, just looking for people with disciplinary history. And then we will be going into these investment advisors to where we are looking at a number of factors when we go in. A lot of what we will focus on is the compliance program that the advisor has in place, what policies and procedures do they have in place to oversee these employees that have disciplinary histories. We’re looking at disclosures, what disclosures are being given to clients and prospective clients related to this. The conflicts of interest related to maybe . . . if this employee is selling a unique type of product or a special type of product or other financial arrangements we would . . . we would look at that. And we’re looking at marketing materials, a lot of what, you know, pitch books, what’s on your website, how are you making statements . . . if you’re making statements are you also identifying conflicts of interest where they’re related to supervise these persons. Just general, just general how the advisor is supervising people who they have hired with a disciplinary history.

Shane B. Hansen: Carrie, question along that line . . . not an uncommon practice for firms that hire someone who has a ding on their record, has had some prior problem, is to adopt what is kind of commonly called a plan of heightened supervision. So it’s actually a written document that lays out what the firm is going to do and maybe what the individual representative is going to do, or agreed to do, or agree not to do. And some firms have that signed by . . . it’s sort of like a mini contract if you will, and the person who has had that regulatory violation on their record then is under that plan of heightened supervision for some period of time. Any thoughts, comments, do you see those kinds of things? Would you expect those kinds of things? Is there mercy when you see those kinds of things?

Carrie O'Brien: I mean I think that’s exactly the type of thing they’re going to be looking for during this initiative. I am not an examiner so I don't go out in the field and do examinations and look through all the documents. My main role is to answer questions from examiners if they have them regarding the law. But when I think about best practices, and what I think they would want to see, is they would want to see heightened supervision over these people especially. For us I guess it would be over a period of time, a couple years depending on, and probably on what their infraction was and that you're following those, you know, sometimes a lot of people will put something in place but then they won't follow up on what their policies and procedures say. Maybe they are supposed to be reading all the emails that have been sent out, or you know, they are supposed to go through it once a month but they're not doing that. That's something that they, you know, if you put those things in place, do make sure that you're following those procedures as well for your heightened scrutiny of the person.

Shane B. Hansen: It's called being hoisted on your own petard. If you say you're going to do something, make sure you do it. You can write things that are inspirational, you can write things that are aspiration, you can write things that are perspirational. It's best to do the perspirational part where you actually do what you say you're going to do.

Carrie O'Brien: Yeah, and just jumping ahead a tiny bit in cyber security, you know, a lot of . . . most people have cyber security policies and procedures in place. What we see in a lot of our initiatives is that they're not followed. People aren't doing their updates when they say they're going to do them, to do their security on their . . . or everything else. And so even if they have the policy and procedure in place our examiners are finding deficiencies in how they're following it. So that's very important.

Shane B. Hansen: Mhmm, and it . . . just as an observation for broker-dealers, investment advisors have what are commonly called written supervisory procedures, compliance policies and procedures that lay out how, and we'll hear at the next panel how the chief compliance officers of firms kind of manages the task of guiding the firms and it's people through the requirements and one of the things you guys do is to look at what the firm said it's going to do and to see if they're following it. And a note of caution is that, firms can of course be more restrictive than what the law requires, but if you say you're more restrictive then you need to be more restrictive.

Carrie O'Brien: Yeah and another thing I think that comes up too is, when you need to show the examiners that you have followed these procedures so sometimes that means keeping some extra documentation to be able to show examiners that . . . that to me is a best practice too, because they're not always . . . I did a lot with the record keeping rules and we don't have a lot of that, they're not required records that a firm has to keep but it makes your life a lot easier if an examiner comes in and they want to know, how did you follow this? And if you have a record that can show how you did it, it makes, it makes it easier for both the examiners and, I think, probably the people who are being examined.

Shane B. Hansen: That sounds good. Do you want to explain a little bit about the share class initiative? What that is? This is kind of a fairly specialized, and it's been a sweep type exam. You'll hear more about that later, but a little bit about what it is. What are share classes and how this has become a concern?

Carrie O'Brien: Yeah, this has become another . . . a new priority. We announced this one in July, so it's . . . the new sweep exams that just started right before our supervision practices sweep. And we're focusing on, again, it's focused on registered investment advisors and it's, you know, focusing on the . . . what shares they are selling. So are associate of persons receiving compensation or other financial incentives to sell different types of shares. You know, we're looking particularly at different classes of mutual funds and 529 plan investments. And we have identified some areas we think are high risk that we're looking at. We're looking at, you know, fiduciary duty and best execution. What are the advisor's practices? To determine if they are acting in the client's best interest and seeking best execution of these recommendations. If, you know, there is three or four different share classes of a mutual fund, you need to make sure that what you're selling to your client is the one that's most appropriate for them. Then we're also looking at, you know, along those same lines, we will look at the book and records of the firm to identify the compensation that has been received by the advisor related to the share classes. I know sometimes share classes . . . one type of share class may have . . . may pay a lot more if you sell it than another type of share class. So we want to make sure people aren't selling unsuitable products to their clients just because they are getting higher compensation for selling one share class over another. And then, along those same lines, another area we are looking at is the disclosures you are giving to your client. Are you disclosing that you are getting higher compensation for selling one type of share class versus another? And, then what is your compliance program around this? What policies and procedures do you have in place to make sure you are selecting the appropriate mutual fund or appropriate fund for the 529 plan share class for your clients?

Shane B. Hansen: And I will add just a little color around that. So mutual funds, and say it's a Vanguard Global Investment Fund, may have share class A B C D E F G I, all the way to Z practically. It is up to the mutual fund company to develop these share classes, and I put them in the category of . . . for the largely payment of distribution, disturbing their shares, and I put them in the broad category of you can pay us now or pay us later. So, there are no load mutual funds that you don't pay upfront but they will pay a trail commission that comes out of the fund's assets or some have low load upfront but you basically, if you hold them for a certain period of time, they may convert to a different share class and it gets fairly complicated. And so as Gary is saying, firms need to develop some procedures around which of the share classes are selected and different classes work for different client circumstances. So, you need to be able to kind of document that the client understands that there are different share classes available and the pros and cons of each of those.

Cyber security - we read about things like Target getting targeted and we see Yahoo that has had hundreds of thousands of customer records hacked and I might add it was only a couple years ago that the SEC staff along with, oh I don't know, 24 million other government workers were hacked in the Office of Personal Management. And so as they say, we are all in soup together in this . . . the government has had issues, the Democratic National Party has had issues with this, it has been fodder for WikiLeaks. So what kinds of things are you guys looking at in cyber security?

Carrie O'Brien: You know, Cyber Security has been a priority and exam initiative since 2014 so we're doing it in different phases. I don't know but I am guessing it'll continue to be a priority of the exam program for the years to come because the area is changing so much and it does seem like there is a new hack every few months. And broker-dealers and investment advisors and . . . you deal with very personal information and a lot of financial information for your clients and customers and so it really needs to be protected. We have you know . . . phase one was announced in April of 2014 and that phase was kind of to go in and understand what are people doing in this area and there is not a lot of specific rules surrounding it and if you do not have your policy of procedures, you know it's part of a good program but there is not a discussion especially in the broker-dealers face, I know those rules a little better so pardon me if I miss a couple investment advisor rules and you know you don't have to do specific things that are related to that so one of our initiatives are to go in and see what people are doing. And then September of 2015 about a year ago we kicked off phase 2 where we are looking at more specific areas you know government risk assessment, access rights and controls, data loss prevention, vendor management, training, incidental responses . . . we haven't announced a lot of exam findings and made them public but you know I can tell you just a couple things. I think I mentioned it earlier most firms do have policies and procedures in this area, so I think that people realize it is an important area that they need to be ahead of and they have policies and procedures. We did find a lot of them were either inadequate or they were not being followed. So firms weren't maybe installing the critical updates and software patches as needed and what was stated in their policy and procedures. There was lack of policy and procedures and they were inadequate of vendor selection when they were hiring people to come in and do new programs they did not have policies and procedures to make sure those vendors had adequate cyber security and protections. There was not very much training to employees regarding cyber security there was no testing to business continuity plans . . . continuity response plans and then you know a lot of firms will allow employees to use personal devices to access client information. There was no inscription being used when people and employees were using personal devices to access client information from outside the firm. Those are some of the areas that some that we noticed during our phase 1 and now we are in phase 2.

Shane B. Hansen: It's an area where there is not a one size fits all kind of rule. A big firm Fidelity or Merrill Lynch is going to have much more robust policies and procedures around cyber security than a small firm over on Hagadorn. And so firms need to kind of tailor those to their own circumstances but it really does get down to some basic stuff like do you password protect and encrypt the phone because the blessing it that you can access it from anywhere; the curse is anyone can access it from anywhere. So it becomes a really . . . a challenge because in part you don't know what you don't know so firms often need to hire some outside . . . somebody more than their 8th grade child who knows more than they do but they need someone who has a little more expertise than that. While we are talking about exam findings, there has been a couple of other sweeps: the ReTIRE program and . . . do you want to talk about those sorts of things that you are finding?

Carrie O'Brien: Sure. Yeah, I can give out some our observation that we have seen in the ReTIRE program so far. This initiative we started in the summer of 2015, so a little over a year ago, and it was . . . the areas we were really focusing on were fee and account selection, sales practices, suitability, supervision, and marketing because the aim was to protect retail investors, making sure when they are saving for retirement they are protected. And so some of the observations we noticed during this was there was a lot of misleading marketing materials out there, especially with respect to rollover activities and other types of retirement based communications and there was a lack . . . a lot firms did not have documentation evidencing the reasonableness of their recommendation. So if there were recommending a product to their clients and customers when an examiner went in they couldn't figure out why the product was recommended because there wasn't documentation showing why it was recommended. There was vague or admitted disclosures associated with the fees and services and then mutual fund share selection issues . . . our newest initiative also showed up here, where there were issues with respect to choosing shares for retirement account there including the failure to affect fee waivers that are available to certain retirement accounts.

Shane B. Hansen: This is a topic we will cover a bit in the CCO panel but the US Department of Labor has come out with a new fiduciary duty rule and so there is some intersection with the SEC looking at the retire . . . retirement kinds of issues. How if at all do you intersect with the Department of Labor or would anticipate collaborating or . . . thoughts?

Carrie O'Brien: Yeah so those rules I think become effective next Spring . . .

Shane B. Hansen: April . . .

Carrie O'Brien: Yeah, so they are not effective yet so we are obviously not examining for them yet. I think . . . that is something we are going to have to speak to them about and make sure we understand those rule because they will be effective in April and we'll have to make sure the firms are following that guidance as well as our own rules. We do look at other rules that other agencies promulgate on occasion and so usually, they're the interpreter of those rules so it does take some cross agency communication regarding the interpretation of that rule. So, I expect when that comes up in examinations, we'll at that time have a contact to DOL we can reach out and discuss what we're seeing in the field.

Shane B. Hansen: So for firms, one of the things you will find when you intersect securities laws and ERISA (Employee Retirement Income Security Act of 1974) is that you can be on the point of a very pointy sword because the two actually do in some respects do overlap. For example, the Department of Labor rule is going to require disclosures. Now, if you make a disclosure as required by ERISA and the Department of Labor Rule, it becomes a public statement, which then has to be accurate and complete, which is required under the federal securities law. So the rules do have some direct intersection in the context of accurate, complete disclosures and things that may be required under one rule and are measured as to their accuracy under another rule. What is the MA initiative?

Carrie O'Brien: So MA initiative has to do with municipal advisors. We had an initiative to go and examine municipal advisors registrants in 2015, we are still doing it. We examine MAs for compliance with the municipal advisor's rules . . . there are a lot new rules in that new space with the SEC requiring a lot of new registrants and also the MSTB has rules in that space so we will also have to examine compliance for those rules. We have . . . as of this summer I think we had 650 to 700 municipal advisors registered with us so it's a population of registrants that has increased and some of those are also registered with FINRA so a lot broker-dealer MAs are registered with both SEC and FINRA. So some of those are being examined by FINRA as well. There are MAs that are not broker-dealers, so those would only be registered with SEC. So similar to investment advisors, we're the only person out there examining them and looking at what they are doing. So the common issues examiners have observed during municipal advisor examines include the MAs breaching their duty of care and duty of loyalty to their clients by not disclosing material conflicts of interests, it's another fiduciary duty issue. We've had them failing to disclose conflicts of interest and engaging in deceptive, dishonest, or unfair practices. An example would be undisclosed affiliations between the municipal advisor and other members of the transaction team. Supervision issues, failing to establish and implement a system to supervise the activities of their employees, and to make sure they're complying with the securities laws. And then one of the big issues . . . or I think it is big now it may not stay . . . is registration issues: municipal advisors who are not registering under the new rules with the SEC or the MSRB, not filing the forms with SEC that they file with MA, or form MA1. And, they have to file amendments to that annually. So some firms are not filing their amendments. And . . . books and records was another area frequently cited in municipal advisor exams. They were failing to maintain and safeguard their electronic communications, failing to make and keep analysis and documents that were material to a recommendation for a client. So . . . let's see if there is anything else . . . failing to maintain originals or copies of written communications. So like most registrants MAs have to keep copies of their business communications related to their business so they were missing a lot of that. And then you know the other things is a lot of time when OC's are doing broker-dealer examination they will notice issues in the municipal advisors space of the broker-dealer. So outside of this initiative there was some other findings that were noticed during broker-dealer examinations and those included same day principle trading in customer accounts, and excessive mark ups, the first day pricing of a new issue municipal securities where retail investors were not getting the opportunity to purchase the public offering at the public offering price because of actions that were taken by members of the underwriting syndicate, and then tax increment financing bond offerings in risky areas where bond repayment were based on unknown future revenues and an attempt to revitalize low income areas with high instances of default. So those are some of the issues that came up.

Shane B. Hansen: And MSRB for the students is the Municipal Securities Rulemaking Board. It's another regulatory agency.

Carrie O'Brien: Yeah so they do . . . FINRA does a lot of broker-dealers. MSRB works with municipal securities and municipal advisors.

Shane B. Hansen: One of the hot areas, municipals meaning government, and that is not just cities . . . so states and universities are covered. One of the topics is pay-to-play. It's the concept of political contribution so that you can get the business from the university of . . . is going to do a securities offering to offer bonds to build a new dorm or something like that and so their proceeds that are invested in. So someone pays contribution to someone in the position like an MSU trustee or something like that. Any comments about the paid to play rules and . . .

Carrie O'Brien: I am going to let Kris talk about play to pay a little bit.

Shane B. Hansen: Okay . . . do want to cover that later?

Carrie O'Brien: Have you been . . .

Kris Easter Guidroz: Yeah . . . we can cover it later.

Shane B. Hansen: We can cover it later.

Kris Easter Guidroz: We have the two others . . .

Shane B. Hansen: Yeah . . .

Carrie O'Brien: We can talk about it now. You know more a little bit more about that area and I know the basics . . . but not much more than what you just said.

Shane B. Hansen: Oh okay.

Kris Easter Guidroz: Initiative in the 2016 priorities because of the election year and I am sure we will see you know things trickle through the pipe from that priority focus. But . . .

Shane B. Hansen: Okay, before we move on to that then let me just hit the last one on the slide and we got to give Kris some time to talk here too. So outsource CCOs. This is becoming . . . frankly firms look at it as a cost saving way of getting . . .

Carrie O'Brien: Mhhm.

Shane B. Hansen: . . . great expertise from somebody who is outside the firm, especially smaller firms who basically can't afford to have somebody full time.

Carrie O'Brien: Yeah and so I think we just to you know we have the risk alert on this area we wanted to make people aware of a lot the issues related to it. But I know we have a lot to talk about with Chris so I won't take too much time with that because I think it is all listed in this risk alert here.

Kris Easter Guidroz: Do you know Carrie if this particular initiative by OC informed the form ADV Amendment Rule making by the division of investment management. Because outsource CCOs is a new disclosure item, and I am not sure if those are linked together

Carrie O'Brien: They could be, I am not sure.

Shane B. Hansen: Speaking of new rule making why don't we use that segway to talk about business continuity rule, which is pending, and transition plans, and form ADV amendments?

Kris Easter Guidroz: There are a lot of things going on with these new rules so I am just going to hit the highlights. Please as Carrie said, feel free to stop us, ask question if you want something covered in more detail in respect to them. But both of these rule making efforts are a part of a broader initiative by the Commission to have more risk monitoring data at the hands of SEC staff and to better inform investors. And some of the other rulemaking related to these area include liquidity risk management by registered funds, reporting of the funds use of divertives, and also . . . let's see . . . modernization of the data reported by registered investment companies. Right now, there is kind of a mismatch on how it's get reported. Some things are publically disclosed in the financial statements by the funds and in their SAIs and some is reported in INSAR in the SEC. The data modernizations would have more information directly reported the SEC so the risk monitoring teams can effectively use that data to monitor the industry. And these two rule makings are part of the broader effort to engage in risk monitoring and to make sure firms are doing the same in-house.

So the business continuity and transition plans really are informed by the staffs experience at assessing advisors planning efforts post-Hurricane Katrina, post-Hurricane Sandy, and watching some of the advisor's transition out of business following the financial crisis. And with that in mind, let's cover that they have five basic components that firms have to consider and address in their business continuity and transition planning. Four of those components relate specifically business continuity and the last one really goes to transition planning, which some of the commenters have emphasized are very different. And just to allay any concerns the release does say that these are different areas that can be addressed in different components of an advisor's written procedures. They don't have to be all in one place. They may address different areas of your business, right? Different risks. But these are things that you have to make sure you address.

The four that relate to business continuity are the maintenance of critical systems and the protection of data and this includes backup and protection of client data. The second one is considering prearranged alternative physical locations. The third is how you communicate effectively during a crisis in recovering from disruption and that would include communications with your own employees, with clients, with your regulators, and with critical vendors that supply services. The fourth one is identifying and assessing who your critical third party suppliers are. And then finally, the plan has to address a transition or wind-down of the advisor in the event that it is losing asset management or just for some reason cannot continue operations. And within a transition plan there is certain components that have to be considered including any contractual or legal obligations that might impede a smooth resolution process. And one of the things mentioned in the release is certain derivatives contracts require unwinding of those positions for clients before an account can be transitioned to a new advisor. So just certain things to think about. I know some of the commenters have worried about this being a prescriptive rule, but the release emphasizes this is still something that leaves flexibility to advisors. While there are specific components that must be addressed, the detail to which they're addressed and the comprehensive nature of how an advisor approaches them is going to really be flexible and really depends upon how complex the operations are, how many employees you have, how many offices you have and that kind of thing. With respect to remote locations, you will have to consider is it a place from which we can securely and safely access the all of our data and serve our clients? So maybe not a Starbucks on Main Street an hour from your primary location but there may be somebody's house who lives an hour away where everyone can convene and get things running. So just to consider as you are working through these plans.

Shane B. Hansen: Okay . . . one comment in business continuity and it intersects cyber security is the increasing frequency of what is called ransom ware. Where a firm will be hit with a hacker that somehow has managed to get somebody at the firm to download a Trojan horse. I love the colorful language. And Trojan, not Spartan . . . sorry. It is then software that locks up the firm's files and as a result that then you have to pay a ransom to get your data back or they will . . . they say 'wipe it' or 'lock it up' or just basically destroy it. So that is a topic to cover.

Kris Easter Guidroz: It is. It is mentioned in the release. One thing I would emphasize is I think a lot of these things that have to be considered under the new BCP rule and transition planning rule are already things that advisors look at in other contexts. For example, when you are looking at your obligations to have a code of ethics and to identify your access people who have access to client's system information and then your regulation SP data protection rules on how do I protect that sensitive data. You know, most advisors have already considered: where is my data? Who has access? How can I make sure this access is protected? How do clients access their own data? How do we protect the data that we have? Where are the critical systems we need to protect and back up? How do we prevent cyber-attacks? So these are some things firms have already given consideration to so the new BCP considerations really do overlap with some things firms may have already considered and have in place. They overlap with the record retention obligations. You know, there is already an obligation to make sure your electronic records are true, cannot be altered, the integrity is maintained. So a lot of firms have a matrix, where are my records? Where are they stored? Who owns them? Who has access to them? So these are the things firms have already considered which may make the business continuity planning a little more smooth.

Shane B. Hansen: And one other element of that is basically making sure that people within the firm know where to go look for or access this information because let's say the CEO gets hit by a bus or has a heart attack and suddenly a key person is no longer in the office. Gone. And so you need . . . part of the planning is to think about okay what if that key person is gone? How do we make that work? We are going to hear more about the business continuity plan in the next session as to how you actually practically deal with that sort of thing.

Kris Easter Guidroz: But to follow up on your comment if I may Shane . . .

Shane B. Hansen: Yeah.

Kris Easter Guidroz: When you are thinking critical of employees, one of the other key aspects discussed in the release is thinking of critical vendors and the same time the SEC published their rule proposal for advisors they issue guidance for registered funds and one of the things they emphasized was the BNY Mellon breakdown and being able to calculate net asset value for funds. And what a stir that caused and how there was no back up service provider or function for that. So, they just really emphasized think of who these key service providers are that impact the critical functions of the clients, for your firm, and know what you're going to do if you don't have ready access to that same service provider.

Shane B. Hansen: Okay, well let's move on to a little of potpourri of topics now. Some recent cases involving different areas and, we'll use this a segway just generally to talk about pay-to-play. What it is? What your kind of experience has been?

Kris Easter Guidroz: So this actually a case and I have to apologize. I saw pay-to-play conversation when I opened it and when I was reading it to prepare for today this was the 10(b)(5) violation that I mentioned.

Shane B. Hansen: Oh okay. . .

Kris Easter Guidroz: So this a 10(b)(5) violation case under the Exchange Act, brought under the SEC and not under our pay-to-play rules. I believe it is a violation of Ohio pay-to-play laws and it does relate to four pension plans in Ohio . . . business of theirs getting allocated to State Street sub-custodial business based on payments made to Treasurer of the state. And, the Treasurer of Ohio had full authority to select both the custodian and the sub-custodians for these pensions. So it was clearly payment for business, which is prohibited by the SEC's pay-to-play rules. And something, as we mentioned, the exam programs been looking at given the election year, but this one was not brought by the SEC under our pay-to-play rules.

Shane B. Hansen: But helpful to say that not only are there SEC rules on it, there's also a FINRA rule on it I think, and then states also have Pay-to-Play rules. It's all basically designed to prevent political corruption and basically being able to use contributions to influence getting contracts. So, wrap fee programs maybe first, what is a wrap fee program and . . . ?

Kris Easter Guidroz: So, a wrap fee program is typically an advisory program offered with a set assets under management fee, but the fee is a little higher, and it covers both the advisory fee usually, the custodial services provided, the transaction services, execution services provided. So the client gets charged one fee and then all transactions are covered and all custodial services covered and any other tangential brokerage services provided. The problem is that the execution services are only covered to the extent that the advisor who is offering the "wrap program" is also executing the trades and in two cases that we have here, the SEC staff found that that the brokerage firm, which is duly registered as an advisor and a brokerage dealer, offered these wrap programs both used sub-advisors to actually measure the clients assets through the program and the sub-advisors almost always routed orders of the clients to other broker-dealers for execution. So in addition to the wrap fee they were paying, which would typically include execution fees, they were paying for all these commissions, transaction fees, to these third party broker-dealers on top of their wrap fee. So both, interestingly enough, one of these firms very clearly disclosed that this could happen and in fact very clearly disclosed that it almost always probably does happen. The problem that the SEC had with this is "OK, you say it almost always happens, but you don't make the advisors report back to you those third party transaction costs that your clients are paying so you have no way to know what the total fees are to your clients. Your advisory reps have no way to know how to balance the cost of the wrap fee program versus these third party transaction costs and which might be better so you're not at all being able to satisfy your suitability obligations to your client and make sure you know when this is appropriate or not appropriate for your client." So both of these cases involve the same finding that they needed to strengthen their policies and procedures to make sure that they had a method to track fees paid to third party brokerage dealers and to compare those to the wrap fee and then to disclose additional transaction fees to their clients.

Shane B. Hansen: And, I'll just add in the wrap fee context, there's another issue, kind of unrelated to what Kris is saying, and that is, if you offer both a wrap fee program, which is to say one fee that covers brokerage and you also offer a traditional commission based brokerage type account so you have two types of accounts, another hot topic right now has been recommendations on which type of account you should tell a client to have. The concern is basically that if you don't trade very often, and then maybe a commission based account, pay as you go, would be more appropriate than paying up for a wrap fee account where brokerage is included, but essentially you're not using it. So you're paying for something you're not really getting. So the two concepts play out a little differently. One is called churning when a brokerage account is traded frequently to generate commissions and the flip-side of that, reverse churning, someone really thought about that one. Reverse churning is basically where you've got an account that doesn't charge for brokerage, but you don't trade in it. So in general. So let's move on, the compliance rule, this is kind of putting . . . this is where the rubber meets the road, I think, in terms of, we've got a body of law and how do we comply with it? And firms actually have to put it into writing.

Kris Easter Guidroz: Right, and I think the compliance rule is something examiners would always focus on because the first thing they're going to ask for is the relevant policies and procedures that cover whatever activities they're looking at during the exam, and so these cases all deal with failures under the compliance rule. Two of them also deal with conflicts of interest, which is something else the exam program disclosed as a priority for 2016. I think they typically look at that every year, but . . . and those conflicts of interest relate to principle trading with clients, so we can cover those in a minute. I thought that *Dupree* was a very interesting case just because it looks more like cases we saw years ago when the compliance rule first came out. And in *Dupree* a firm, you know, got started, registered with the SEC and bought, it appears they bought an off the shelf compliance manual because it doesn't appear they ever read anything in it. They designated the administrative assistant as the Chief Compliance Officer for the firm, but then they never gave her training on what that means. What the Advisor's Act is. What the rules require. What the firm has to do. She didn't know anything about the procedures manual and she was still doing all her administrative functions. So for four years in a row this kept on going and, of course, they did no review of their procedures, no testing under them, and no assessment for their continued effectiveness. So, this was a major failure under the compliance rule, but I did find it fascinating that that's still happening so many years after that rule has been in place. Two of the cases are violations of 206(3) principled trading with clients without disclosing that capacity . . . that the advisor will trade in that capacity with clients and without disclosing the conflicts and the fees that the advisor will gain from those transactions, and *National Asset Management* actually involved many other 206(4) violations, I think it's 206(4), many other 206 violations, and a 207 violation for misrepresentations on their form ADV, so I thought that was an interesting case to cover. They had a lot of trades routed to their affiliated broker-dealers who executed them as principle, over 20,000 trades I think in a four-year period. They knew that can happen. They had no systems to make sure that it didn't happen. That's a violation of 206(3). And since their procedures did not have any way for them to make sure that they complied with their obligations under 206(3), it was a compliance failure. They also failed to make disciplinary disclosures. They had over 18 or 19, I think, disciplinary actions that were not disclosed on form ADV, so that was a pretty big deal. And, the disciplinary events ranged from just someone who traded away from their firm and got fined $2,500 by FINRA and suspended for a few days to someone who was indicted for securities fraud. So they had a pretty significant issue there and they also did not disclose all of the relevant disciplinary events to their clients as required in the Brochure Supplement, so that was an interesting case.

Shane B. Hansen: Good, as were starting to run out of time, we want to make sure that, misery loves company, we want to make sure that private equity firms are not, you know, totally free from being targeted either. So we've got a couple of cases here, and the SEC has come to examine private equity firms because when the Dodd Frank Act caused a sea change in the split between federal and state investment advisor registration, they also changed the law in terms of the exemptions, took away the exemption that private equity funds used to have so, the SEC is now, if you're $150 million or more aggregately in assets in one or more private funds, you have to register with the SEC and below that, between $25 million and $150 million you're an exempt reporting advisor and you have to do reporting to the state and to the SEC, but you're basically state regulated at that level. And below $25 million you are definitely state regulated, you have no reporting requirements. But, as a result of the SEC coming and doing exams of the previously unexamined private equity funds, they found a number of problems. Do you want to kind of comment about that, and . . . ?

Kris Easter Guidroz: I mean, just the private equity exams generally? I know there's been a lot of focus on fees, fee allocations among the funds, what fees are the funds paying, are they disclosed in the limited partnership agreements? There's been a lot of focus on in that and the case that's up here, *Blackstreet*, relates both to fees charged that were not disclosed, limited partnership agreement transactions that happened that were specifically not permitted under the limited partnership agreement, and the advisor acting as a broker-dealer without registration as such, and so . . .

Shane B. Hansen: And I'll just add to that, and we'll kind of wrap it up fairly quickly. The *Blackstreet* in particular is the poster child for a private equity fund that fully disclosed that it was going to take, in this case it was a transaction fee for buying or selling a portfolio company. It disclosed that. It didn't disclose some other stuff, but it did disclose that, "hey, we're going to take a transaction fee," which is to say the fund's investors are going to bear the cost of a transaction fee to buy or sell a portfolio company. Well, to get transaction-based compensation requires that you be a broker-dealer, registered as a broker-dealer, and the SEC has a poster child here for what happens when you are not registered as a broker-dealer. The next case, the *Ranieri* case is also an unregistered broker-dealer case in a little different context. It is where the fund was raising capital for the fund by having a finder go out, unregistered, and find investors for them. And the SEC brought enforcement actions against the unregistered finder, but also against the firm and against its executive officer for facilitating raising capital using an unregistered broker. I'm going to jump down to the whistleblower program and just observe that this is a program that is not just limited to public company employees who whistle blow on their bosses. It could be a broker-dealer, it could be an investment advisor. It's basically anything, any employee, or it doesn't have to be an employee, there's actually a case, I think it's an independent contractor who actually blew the whistle on somebody. Lawyers are subject to attorney client privilege so you don't get to go blow the whistle quite the way an employee does but, any comments about the whistleblower program or . . . ?

Kris Easter Guidroz: I think they had the largest award ever this year? Didn't they?

Carrie O'Brien: Yeah they, it was very large. I think close to a hundred billion, it was very large. It's actually I think been a good program for the SEC, the whistleblower, we have an Office of the Whistleblower. They have their own webpage. It shows the different awards people have gotten for it. And I think it's a good source of tips and complaints for us, for the exam program, for enforcement.

Shane B. Hansen: OK, well with that I'll just highlight the last slide, the SEC has lots of information on its website and this is just the tip of the iceberg you can drill down into lots and lots of information. We have talked too long because we've run past our time so we'll be around later on as we go. Now we're going to have a panel of chief compliance officers talk about how do we deal with all of this regulation and they need tools and the first tool every chief compliance officer needs is a [electronic voice of Staples Easy Button says:] "That was easy" one of these little "that was easy."

Kris Easter Guidroz: you need the 'no' button right?

Shane B. Hansen: Yeah, or no —

Kris Easter Guidroz: Or the no button,

Shane B. Hansen: — no also works.

Kris Easter Guidroz: they make a no button also

Shane B. Hansen: Let's thank the panel for a great presentation

Raymond Henney: While they're setting up the compliance officers, I thought I'd take a moment for the students particularly to talk about the legal landscape that the last panel and this coming panel deal with, there's talk about overlap with the FINRA and the SEC, investment advisors and broker-dealers and I thought for the sake, at least for the sake of the law students, to refresh their memory about what the regulatory climate is and what they're talking about, to give you some context in what's going on. So there's the '33 Act, which is, if you want to issue shares to the public, what the requirements are. There's the '34 Act, which is the Securities and Exchange Act, which deals with the trading of stock and the disclosures of public companies.

That regulatory system is . . . you really have to have a conceptual understanding so that you can understand what they're dealing with as chief compliance officers as far as regulatory schemes. So part of the Securities and Exchange Act is to make the SEC the chief cop with respect to the trading of securities, and that scheme starts with the SEC and under the SEC is what's called self-regulatory firms. Self-regulatory firms are like FINRA, which is the predominant one and the New York stock exchange. In order to trade securities in the United States, you have to be a member of a self-regulatory organization, such as FINRA, and you have to be what is called a "member broker-dealer." A firm broker-dealer that's a member of a self-regulatory organization that answers to the SEC. And these member firms have registered people that are associated persons, so that's the broker-dealer landscape: the SEC, self-regulatory organizations, member firms. The people on this panel are member firms with respect to the broker-dealer aspect.

There's also the '34 Act, which is investment advisors. Investment advisors are only regulated by the SEC and not by FINRA. So there's those federal level sub-regulatory organizations, the SEC. And, the SEC of course does both of that, and these individuals also deal with the state regulators. So there's quite a bit. The landscape can be somewhat complicated and there's a lot of moving parts for them. I'd like to introduce the moderator to our compliance officer perspectives, broker-dealers and investment advisors. Florence Affatato, Florence take it away.

Florence Affatato: Thank you.

Raymond Henney: Thank you.

Panel 2: Compliance Officer Perspectives on Broker-Dealer and Investment Adviser Regulation

Florence Affatato: Welcome everyone, I think we're all honored, and I'm certainly honored to be here to bring to you what we hope will be our insights and best practices as we navigate through the regulations and many, many types of firms. I'm General Counsel and Chief Compliance Officer at Portfolio Solutions, we're, I'd say, a midsize registered investment advisor. We're federally registered and I have my colleague to my right . . .

Kimberlee Levy: Hi, I'm Kim Levy. I'm with the broker-dealer and investment advisor Concorde Investment Services and Concord S Management in Livonia, Michigan. I've been in the industry about 17 years now, since I graduated from law school and it's been a wild ride.

Andrea McGrew: I'm Andrea McGrew. I am the chief legal officer and chief compliance officers for USA Financial. We have a lot of companies . . . most relevant to this would be a duly registered broker-dealer and an investment advisor, an investment advisor that operates as a third party money manager, an insurance wholesaler and another RAA that operates as a TAMP. So I've been doing this since I graduated from law school in 2004 and I'm a proud MSU Law grad, so I'm honored to be back.

Amy Eisenbeis: I'm Amy Eisenbeis and I am Chief Compliance Officer and General Counsel at Clarkston Capital Partners in Bloomfield Hills and I've been there just for a short time. We are a federally registered investment advisor. I've been in the industry about 25 or so years and I have experienced, not only on the investment advisory side, but also on the mutual fund and broker-dealer side, so, thank you.

Florence Affatato: So, a little bit about our agenda, we're going to cover SEC exams, I will be covering that. Amy will be covering our business continuity, Andrea, the new DOL fiduciary rule, and Kim will be covering cyber security. But a little, just a note, we're all going to jump in because we all see all of these issues and experience them in each of our firms so expect that you'll get a diverse response and best practice type of comments from all of us. So we hope that you know, in the group if you're representing different types of firms, you'll have some take away from us.

And you know, I think that goes to this slide that there's, as you can hear from my esteemed panel, we have our broker-dealers, IAs, investment advisors, we have CCO's here who have been part of private funds, due registrants and mutual funds.

And just lightly I wanted to cover this, so for anyone who is a CCO out there, or general counsel of a firm or is for the students in our group, we wanted just to let you know that there are a myriad of rules, as you've heard from our great panel ahead of us, that all, many times interact with each other, depending on what's going on, so it's . . . suffice to say there is quite a bit to challenge you in these roles, so it just, I think it keeps things very exciting to me and very challenging to help our firms strategize and grow their business in the parameters of these rules and regulations

Kimberlee Levy: And just when you get complacent and feel like you know it all, they spring a new rule on you, like the DOL.

Andrea McGrew: And I think an interesting aspect of it that I wasn't prepared for, for anyone who might be interested in going into this field, is trying to work with the business side of it because typically your CEO, your president, they're not going to be lawyers, compliance minded people, they're typically going to be sales people. And, so forever I had to fight, and I'm sure that my colleagues had to fight that stigma that lawyers are attached to that they just say no all the time. I've been called the business prevention department.

All of you have as well, but what I just try to impress upon my CEO is that lawyers are sales people, we sell ideas, and what's harder than selling an idea? And I think that that's something that they kind of cling to and it's been a big change at our firm and is helping them see that perspective and realize that it's in the company's best interest.

Florence Affatato: Absolutely, so next, I wanted to . . . I'm going to be covering, you know, SEC exams, but from a very practical point of view.

There are slides, and as you can . . . go through them for you that just highlight three types of exams, although I of course would never presume to speak for the SEC, but I'm sure there are many other different reasons that would bring them to your firm. Just a little disclosure about me, I'm a retired FBI agent, so I did get caught in the OPM identity issue, so it's been kind of interesting. And I approach the exams and dealing with the SEC examiners from a little different position because I've been in a position of doing exams within the FBI. So I wanted to, just also with disclosure to all of you, we just had an SEC exam at my firm wrap up from examiners from the Chicago office, and I wanted to begin by telling you that each and every day is how you prepare for an SEC exam. And this is just my personal opinion, you know, every aspect of what goes into your business and how you implement the rules has to be on your, I would think, on your mind each day. So the way I approach it is each thing I touch and I do, I think from the point of view "how do I make sure that I document and sufficiently record why we made the decisions we made, how I implement a rule, and how I understand the rule." I would also, secondly, say that I think education is probably the biggest thing that you could do. Not only educating yourself, this forum, I've attended it for a number of years, is extraordinary, I never leave here without some, even a sentence or two that I can take back and use. So to the greatest degree possible, I'd start with the SEC site, loaded with information, No-Action letters . . . rulings, rather, and letters, and a number of different types of materials you can use to help you navigate your firm. Educate yourself about your firm, and I cannot stress that enough, be in involved in as best as you can and I know we're all under a great deal of time constraints, but exactly how your firm does business from the time, you know, they open the lights to the time, you know, you go home and close every day. Avail yourself to webinars, blogs. The SEC does a great roundtable for CCOs. Take part and find time to listen to that and I think you can also get many things if you can attend the actual event or listen to it, I think the last SEC CCO roundtable you could get the recording and listen to that. And educating your employees and, as Andrea said, it's very difficult, the Office of No and why can't I say we're the best, why can't I say, you know were going to give you the greatest, we're the best experts, you know those are things that, it's sitting down with your colleagues at your firm and educating them how, the reasons why this is so important, and getting their buy-in to what it is these rules are trying to do.

So I would almost always start there and, you know, make sure that, in addition to knowing your firm, you know the rules and you know your weaknesses, and when you find your weaknesses, how do you shore them up and how do you fix them? And then how do you demonstrate that? And keeping those records, leverage technology. I can't emphasize that enough, you know, create your catalogue, if you will, of all of the different areas that the SEC will look at. In the presentation materials, we included a couple of the SEC exam letters and please take those if you haven't already done so and use them as a way to create your record keeping if you will. I assume most firms and people do it electronically, and you go down and so when the examiner, you get their call and you get their letter it's as easy as swiping it over into a file folder that you create for the examiners and they'll ask you to electronically send it over to them and it's that quick and you can easily meet their demands and preparation of course is everything and every day you prepare. It's, you know, I think that I've found that to be the most helpful. And Shane, I think couldn't emphasize it enough, I won't either emphasize it enough, prepare, prepare, prepare. And if you do it, you say you do, do it, no doubt about it and document that you do it. I mean, I think that would be your best way to approach it. Look at your, when you do your annual reviews, you know, grab your compliance manual and match those two so as you make sure you review everything that's in the manual. Are you doing it? Is it working? I go and interview all of my department heads and go through the parts of the rules in the manual to make sure that what they, what I'm expecting them to do, they do. Do you keep your books and records, for example, on . . . we do block trading, I want to see them. Where are your records for you know, for example, marketing material or portfolio management? I also have access to all of their drives where they keep all of the material. So, when I sit down in from of the examiner and tell them, so this is my annual review and these are where I think the problems are, you know, I'm not guessing, I really do know. And then what have I done to fix them?

Andrea McGrew: And, Flo's right, that's so important. Because I can't even tell you how many times I sit down the business department and we know what the procedure is, we've trained on the procedure and you ask them, "Well, how are you doing this?" And it's absolutely nothing like the procedure, so finding that out about your own about your own internal workings, its way better when you, as the CCO, find out about that than if FINRA or the SEC finds out about that so. And it happens all the time.

Kimberlee Levy: You know it's an annual review, but you don't have to do it all at once, you can actually space it out over the course of the year so that you're not too overwhelmed. And as you're finding issues, because I think as the CCO, you're pretty aware of what's going on in your company, so as you're finding issues, that's a good time to document your annual review of that item and keep it in a safe place, so that when you go to put your whole annual review together, you can just put together everything you've been doing for the entire year to be exam ready all the time. I'd like to say a little about the difference between SEC and FINRA exams. The SEC rules are more broad. They're not really going to tell you exactly what to do. Where FINRA rules sometimes do tell you exactly what to do and there will be instances where they say if you are going to embark on this behavior, social medial, correspondence review spot checking versus reviewing everything, the FINRA rules are going to be very specific and say 'you can only do this if you educate your representatives in advance.' Those are situations where you want to make sure you're saving those materials that you've used to train your representatives because they'll ask for it when they come in. You want to have it in an easy to access place so you can say yes, we've done what the rule is requiring. Those are probably best practices on the SEC side, so if you've doing that save it also. It is going to make you look good, and that easy and fast transfer of information in an exam, and I've had FINRA tell me it does help them. I'm not sure if it happens on the SEC's side too. But the faster you can produce that information and the more complete it is to what they're requesting from you, they tend to get a feeling about your firm, that this is a compliant firm, and while, you know, they may need to dig deeper in certain places, they're not going to go on a wild goose chase because they have a good feeling about your firm that you have good systems in place and good processes and you're a compliant firm that appreciates the rules in the industry that you're working in.

Amy Eisenbeis: I would like to add to something that Kim mentioned, if you are a duly registered firm and you comply with FINRA rules with regard to your broker-dealer activities and you don't comply because you don't have to, you comply with the FINRA Rules with regard to your investment activities. It's really important that you document that you did something in one area and you don't do that for the other set of the materials. You know why they're split, "Oh, we're just not going to do it on the set of materials. You know, it's really important to know what falls under the FINRA rules and what doesn't fall under the FINRA rules. So, you understand you only need to give FINRA what's under their purviews.

Florence Affatato: Before I move on to the last slide, two points: leverage your networks- and I can't emphasize that enough, even my colleagues at the table, get to know them, if you can, get to any events, grab business cards, and stay in touch. Because there is so many different ways to do things and things that you haven't thought of or rules that you may not have come across, because there is quite a bit to consider when you are working in your firm. So, by all means please do that. Lastly, knowing what the SEC is looking for and, I think, when you sit back and talk about your fiduciary interests to clients. Identity theft is near and dear to me, I was just a victim, along with all the federal employees and retirees. So, I tend to approach the cyber security with a little bit more aggressiveness, if you would, because I know how difficult that can be to navigate around. So, I think that if you are always putting your clients first, and you take a look at the rules and regulations and you apply them to your firm, and help them understand why they are so important, I think, that when the SEC does come to your door, that will come through. And, they will hear that, and they will see the back up for it in your records and documentations. And just an aside, when Andrea was talking about going to her teams and asking about whether they keep books and records, fortunately sometimes my employees will say I don't have to keep that record because it wasn't between the firm and a client . . . oh, my goodness . . . no, no, no . . . there's business . . . no, no, that's not even close. But you have to keep everything between the business and a client, however, everything this business touches is a business record, from your contracts to vendors, and they have to be catalogued and very well organized. And, thank heavens for electronics . . . the industry of technology, because it really does help make it so much easier.

And Finally, I can go through and read this, I think everyone here is extremely well educated and can go through this. But, you know . . . we recently received our call, followed by our letter, and then our on sight visit. And just personally, my approach, being a former federal employee is a bit different for me. When the SEC comes through the door, my attitude is: what do you need? How can I get you the things you need to see? And how can I communicate to you the tone of this program we have and the records to back it up so that you can get your job done while you're here. At the same time, of course, I have my role as an advocate for my firm as well. And, I think that has . . . in the last two SEC exams, I've had my colleagues . . . sorry not my colleagues . . . examiners from Chicago and just personally, I'm not going to speak for them, I think that was extremely helpful in having them in our office.

And you know, I know this goes without saying but honesty and integrity is everything and no matter how bad something will make you look, I can't emphasize that enough. I think that is critical when you have that exam.

Andrea McGrew: I may be sick and twisted but I actually enjoy regulatory exams. It's a great opportunity as a firm. I mean, you often go many years without seeing anybody. I mean, our firm is on a two year FINRA exam schedule, the SEC is kind of . . . there's nothing quite as set but is usually a little bit longer in between SEC exams. So you get, sort of this feeling of I want to know what I'm doing. I want to know, how can I improve? Because everyone can do better and to touch on Flo's point of networking with people, I think that's important. Treating the examiner as a resource, helping them, talking to them, finding out your weaknesses. And for the firms in the room, having good outside counsel and can tell you I've worked on this issue, its invaluable to get that feedback because you look at that list-working in this industry is like herding cats and its helpful to have other herders helping you figure out where things need to go and what you can do better.

Florence Affatato: And before . . . any questions? Before we move on. Yes, sir.

Audience Member: Do you produce your cultural values to the SEC? Or a FINRA sweep letter?

Florence Affatato: I'm sorry, how do we . . .?

Audience Member: Yeah, do you give that to the SEC?

Andrea McGrew: Absolutely, it's like one of the first things we do. The examiners sit down with the executive team, give them an overview of the company and our philosophy on business and compliance.

Amy Eisenbeis: Us too, when they come in, we're an open book- if they want to know about our culture, our core values, who does what, we let them sit with employees if they want to and walk through different systems with them. Certainly establishing that compliance tone at the top is very critical when the SEC or FINRA comes in. And I think it's valuable to when, like you said, they get a feel for your firm and what kind of firm your operating.
Andrea McGrew: Okay, so I'm going to talk about the new proposed

rule on business continuity and transition plans and the SEC actually touched on this and gave you all the requirements under the rule, so I'm going to go a little bit off topic here and, kind of talk about how I prepare to have a new rule implemented and to write the policies and procedures that will apply. As the SEC said, part of the new business continuity and transition plan was informed by Hurricane Sandy and Katrina and they did a SEC sweep exam after Hurricane Sandy, because it was a good example of a regional disaster. So it hit in . . . and wasn't just a firm specific issue, it hit all the firms in that area. So, they went through those firms afterwards and looked at not only did the firm have a business continuity plan in place, but how did it work when they had a disaster. Throughout the proposal, they talk about the fact that they saw some disparate practices among firms. And so they saw whether the firms had adequate procedures, they may have had their procedures but did they really work when things came down to being put into reality. That's a good resource to look at when revising policies and procedures with regard to business continuity. So, there would be a new rule that require the advisor to have a business continuity and transition plan and, like the SEC said, the new part of that is the transition plan. So, it's not just what happens in the event of a natural disaster, but also what happens if the firm is going to go out of business, either voluntarily or involuntarily. In 2008, 2009 Lehman Brothers went under and so they have some experience as to what happens when a firm goes under. But sometimes the firm itself chooses to transition out of the business, so this requires that firms have in place some business plan for transition in the event they are going to go out of business. And there are some other references down there, FINRA has a requirement for business transition . . . a business continuity plan and the state regulators have BCP requirements and as the staff mentioned they also put out investment management guidance for mutual fund companies for business continuity plans. So, right now there is not a rule that specifically requires the business continuity plan as a part of the compliance policies and procedures requirement. So the new rule actually has some factors that you have to set out and include in your business continuity and transition plan and the staff talked about what those are. The rationale, as I said, was informed by some actual disasters that happened, it was informed by the 2009 activities in the market, and it also . . . when you read the release, they focus on the fact that they want firms to consider their clients when they are putting together their business continuity plan. The feeling is, from my interpretation of the release, they're concerned when you are in the throes of a disaster that everyone is thinking what's going to happen to the firm, what's going to happen to my job, how are we going to get this stuff up and running. All that stuff. And they are afraid that clients will get left out of considerations at that time. So what they are saying is, when you are putting your plan in place consider your clients at the time. So that you have something put in place so that you have something set out as to how you are going to treat your clients, how are you going to let them know what's going on, how are you going to make sure you have access to their records, how are you going to make sure that their accounts aren't shut off and they can't get their funds. All that kind of stuff. If you think about it before hand and you have it place, when something actually happens and you are so worried about the firm, you will just be able to go to your plan and say this is how you are going to protect your clients. So that was one of the things that they really continued to talk about in the release.

Like I said, since the staff did go over the requirements, I thought I would just talk about how . . . when a new policy comes out and procedures. You know, how I approach it and I think it's important to really read the proposals, both the proposed release and actual release because it actually shows you what the SEC's intentions are in putting out the new proposed intention of the release and then the final release also includes comments from other firms and industry groups. So you can find things in there that you didn't even think about or you can find interpretations in there as to how other firms read a particular requirement. And, I think it's really helpful even on rules that have been out there for some time. If you're going back and if there's a reason that you are relooking at your procedures or if you are just reviewing them on your annual review, it doesn't hurt to go back and read the release and just see if you are kind of on point to what the expectations were at that time.

The next thing is, as everybody already said here, it's really important to talk to the employees in your firm. You need to talk to management to let them know about the requirements and also to make sure they're involved in any policy decisions. In the business continuity plan, I'm not sure if there are any policy decisions to be made, but in the new DOL fiduciary rules, there are some policy decisions that have to be made. You may have to change the way the firm does a particular sales thing that it's doing or whether or not it even wants to be in that business anymore based on the new requirement. So, it is really important to talk to management but, as we said, it is also really important to talk to the people who are going to be affected by the new policies and procedures because as a compliance officer what you think might be an easy thing for someone to put into place, it can turn out as not so easy or you may have a completely different idea as to how things really work. You may think, for example, in the business continuity plan you have to be able to . . . you have to have an inventory of all of you service providers and how you can get a hold of them. So that would include having passwords for anybody who goes into those systems in order to take care of client transactions or whatever. So you may think that "oh, hey everyone has their passwords in a file protected, in a excel password protected file, that they can easily access whenever they want," and you go talk to your portfolio administrator and she says, "No, I put all my passwords on a sticky note and stick them on my computer, because it's a pain because I have to change them every three weeks. And if I have to keep my excel file up to date, I can't remember what it is, and then I have to go into my excel." What you think as a compliance person when you're writing these policies and procedures may be totally different than what actually happens. So, it's really important to talk to everybody before you draft your policies. And like you said, you don't want to draft something that isn't in reality how it works, because that doesn't help either. You know, you can't prove out that you are doing what you say you are doing. And then you want to assess how the new rules apply to your firms. So, it does matter how big you are, what the services you offer are, how your business is structured, so if you have a larger firm, you may have your typical executive management team, then your next level of managers, then your employees, but if you're a smaller firm, it might be everybody pitches in. So, with regard to the transition plans, you have to be prepared in the event that somebody is temporarily or permanently unable to continue to fulfil their job functions. So, it may be that if you are a smaller firm and everybody kind of pitches in, if you lose to somebody, it's not as easy for someone to pick up the job because you are already stretched thin. Whereas, if you have a more formal structure because you are a larger firm, it might be easier to say we can have people pick this up until we find someone new to fill that position. Or, if you have a portfolio management team that's one person, so it's kind of cult of personalities, for example, like Bill Gross was a Pimco, if that person leaves, are you going to lose all of your clients or are you going to lose a 1/3 of your clients and how is that going to affect your firm. Your revenues are going to drop, because you've loss all of these clients. And so, you have to think about that. If you have a deeper bench in your portfolio management team, maybe loosing that one person is not quite as big of a deal. So it is important to understand how your business is set up and where the different points are that you need to think about a little harder that other points that are easier to cover. And, then when you create your policies and procedures, make sure that you're describing what you actually do so that you can test them and document that you are doing what you're doing. And then finally, it's really important to train everybody and I don't think of training as a one-time thing. I feel like when I go out and train, I'm going to say the same thing multiple years in a row and it's always amazing to me. One of the prior firms I worked at over 10 years, I basically trained on the same stuff for 10 years. I might have said it different, but it was the same stuff, and after 10 years somebody had come up to me and said "Wow, I didn't realize, under the code of ethics, I didn't realize I had to report that account."

Amy Eisenbeis: A video tape of yourself for the last 10 years . . .?

Andrea McGrew: Yeah, So it's important. So, I look at training more like hopefully what I'm doing is not making everyone an expert on that particular subject matter but that I'm putting the idea out in their head, so that when something happens and it triggers this thought that "Oh, she's talked about that before and maybe I should go talk to her" or "maybe I should look into this a bit more." Not necessarily "I know exactly what happened in this case." So, with regard to the business continuity plans, we hope we're never ever going to have to worry about putting them in place but we do want to make sure that the people that are going to or would have to put them place when something happens, are going to know that there is a business continuity plan and they were going to know where to get the records and would not all be running around going, "Oh, No. What do I do now" That they have some kind of background. So, when you train, you want to make sure that they are going to have people who know they should ask you questions that this issue is out there. Not necessarily trying to make them understand every nuance. And again, you have to train more than once, you can't just train one time and hope that everybody will remember what was said.

Amy Eisenbeis: And some of the training we do to test our business continuity plan, we might do fire drill and then I'll walk around the office to see what sort of risks we left out, such as laptops in the office that people haven't shut down or brought with them. We also take advantage of regional issues, so, hey there's going to be a big snowstorm tomorrow and we have people living all over the tri-county area so we're going to implement the business continuity plans tomorrow and everybody's going to work from home and we are going to see how it works in practice, versus just in theory, how we think it's going to work. And we always learn a lot that way.

Florence Affatato: Also, I think your IT department as you prepare a draft of a business continuity plan is your best friend, because they have a lot of what you need to know how to secure your systems and where to find your vendors and its funny. It's really good . . . I'm glad to see this BCP becoming a rule, because what it forces you to do is sit down and say where are all of these vendors and how do we get in touch with them. You think the website link works and it doesn't and the sales guy for the RICO, for the printer is gone and somebody else took his place, so there is a myriad of things that you will find out about your own firm and how to keep it going that you never know. So its good exercise.

And one of the things that was touched on is the Bank of New York issue that happened in the summer of 2015, I believe, and what that was, was Bank of New York was the administrator and fund accountant for a lot of third party mutual funds. And they were undergoing a typical upgrade of their SunGard Investone system – as a part of the upgrade, they lost all of their functionality and all of the backup that they had. So, all of the funds that relied on the Bank of New York to do their daily NAV calculation or Bank of New York is also the administrator for a lot of exchange traded funds, so exchange traded funds priced throughout the day on the exchange, but they have to have an indicative NAV also throughout the day. And, Bank of New York was totally unable to do that, and I think, if I recall, for about five days that they weren't able to do that. And so many of the funds that use third parties administrators like that are smaller funds and they don't have their own people in house able to do that. And, so it is important to not only think about what the firm's issues are but to think about what happens when a sub-advisor can't provide the services they're supposed to provide and so they rely and they aren't supposed to rely on from the provider. So, you think Bank of New York is huge, and this was a software upgrade, so it shouldn't have been . . . they should have probably backed up beforehand and then did their software upgrade, and they didn't do that. So you don't even think about that, so those are things too you need to consider under this plan – what your service providers do for you and what your backup is when they can't do that for you? Like I said, I didn't stick to my slides, so I'll go through them quickly.

Andrea McGrew: I voluntarily threw myself on this grenade; I don't know what I was thinking. How many firms are in the audience? Broker-dealers? Registered investment advisors? Ok. This rule is a game changer for our industry. It's not even out yet, and it's one of those ones were it created more questions almost than it has answers. We were giving a presentation to a group of reps the other day, and our Chief Marketing Officer whipped out this quote, "The larger the island of knowledge, the longer the shoreline of wonder." It's a little deep for the meeting that we were in, but it actually is true because I think the more you learn about this rule, the less you know what you're supposed to do. When it first came out, everyone was like "that makes sense, that makes sense." As you start digging in to all of the rabbit holes and the trails this goes down, you're left with more questions than you have answers. I think the DOL had said their going to release some guidance soon. I'm hoping that that comes really soon, because the implementation date for the best interest standard itself is in April, and I'm also hoping that that gets pushed back a little bit because now I've heard some chatter in the industry that mutual funds companies are going to start creating fund classes for specific broker-dealers with their own fee schedules. We all know how long . . . well, it takes what 6 to 8 months? Our SEC colleagues can talk better about how long it takes to get those funds to get approved, but you're talking at least 6 to 8 months to get those approved, and if that's what each firm has to do, were talking about a lot of upheaval in the industry. It applies to everyone, broker-dealers, registered investment advisors, insurance producers, and sadly insurance producers, if you are only an insurance producer, you're most likely going to be out of this industry because the insurance companies are not going to be willing to take on that financial institution role for you, so I think that it's just going to be something that's really different for our firm and its going to take a lot of adjustment and a lot of learning. So I certainly don't have all of the answers as we sit here today; we're ourselves going through our policies and our procedures, working through the different business lines trying to figure out what we have to do, but I'll go through these slides pretty quickly in the interest of time. If you have a question, feel free to let me know.

Like I said, it's a game changer. Does anybody feel like they're perfectly, of the firms, like you're all set, you're ready for DOL? Nobody? Ok, I didn't think so, because if you are you can switch places with me, because we're certainly not there. Basically, fundamentally, what this boils down to is currently you can accept transactional based compensation, so commissions, for retirement accounts. Under this new rule, you will not be able to that unless you comply with an exemption. And so, it's really changing the way firms are having to think about the products that they sell, how their financial advisors sell them, how you're getting paid on them, and it's going to be something that causes a lot of waves throughout the entire firm and down to financial advisors. I know there are some financial advisors who are simply retiring from the industry because like "I just . . . it doesn't make sense, it's a whole new business model for me, I don't what to do this anymore." It expands ERISA's prohibitions to all types of retirement accounts including IRAs and recommendations, and I think this going to be one of the trickier ones, recommendations to move retirement assets. So the IRA rollovers, because inherently when you're going from an IRA rollover you're going from most likely a cheaper, less expensive option for the client to something that's going to be more expensive to the client, so you need to be able to justify why that's in the client's best interests under this rule. Because as we all know in the broker-dealer industry, we've always been under the suitability standard – "is this transaction suitable for the client?" – well now it has to be in their best interests. So we have to start thinking a little bit more in-depth about what that means, how we can apply that to a client, what information do we need to get, and how are we going to apply that, what kind of fees are getting paid, is the compensation reasonable, are we treating all of our clients the same? There is just a myriad of questions that kind of go along with this. In order to receive transactional based compensation going forward, you have to comply with the best interest contract. The best interest contract is something completely different because right now you have standard agreements with clients, but the best interest contract is going to create a private contract right of action for the clients to sue their firm. So that's completely different than what we've been under right now, and I think the 401k industry has been subject to this forever under ERISA, and there is a lot of litigation that comes out of it, and I think that it will be interesting to see how that plays out here, but it definitely creates a different cause of action and a different relationship between the client and the firm than has been created in the past, and it also allows them to bring class actions against the firm.

So obviously as a firm, a financial institution as defined by the rule, it's a scary proposition because those law suits can add up pretty quickly, even if there is nothing to it, even if it's an unfounded complaint, or an unfounded litigation, even just the cost of litigating that to the point where we realize "ok, the firm did nothing wrong," you're talking six figures easy. And if that happens frequently, as a result of the plaintiff's bar, then that could be something that firms have to deal with, and it's definitely a scary proposition. I kind of already went through the standards there, but as I said, there is a bunch of unresolved issues and debates that are still raging in the industry. Some firms have talked about stopping commission based IRA accounts completely, so you just can't do it anymore, you can only go to a fee based structure. Some are going to impose the best interest standard on all types of recommendations regardless of the account. Now, legally I don't necessarily agree with that because I feel like why would I take on a legal obligation if I'm not required to do that? But I think some firms see that as the path of least resistance because I'm laying down this contract in front of everybody, then I'm not going to miss anything, I'm not going to have a transaction that goes undocumented, I'm not going to have an instance where a client doesn't get a contract that they should. But still, I think that's a scary proposition because I don't want someone to have a right to a class action lawsuit if they're not legally required to have one.

So I think the way our firm is going to approach this is that we're just taking the stance that were going to have different standards. It's just how it's going to be, and we're going to treat them all as if they're under the best interest standard. We're going to follow the same process, we're going to use the same tools, we're going to treat them the same way, we're just not going to give the best interest contact to everybody. And the way we kind of handle that with our reps is we try to make it very understandable; we create product packets for them so that everything is outlined and named so if you are doing an IRA rollover, you just go to the website, you download the IRA rollover package; everything's in there. You don't have to . . . there's a checklist they can go through and check it off, just to make sure we get everything into our firm that's required, and then that way it's really easy and we're not missing anything. One of the other scary things about this that I'll just talk about is the best interest contract exemption: if you are found to have not been complying with the BIC exemption, in addition to all of the other nasties that you can get, there's also a 15% excise tax penalty from the IRS. So, there's a lot of teeth to this rule, which I think, and I don't think anybody in the industry or any of my colleagues would argue that this rule isn't a good rule, and in theory of course it is, everybody is going to put the client's best interest first. Most people are already doing that, it's just trying to figure out how to implement these within the structure of the industry when it currently isn't set up to handle some of these things. Variable- and fixed-index annuity sales are also subject to this. This has been a big freak out for our firm, I don't about for the rest of you because our company started as a result of the insurance business, and so a lot of what our financial advisors do is they sell insurance and it's been massively different, especially on the fixed and the equity-index annuity side because the insurance companies are saying, "Hands off, we're not going to touch this," and so we have to figure out how the broker-dealers is then pulling in all of these products that are not securities products. We have to somehow pull them in, review them, get paid on them, pass that payment along; it becomes definitely a different animal than it was before. And the insurance companies haven't been a whole lot of help there; their kind of hands off.

I think I already covered that. Like I said, I'm skipping through these pretty quickly so if somebody has any questions for me, let me know. These are the contract disclosures. So under the BIC exemption, there's a lot of disclosures you have to make. First of all, there's contract disclosures and there's also website disclosures. Essentially, you have to clearly and prominently disclose to your clients what the best interest standard of care is, any conflicts of interests that you might have as a firm, and there's a ton of them, and you have to talk about the anti-conflict policies and the compensation structure that you've gone through, you have to link to the firms website and provide updated disclosures regularly, you have to identify if there's any products that are proprietary to your firm that you sell, and you have to talk about third party payments. Like I said, the tentacles of this kind of go everywhere because it also applies to affiliates, so if you as a firm are thinking "well I'm going to take and move everybody to a fee based compensation structure," if you have any affiliate that gets transaction based compensation then it's not going to work. You need to figure out a different way to do that, so there's a lot of issues that come along with that that I think that firms need to do, which is why one of the things that I would tell you to do right now as a firm, I'm thinking, is you need to be inventorying your activities, you need to be reviewing all of your educational materials, because another issue of this rule is if you're providing educational materials that are general in nature, then that's ok; the more specific they get, there more likely it is to be a recommendation, and the more likely you are to be covered under this rule. So, you need to be analyzing the educational materials that your reps are using, the educational materials that you as a firm are producing. Review your procedures. Every aspect of your procedures are going to be important to review under this rule, especially the moving from commission accounts to advisory accounts. Firms are required to do that now because the advisory accounts still has to be within the client's best interest to make that move, but I think it's something that firms should be looking at their policies and procedures with really closely. There's no limit on the products that you can have within the IRA this time; under the initial proposal of the rule there was, they were going to limit certain specific products into an IRA. That's not the case anymore, but there are different tiers of investments, so if the investment gets into Tier 2, I think they're referred to in the rule. So the more complex they are, the less liquid they are, the more difficult it is to get in and out of the product, those are going to be ones you're going to have to analyze your WSP's for to make sure you're accounting for them properly. Talk to your sales people, and above all else create a conflicts committee or have a person designated for that because the rule requires you to have it. We're taking the committee approach; I don't personally want one person responsible for identifying conflicts within the firm and addressing them, but there's a whole host of sort of ramifications for that and qualifications for people who can actually apply and be on that committee. I think it's something that as a firm you should be looking at closely. Like I said, I ran through that super-fast, but I want to leave time. This is the timeline, April 10th is when it's applicable for new transactions, we can grandfather preexisting transactions during this time period, but you still have to complying with the best interest standard. January 1st of 2018 is when that contract actually has get laid in front of clients. So there is some time on that, but all of the framework has to be laid well before that. And, so I would say a good analysis needs to be done before the 1st of year to make sure you're ready to move forward with this rule.

Kimberlee Levy: I'll try to speak quickly, I can add like so much to the DOL, but we don't have time. We talked about it, we could talk for two days about DOL.

Andrea McGrew: I'm sorry that was thrown into like ten minutes. [Laughter].

Kimberlee Levy: I believe you're getting a copy of this so you'll have all of these links, that's everything you need to know to go to find out about cyber security. What's important to know is that there's no cyber security rule. It's all covered under our privacy rules, our identify theft protection rules; there actually are already business continuity plan rules on the FINRA side of the business, so it's covered there. And then each state has their own data breach rules, so if you're a national company like Concord, and you have a customer that's breached, and its happens through our firm, and in another state, I really recommend calling outside counsel because I have no desire to become an expert in the security data breach rules in 50 states. I actually have a full time job. I mentioned briefly before, the cyber sweep exams, and I think this slide is important as you look at the evolution of where the regulators are going in cyber security. Definitely changed over time, and they're really looking for companies to be prepared to be training, to detect issues, to be looking at their vendors and third parties and have a protocol for reporting.

I personally do not like the term "cyber security." In practical application in firms with representatives, when you say "cyber security," their eyes glaze over and they think it's not an issue that they have any input on. Cyber security is an IT tissue to them, not an issue that they can be engaged in. When you say "information security and fraud detection," you're kind of unpacking that word for them and they get a better understanding of what part they play in cyber security. I recommend a three pronged approach: prepare, detect, and respond, which is what the regulators are asking for. You want to not only prepare your team, but your clients for cyber security, that way when you're representatives go to an investor on a cyber security issue, they want to verify their identity, they're not completely taken unaware as to why they would do that. You want to document your firm's fraud prevention policies and procedures, establish controls have a process for third party vendor due diligence, train on your policies and ways to spot breach or identity theft issues. And again, like I said, educate your clients. Many times in the industry, representatives think that they're not giving a customer good service if they don't do exactly what the client wants, and their actually do their customer a great disservice by doing whatever they want in this information security area. It's their job, and that's where the training comes in really handy to both the customer and the representative, so they understand it's their job to tell the customer why they may not want to take the course of action they want to. Why wouldn't you want to send a wire to a third party you don't know? I can think of a million reasons. I have listed a couple of standards and resources that have been mentioned in various regulatory notices that firms can follow. These are good ways to show that you have some cyber security policies and assessments in you firm. I don't think anyone is saying one is better than the other, but I think it certainly helps to do one or the other. *R.T. Jones* I think is the first case, at least that I'm aware of, where a firm was fined for a cyber security issue. At the time that it came out, it's about a year old now, I think many in the industry thought that the regulators were blaming the victim, but as you see in the slide, there were actually some things they could have done and I think the regulators had to put their foot down and say "the bar has gone up, and these are the standards you need to adhere to." It's a really good case for understanding what's required, and what not to do. Since encryption is mentioned there too, I'll just say a little bit about that. Messages that you're sending out of your system should be encrypted. There's a difference between encryption though: there's encryption in-transit and encryption in-rest. Consider where your information is going, and this is where you want to train your representatives. Is it going to a customer's Gmail account? Then you probably want to encrypt it in-rest and not just in-transit because, I don't know about you, but I have like 10,000 emails in my Gmail account, which means if I get hacked, there's going to be a lot of information there. So you want to train your reps to never send passwords, and even be careful with your firm name and their account information, because if they get hacked, someone's going to learn a lot about them from reading their emails.

Andrea McGrew: And to drive that point home to our reps whenever we talk about this, IT puts up, and I'm not an IT person at all, so I don't know this site, but there's a website you can pull up and in real time shows you the attacks that are being made from different cities all around the world to other cities, and it just pings them back – it's frightening – and so you tell them, "hey look at this, this where you are and these are where all of these attacks are coming from," and suddenly cyber security becomes much more of a relevant issue.

Kimberlee Levy: For sure. One thing we've noticed at our firm also is that while we were becoming very careful in sending encrypted information out to our customers, when we asked them for information back, we weren't giving our customers information on how to secure that, their information they were sending us. Many times advisors will look at their customer's tax returns at the end of the year to help them do some tax planning. Can you image the harm that can come to an investor by just sending their tax return through their Gmail account? That's where I tell our reps, handle your customer's information the way you want yours handled. They would never, probably now since they know a little bit about cyber security, send them their information that way, so they need to help educate their customers on how to do it the right way also, or they can open secure portals for their customers to transfer the information.

Detect and prevent identity theft: make sure your staff understands and adheres to your policies, that there's no exceptions to it, and anyone that's giving exceptions on their own is going to be disciplined. Make sure their trained on how to use emails and websites cautiously, not clicking on links from unknown sources, not acting on emails that requested sensitive information, money movements or trading; again, you're not giving your customer good service by doing whatever they want you to. It may not even be them, it could be someone that ready every email in their Gmail account, found out enough about them to send you an email and ask you to do something that the customer doesn't want. Directly verify their transfer requests, and there's creative ways to do this without asking a customer for 30 years of their address. I think lot of times reps fell like so awkward to do it, but there's creative ways to do it that don't make the relationship feel uncomfortable. And again, make sure they understand, that your reps understand, that they should be treating their customer information the same way they would want theirs treated, their funds as well. Protect your customer's information, and I highly recommend everyone do some phishing simulation testing. There are companies that will do it for your employees that fail, it's now an opportunity to train them, but it's just so easy to fall prey to phishing, when you know, especially with reps that want to help their customers, but don't realize they could be doing some harm.

Responding, if you suspect fraud, is very important. The faster you respond, the more likely the funds are going to be recovered. All money movement, notices, should be monitored. Know your customers habits and act on exceptions to their habits. And help them find safe ways to transfer their money. They may not think that sending a third party wired to someone they met on Craigslist is an issue, so you want to help them, even though you don't work in the banking industry, you want to help them by finding a better way to do it. You may have to make some notifications if there's been a breach, a suspicious activity report, notifying local enforcement, you want to document your response, regulators are going to ask for it when they come in to meet with you; if you have nothing, that's probably not going to speak well for your firm. If you have a policy on reimbursements, this should be documented as well, as it's been an issue recently for some firms. But, just remember that these records are discoverable in litigation and arbitration, so you want to be careful of the paper trail that you leave.

Florence Affatato: And just a couple of comments to what Kim is saying, clients will do very interesting things, and they will sit in a cyber café or Starbucks and start going through their account, and open up their Gmail and get hacked that way. We're finding that the hacker will clone the account so the client has no idea that every time they communicate with you through their Gmail account, the hacker is getting all of those communications, and when you send a communication to a client through their Gmail account, it's going right to the hacker and the client never sees it. One of the things that, and Kim mentioned, know your client – that's also a rule for investment advisors. Don't contact them just once a year because you don't know what the ins and outs of their lives are, and when you get an email that says "Hey, I need $200 grand because I'm buying a house in Turks Kakos," and the client lives in Butte, Montana, has never left the state, "Ok, how do we do that?" I'm swearing to you it happens.

Andrea McGrew: Absolutely. It happened to one of your clients and our rep, talk about knowing your customer, contacted us and said, "This is not the tone that this client would use to write this email." There's nothing about it, it was perfectly fine, it was pretty simple, straight forward, but it was the tone and the word choice, and she know her customer enough to say "there's something wrong here."

Florence Affatato: Because, it's imperative, cause were are remote, I'm not going to hide that fact that we don't always meet our client's face to face, but boy if you're in and out of phone conversations with them, whatever, we're now going to video communication with our clients, it's really important. Secure portals is another, and VOIP, we just recently went to voice over internet phone, and we record client calls when they call in say "oh I want to make a transfer from one account to another." Well interestingly enough, so weird as that phone recording sit, all kinds of things are discussed on that, and who has that, and how long is it going to be in place, so as General Counsel, what's very helpful for me is, we don't sign a third party vendor agreement unless all the due diligence is completed, in and outside this company on how they're going to protect things, that contract does not get signed. It's better on the front end, you don't want to wait for someone to get the contract signed and then you have to go chasing after the vendor. "Hey, how do you secured and train your employees those kind of issues that go on?" So if you are a GC at a firm, leverage your position, get in front of those vendor contracts, and make sure that you do your due diligence before you sign it.

Kimberlee Levy: So I know were short on time but I want to give one cyber security example of how bad the situation is. So you get hacked, there is a black market for you information. You may not know you got hacked. Months, years later, your information is sold to someone for like $5. Recently, at Charles Schwab, someone took a customer's information and opened up accounts in that customer's name. You probably wouldn't verify because it's not third party, the accounts in the customer's name. Overnight, they transferred all of the customer's funds in one account to twelve different accounts at twelve different institutions in that customer's name, but the customer didn't have access to the account. Schwab caught it because they saw it going to twelve different accounts, I think the rep caught it too because he had just met with the customer, and the customer was happy. Nobody knew why they were transferring, but the extent of this issue and why it's so important to keep everything secure, because for $5 anybody can have your information – it's terrifying to me.

Prof. Spoon: I think we have a minute or two. Any questions for the panel? Alright, well look this has been a very important and interesting perspective; I think I adds a great deal to our conference. Thank you very much.

Panel 3: Securities "Transactional" Hot Topics

Professor Spoon: Well thank you for being so prompt and getting back to your seats. We're going to pivot now from the concerns about broker dealers and investment advisors to transactional lawyer concerns. We are going to be talking about things that relate to disclosure, to running the securities compliance within the public company, and with respect to issues . . . issues with raising capital. So, I am going to turn over to our all-star panel, which has remained intact for several years now. We're very pleased to have them all back and rearing to go. I am going to turn it over to . . . Mark I guess.

Mark A. Metz: Good morning everybody, everybody hear me ok? Good. In May of this year the SEC's corporate finance staff published some new interpretations relating to non-GAAP financial measures. These interpretations are noteworthy because non-GAAP disclosures by public companies become more and more common over the past few years. And, many times the companies don't follow the rules just quite on. So, many believe that the new CDIs indicate both a more skeptical view by the staff of non-GAAP measures, and that the staff intends to scrutinize compliance with their rules on non-GAAP measures a little more closely. The shift in the increased scrutiny are consistent with some remarks that high level SEC staffers made in the few months leading up to the release in May of this year . . . of the new interpretations.

Before we go any further . . . I want to make sure that everybody understands kind of where we're at and what is a non-GAAP financial measure, just in case this isn't something that you eat and breath and sleep all day. So as you can see from the slide, non-GAAP financial measure is a numerical measure of performance that has been altered from the measure yielded by GAAP accounting, generally accepted accounting principles accounting. So one common example of a non-GAAP financial measure would be EBITA, earnings before interest, taxes, depreciation, and amortization. Companies have lots of flexibility to present any financial measures that they want subject to anti-fraud rules. But if they are not calculated under generally accepted accounting principles, the current concern is that they might be misleading, or that they might obscure GAAP results, unless they have some helpful explanation or disclosure that accompany them. And many companies disclose earnings that are adjusted to remove unusual expenses, like expenses that relate to a big acquisition, or a restructuring that the company is doing, all in an effort to sort of give investors a sense of . . . how the base business did. But some companies get a little more creative and they disclose measures that are what I would call EBAT BS. Everything . . . I was hoping I would get a couple chuckles on that. Earnings before all the bad stuff. In an effort to hide bad GAAP results. I think this is what the staff had in mind or was concerned about and that helped drive the new interpretations and the revamping of the interpretations that had been out there for several years. So before 2002 there were no standards governing how non-GAAP measures would be calculated. Let me make sure I'm on the right slide here. There were no standards. So, Congress was concerned that investors were being misled and so it included a section in Sarbanes-Oxley Act, in 2002 that directed the SEC to make rules concerning non-GAAP disclosures, which they called pro forma disclosures for whatever reason. But that is what they were getting at, non-GAAPs. And the SEC fulfilled that directive with two rules. The First is Item 10(e) of Regulation S-K, all of which applies to non-GAAP disclosures in filed reports and some of which, the guts of which, apply to earnings releases and related materials that get furnished to the SEC under Item 202 of Form 8-K. Those are your quarterly earnings releases mainly and the presentations that are made by management in their earnings calls with the analysts. The other rule Regulation G applies to other disclosures and requires just a small subset of what's required under Item 10(e). So one more background thing just to provide some context for discussion of the revised CDIs. Let's just go through the main requirements of . . . the rule that applies to practically every non-GAAP financial measure that you are going to see or have to review. So, if you just walk down through that top half of the slide, you have to have disclosure of the most comparable GAAP measure, if you are going to show a non-GAAP measure, you include disclosure of the most comparable GAAP measure with equal or greater importance or prominence, a numerical reconciliation to the most comparable GAAP number, an explanation of why management believes that disclosure of the non-GAAP number is useful to investors and, if material, the purposes for which non GAAP measures . . . the non-GAAP measure that is being used there, is used by management. Such as bonus compensation, a lot of times you will see that, or it will key into something that is in the company's loan disclosures, or loan documents rather. So, the new CDIs break down in to four big basic groups.

So I have four slides just too quickly summarize the CDIs. The first set of changes is basically a laundry list of examples that the staff indicates would cause non-GAAP measures to be more prominent. Which relates to that first couple things that I mentioned in that list on the last slide and to which the staff will object because the non-GAAP is more prominent then the GAAP. Note that these range from clerical issues like type size and the order of presentation or particular bullet to more substantive things like whether the descriptive words used for the GAAP measure are as descriptive as the words used for the non-GAAP measure. And it's interesting that including a non-GAAP and a GAAP number in the same headline or bullet with the same type size and font would, in the staffs view under this CDI, violate the prominence standard if the non-GAAP measure happens to be listed first. Even though many of us would consider that may be equal treatment. And remember equal or greater prominence of the GAAP number is the requirement. So little different non-intuitive interpretation there and also the staff continues to believe that even if you have a full GAAP earning statement in the earnings release its still not appropriate to include a full non-GAAP financial statement to reconcile to the GAAP number.

Martin Dunn: So think about how silly that is and it's something that I disagree with completely but don't have a say anymore so I go along with it but what they are asking you to do then is instead of putting in a full income statement to reconcile it they are asking you to take out chunks of it, so you can't follow it all the way through, so here is how you satisfy this comment . . . you take out some of the items that don't change. You know and . . . How is that helping anybody? I don't get that but one of the notions that has been with non-GAAP since the beginning in 2002 is the accountants at the SEC have never been huge fans of non-GAAP and so even after the rule was first written they were applying it more strictly than the rule itself said and then you saw a little bit of a change around 2010 when Meredith Cross came back and was director where she was like "the rule says they can do this quit stopping them." She is not the director anymore and it seems pretty clear that they have gone to a very strict approach on the accounting side. The accountants are kind of running the show now on non-GAAP is what you see with this

Mark A. Metz: Right, yeah absolutely I agree with all of that

Peter Sugar: Do you have any insight Marty as to what is causing that reaction?

Martin Dunn: Well as I said. . .

Peter Sugar: Is it just harder to regulate this stuff?

Martin Dunn: You know I love accountants, my wife's an accountant, my dad's an accountant, you know, accountants are fine people. But accountants have a different way of looking at these things they have a different way of thinking and it is very much does it fit in a box or not. And a lot of it just this isn't what they were raised on they were raised on GAAP not non-GAAP. The other thing is if you do look at a lot of the earnings releases, people have gotten pretty lax. I mean there is a lot out there that is potential problems and so I think they see that as well and I can understand that I mean I have been going back to my clients and looking more closely at the earning statement . . . the earnings releases based on these and there is a lot you can do, that people aren't so

Peter Sugar: It's especially unusual from my perspective because you have these massive complex assets . . . big companies trading in the M&A markets all the time. Multiples of EBITA which is a non-GAAP measurement. This is the speak of transactional world and to have all of this sort of paranoia about using that information. Sure, fly shit out have the GAAP measures also but

Martin Dunn: There is a notion they have that it is by its nature misleading, you know, and once you come into it with that mindset you are not going to show it a lot of love

Mark A. Metz: And it all comes back to its not GAAP, it's not generally accepted accounting principles that are driving the calculation, it's whatever management decided made the most sense. And I think there is a line that the SEC staff must feel has been crossed between things that are useful and things that are EBAT BS.

Peter Sugar: And you have also seen the enforcement folks, and I don't know if you were going to mention that, but they have sent out a lot of letters from the enforcement side saying we want all your background materials, we want this, and we want that on your earnings release because we want to know how you came to this. So the enforce . . . I don't know if they are going to do anything with it but it is enough to shout across the bow to get people's attention

Mark A. Metz: Yeah that's a little scary and I was going to touch on that just a little bit at the end. Just to finish going through the CDIs very quickly this next set of four CDIs addresses practices viewed as just per se misleading or potentially misleading. The first one in particular seems directed at the EBAT BS issue where if you exclude certain things SEC says, "No, no, no, no. We don't want that. We don't even want that disclosed at all. Don't try to put disclosure on it, just take it out, we don't like that. We think it's . . . misleading by itself."

The next slide is just a real small point, but one that I think will affect a lot of people and that goes to how you show the effect of income taxes on adjustments when reconciling and that methodology is changed. The SEC wants more information they want you to lay it out as opposed to the sort of parenthetical, very short hand parenthetical way that people typically do it or have typically done it before these came out. And then the last set goes to an interesting issue that goes back a long ways, the SEC historically has taken the position that disclosure per share measures of liquidity or cash generated are by themselves per se misleading, not permissible. And to skirt that issue with non-GAAP measures some companies try to disguise their per share non-GAAP liquidity measures as financial measures by reconciling them to a financial measure earnings per share and used to be that the staff would generally give some credence to that and defer to what the company is doing and allow them to get by with it. The SEC has said, "No, no, no. We're not going to do that anymore. We're going to take an independent look and make sure that you are reconciling to the right number. And if this is in fact a measure of cash generated or liquidity, we're going to make you take that out."

So, that's the background on the new CDIs and now the question is do the staffs comment letters since May 17 when they first posted the new CDIs support what we believe the staff was signaling? As I mentioned earlier the new CDIs and public statements by staff members seem to indicate that the staff was going to look at non-GAAP measures more closely. And that in fact appears to have been the case. Based on some rough internet searches that I did, it looks like the number of comment letters within the three months or so that I looked at after May 17 through to around the end of August, there were almost twice as many letters issued that had non-GAAP comments in them as there had been in the years 2015 or 2014. So a lot more tension seems to be given to non-GAAP measures. And then I also mentioned earlier that the new CDIs appear to be driven by a perceived lack of compliance, Marty mentioned that too. We reviewed SEC comment letters issued in that same time period and found well over 130 comment letters issued in that time frame that included one or more comments addressing compliance with the non-GAAP rules. And I see a couple of you have this out already, there is a chart where we charted it all out and you can kind of see my inexact science way of sort of categorizing these. As you will see from this slide . . . the issue getting the most attention is that equal or greater prominence issue, the first one that I mentioned. Well over half of the letters included at least one comment on this issue and some letters included multiple comments on this issue getting down to the real nitty gritty type sizes should be as big with the GAAP number as it is with the non-GAAP number. Well over half of the letters had at least one comment on that issue and it indicates to me sloppy compliance in that area may have been part of what drove the SEC to have this heightened scrutiny. None of the other new CDIs received anywhere near the same amount of emphasis although each of the new interpretations drove at least a few of the comments during the comment period that we looked at.

Another major area of emphasis on the recent comment letters continues to be and this is true for the last many years adding or expanding explanations of why the non-GAAP measures are disclosed and how they are helpful to investors. The issue has been an area of emphasis for a long time and I think the staff uses these kinds of comments as a way of ferreting out the EBAT BS issue to make it a little bit harder for issuers who are just trying to cover up bad GAAP results to do that without . . . doing a lot of back and forth of the SEC which I think . . . hiding bad GAAP results is one of the main reasons why they don’t like to see these non-GAAP measures. And as Marty said it is the accountants at the SEC who are giving these comments, so they are going to be generally pre-disposed to liking GAAP better, it’s just what they do. So what conclusions can we draw from looking at the recent comment letters well the first conclusion that I draw is that if non-GAAP financial measures are disclosed in earnings releases and investor decks. Securities counsel and the company's disclosure committee need to be a lot more involved in reviewing the documents, for the same reasons that they are typically involved in reviewing SEC reports. We all have been put on notice that the SEC is going to look at these a lot more closely and so compliance failures are more likely to be found and it's riskier to not have somebody looking at them to make sure that you complied with the Item 10(e)(1)(i) and ignoring the guidance's asking for at least a comment letter and, as Marty had pointed out, there are enforcement actions sort of in the offing that may come out of this. The other main conclusion and then I'll give these guys a chance to chime in, the other main conclusion I draw from the review is that the emphasis on the prominence issue may cause companies to just rethink their use of non-GAAP measures completely and how they communicate their results if the discussion of non-GAAP measures is truly subordinated in the earnings release to the discussion of the GAAP results as it is supposed to be under the rule then some companies may decide it's just not worth giving all the discussion of the GAAP results and then getting to what they really feel is the meat. And, as Pete mentioned, that's somewhat unfortunate because in many cases the non-GAAP results are important they are things that analysts and institutional investors and many in the investment community are looking for. They are good ways to track performance better than just earnings per share. But companies may decide it is just not worth going down that road. And, I think that may be one of the staff's goals in publishing the new CDIs and having this increased scrutiny is just to discourage people from doing this at all and using non-GAAP measures at all. Guys any other thoughts you sort of said what you think . . .

Martin Dunn: Yeah I would say the one thing the second quarter and going into this earnings release has been the pushback from a lot of companies and clients has been why is this coming up now? You know. Why weren't you raising these comments before if this was the way it was supposed to be? And the fact of the matter is I think a lot of folks did raise these comments and, as years ago, one practice just kind of changes and you raise the comment three times and you are like they aren't going to change this so why am I raising this comment. And now there is a new motivation to do it. So that's been the most common conversation is "Why now?" And the people who are in-house hadn't seen the CDIs or had heard about them but hadn't read them closely or didn't know about the comments and were a little taken aback by us kind pushing on them to say I believe you have to at least show you are trying, you know, you have to make some kind of change

Peter Sugar: In thinking about this I, you know, my brain goes to the mysticism, if you are looking for meaningful disclosure the fact that you are disclosing something in numbers, as opposed to words, in my mind shouldn't change the standard to which the person making the disclosure is held and this is almost a standard change because, you know, we are permitted to talk about risks and risk factors . . . yeah we get comments about, you know, qualifying statements and things like that but we can choose the language we want based on an observation of what the investor who is the important consumer of this information needs to know or would like to know. And so I think we are off a little sideways just because we are talking about financial information rather than, you know, descriptive disclosure. Away from the idea of full disclosure, good disclosure, little bit of protectionism, you know. Certainly for analysts, I mean, they know how to read this stuff right, so anyway.

Mark A. Metz: So just one other observation is that right now to write down what you see in the public eye, as you see comment letters that say in future filings, please do this, this, and this. So it's very low key, you getting a comment and there is lots more comment letters as I mentioned, but the push is very low key. But, as Marty mentioned, there is some work being done in the background that may lead to enforcement actions and it wouldn't surprise me at all to see, like we saw a few years ago when Reg. FD came out and to what we have seen in some other situations to where new rules and new interpretations come out and then the SEC makes an example out of a few companies who don't get the message or don't take it very seriously. So the moral of the story is if you are counseling companies on these kinds of disclosures, or just if you have public company clients and they will listen to you at all, make sure that they're taking this seriously and that they're paying attention to these new CDIs and that they have procedures in place to review them properly and make sure that they are in compliance, so that they don't end up as one of the companies that is being made an example of. Any other observations from the panel or questions from the group before we move on?

Martin Dunn: Thank you sir . . . ok so we are going to talk about proxy access, and I am a little embarrassed because Mark had all of these type written notes and this is the extent of what I wrote down. So hopefully I'll do a little bit better, then it appears as though I'm going to, to be pertinent and . . . to get everyone on the same page, I'm not going to go through the history of this because but I want to make sure everybody knows what we are talking about here. And that is proxy access and that is every state every by-law says shareholders can show up at the annual meeting and raise a matter. Most also say you can come and nominate somebody for director. The fact of the matter is if you show up at the meeting and the company has already collected proxies and it's not in the proxy, you are not going to win, right? So it's not there. So the big question has always been: how do I as a shareholder get either a proposal or a nominee for a director into the company's proxy, so I don't have to do my own contest in order to get it. With proposals the commission adopted Rule 14a-8 in like 1941, that says a shareholder can raise a proposal to a company and if it meets certain procedural and substantive requirements, the company has to include it and it has to go to a vote just like every other matter that is on the proxy card. The commission decided at the time not to do that with director nominees. They felt that that was a different matter that there should be a contest. It's been a . . . it's a tight question, judgment call, feel about it as you wish. But so the commission went back and forth for years, should we do this should we not. And like every 25 years they would do a study and say not this time, we'll do it next time right, and so they never did. And then around 2002 the staff was asked to do a study about access and we did round tables and we did the whole thing and we proposed a rule that had basically triggers, and if the company didn't do x, y, and z, then they had to allow access for nominees. It got proposed did not get adopted. 2007 did it again, got proposed did not get adopted. 2011 they wrote a new Rule 14a-11 and it got adopted believe it or not and they created . . . a proxy access right for shareholder director nominees. The D.C. Court of Appeals vacated the rule, so that the commission had not done everything they had to do. But one interesting thing that they had done was within Rule 14a-8 itself, the reason you couldn't do this is that it had a provision that said a company can exclude a proposal if it relates to an election of directors. And so, there was actually a court case in D.C. in like 2006 about what the meaning of "an" was. Did it mean this election or any election ever? Because the argument for the proponent was, all I want is a process whereby in future elections, I can put my nominee in, I'm not saying I want my nominee this year. The staff had always said it's any election and the D.C. Circuit said no you got that wrong, so figure something out. And so, okay, that wasn't very good because when I say "the staff" I meant me. So, right so I got a little humiliated by the court but you get used to it. And I didn't have quite that view at the time, but now you know looking back alright whatever. So . . . the important thing is when they adopted 14a-11 which later got vacated they also changed 14a-8(i)(a) to get rid of this "an election" and to make clear that you could have shareholder proposals that says . . . shareholders vote on whether the company has to change its by-laws to say, "If a shareholder meeting certain requirements comes to us and gives us a director we will include it on our proxy." So, when the court vacated the 14(a)(11) it didn't change that rule, which lays the ground work now for private ordering. Right? So okay there's not a commission rule, but at every company there's a really high standard for being able to submit shareholder proposal you only own two thousand dollars' worth of stock in the company for a year straight. Pretty much, that's not too hard to meet.

So, that was 2012. 2013, you didn't hear much. And then in 2014, is when you started getting a large number of shareholder proposals, requesting proxy access. There are two rules that we need to think about as we go forward in my little tale here, which is: 14(a)(8)(i)(9) and (i)(10). (i)(9) says you can exclude a proposal if it conflicts with a management proposal, and (i)(10) says you can exclude a proposal if you've substantially implemented it already. Historically, the staff read (i)(9) very broadly, said pretty much anything can conflict, and (i)(10) very narrowly, and said you never implement anything unless you do exactly what they say. Alright so up until 2014, that's what we had. So when you saw these shareholder proposals starting to come in . . . these are the three seasons, and I am going to go through each one now . . . so when you see the shareholder's proposals start to come in, you saw companies say alright, how do I want to deal with this proposal? Do I want to adopt proxy access? Do I want to fight it in the proxy? Do I want to do my own proposal that conflicts? What do I do? So given the history of (i)(9) and (i)(10) everybody thought the better route to go was to say it conflicts. So come up with your own proposal, put it in there. Make it much more like you would want it to look than the shareholder wants it to look, like higher thresholds for nominations, lower numbers of nominees, that kind of thing. And so you had companies doing this. Wholefoods got a proposal that said . . . and remember 14(a)(8)(11) said your ownership threshold to nominate somebody had to be three percent for three years . . . you own three percent of the company for three years. So, all the shareholder proposals, after . . . the beginning there were some weird things in there, but everybody kind of coalesced around okay three percent for three years is what the shareholder proposals are going to say. Wholefoods got one that said three percent for three years and whole foods said, "It conflicts with ours, and our ownership threshold is nine percent for five years." Really, way past what it was. And the staff consistent with their reading of (i)(9) said, "It conflicts, we don't like it, but we're not in the judgment business and we're just asking whether it conflicts." So, that sits there, everybody goes berserk. So maybe a month, six weeks afterwards the chair announces I want the staff to review how they're looking at (i)(9) and the staff comes out and says we're reversing *Wholefoods*, you can't rely upon it and for the rest of the year we're not going to answer whether something conflicts until we finish our study. So everybody's like what do I do now? I mean the process says I have to write to the staff and the staff says they're not going to answer it. That's never happened before. What do I do? And so what most people wound up doing because they didn't want to get sued and without the staff guidance there's potential for it, is . . . they just included the shareholder proposal. Sometimes they included the shareholder proposal and their own, and said depending on the vote we'll do something. But for the rest of that year there was this confusion. How are we going to deal with proxy access going forward? What's the thing to do? Then you've had an interesting thing happen, which is the staff unfortunately finished their study and came out with Staff Legal Bulletin 14-h, which the quote right there is one of the craziest things I've ever seen in my life. They basically went through the old releases and, they even cited a couple of letters as the basis for this, that say the exact opposite. Alright . . . you got my point. So what they did there is . . . they said that you have to not logically be able to vote on one or the other. And the example they give is a shareholder proposal for a merger and the company proposal saying we don't want to do a merger. Okay, so one company has actually gotten litigation no action letter this year because they took the shareholder proposal and just made it theirs and put "not" in front of it and the staff granted it. So that gives you an idea.

At the end of every proxy season they have a little meeting in D.C. for the losers of the world like me who live inside the stuff and we go over the prior year. The staff said, does anybody have questions on 14-h? Do you think it's clear enough? And I raised my hand and said I think it's perfectly clear what you did, you just killed 14 . . . (i)(9) I think we all got that. And so, really you got to change your complete thinking about it. What they then did though, is all of the sudden they reversed how they feel about substantial implementation and suddenly became all about love and said so long as you implement the essential element, which is you give them proxy access – there can be a lot of different terms there. We'll get to what some of those different terms are because proxy access bylaws got a lot of gears to it, right? And so all of the sudden the script is flipped. And now after this proxy access . . . after 14-h and after 2016 season everybody thinks okay we can't do (i)(9) so we're not going to do our conflicting, what we're going to do is implement it, but sticking to the three percent for three years because, that's kind of like I said coalesced, we're going to make it on terms that we like. How much of the board you can have. How big a group can be? These kind of things. So that was the approach. Everybody kind of got used to this and then another weird thing happened on the journey was that when people first started getting proxy access bylaw proposals it was like "we got to fight this, what do we do?" The board's going to go crazy. Then we found out that boards really didn't care all that much. It isn't the end of the world because it's three percent for three years and if somebody already owns that much they're already talking to you. So the notion of access bylaws went kind of like "Oh my god, oh my god, oh my god" to "Sure we'll do it. That's ok." So you see a lot more of them, which is why you get the implementation parts, so they kind of go hand in hand. If the staff's going to be easier on it and people aren't as worried about it, it's the route to go.

So then you get this season, and it's the proxy access 2.0 where the line item veto proposals. And what this is . . . is the folks who put in shareholder proposals said we want it to be three percent for three years, we want it to be a quarter of the board, no limit on re-nomination loan shares are treated as owned shares. These details of it as you go that maybe companies didn't do. So now what they're coming in with is proposals that say we want you to amend your bylaws to do these five things or these three things or these seven things that basically were in our proposal that you didn't do before. And so, companies are writing in and saying we've done the essential objective, we've given them proxy access, you know we just didn't do it the exact way they did, so why isn't last year's letter where we adopted it good enough this year again? The staff has come back and said for, the substantial implementation, if it's a brand new shareholder proposal . . . you don't have access, so it's just like it was last year, we'll grant the substantially implemented if you do some form of access even if it doesn't match. But if it comes in and says amended to change these three things, four things, five things, we don't think that's substantially implemented because the proposal now isn't access, it's these five things. And so, they came out with a letter and *H&R Block* that said we're going to deny your request because you haven't met your burden of proving that you can exclude it. All the people in my little world are like okay that means there's an argument there somewhere. Right? Because they said you didn't meet the burden, not that you ever could. So we tried to come up with every argument we could possibly could think of and the staff has denied five or six letters. They've gotten rid of the burden language, so all of the sudden it's like oh my goodness what's going on? Well, I've got a couple letters in with the staff right now on this exact issue that they haven't answered and the argument that they make . . . that it makes is 14(a)(8) says you can have one proposal. Right? And (i)(10) says if you implement the essential element you can get it out under that, so we've written in and said okay this wants three things . . . five things. That's three different proposals or that's five different proposals and, therefore, it violates 14(a)(8) and we can exclude it. And if you argue to me that, "No, because the analysis under the proposal is there an essential unifying element?" And if you argue to me that no it's one proposal because it has one element and that's proxy access, then you better be (i)(10). You can't logically make both arguments. At least that's the point we're trying to make. Those are still sitting there. We'll see . . . you know, give it a shot right? One of the interesting questions – I don't know about you guys – I was talking to a friend who said if you give these proposals with three things in there . . . yeah I have like one or two friends . . . with three things in there, there's a requirement rule 14(a)(4) that says separate proposals have to be unbundled and presented separately on the proxy card. The question is: as a company if I get this, do I include it as one thing on the proxy card or do I include it as three things on the proxy card. In other words, is it three proposals? So we'll see, it'll be interesting to see what the staff said. The staff has been very much of the view on shareholder proposals, in the last year or two, that just put them in and let them vote. They've been very limited in on exclusions. Things that used to get excluded, don't anymore. So, we'll see how that goes. As I like to say shareholder proposals aren't nearly as much fun as they used to be. You could really get into the nitty gritty arguments, and now the staff is like "Ehh…, close enough." We'll see how that goes, but I think the future of access is the staff wants private ordering and wants substantial implementation to be the name of the game. And so I think what you'll keep seeing is companies just adopting it on their own, and at the same time not worrying about it that much. Also on these 2.0s I'm hoping that what it gets down to is that they can come up with one proposal each year that says change this one part, not change all five parts. We'll have to see how that goes. But more and more I just think companies are just going to do it because it used to be proxy access was used as a threat, you know fix your exec comp or we're going to send you a proxy access proposal. And now it's like "Oooh don't throw me in that bracket. And you've seen that threat go away. It's been interesting to watch. Sorry, all yours man.

Peter Sugar: Thanks Marty. So just an observation about this conference. I want to congratulate Elliot and Ray and Joe Spiegel and a host of unnamed persons that supported that crew to bring this conference into being. The observation is that by being an annual and recurring conference and being a member of a panel that has been talking about the same subjects from year to year the quality of the information that we pull – and there are many other conferences that are similar – is heightened because as we're practicing and as facts pour in, transactions pour in for this panel. We see developments in the rules. You're building on something that you've heard before. So, thanks for doing this and thanks for attending. It's also important because there's not enough time to really talk from the beginning of time in the world to today and sometimes that explanation is necessary for full understanding.

The topic I'm talking about and I've called it Section Three and Four offerings, but essentially its capital formation through means other than what we know as a full-blown registration statement under Section Five. So, some stats and last year we were drunk with stats because we . . . the SEC was doing all kinds of studies, rules were new. This year it's a little harder to pull them out. Most of this information is from public statements. I've cited a couple of them, but if anybody wants detailed information, if you're looking at these issues, send me an email and I'm happy to give you the source. This is from a public statement by Mary Joe White in May of this year, regarding Regulation D offerings and just to refresh your recollection, Regulation D was amended, and what we've known in the past as section 506 offerings became known now as a 506(b) offering, which is an offering whereby you can make an offering of any size to accredited and non-accredited . . . limited non-accredited investors, and do so on the basis of having some indication that you've diligenced whether or not that investor is accredited, diligence was met by self-statements in those days and still are. Now 506(c) has done a couple of important things, again I won't spend a lot of time on this, I think most of you are familiar. The most important thing it did is it said "this is no longer a private offering. If you want it to be a public offering, go ahead." You can put an ad in the newspaper, on the radio, you can generally solicit, you can call on anybody you want to call on. Where there was a whole process that was developed under 506 previously following the concepts in section 4-2 of '33 Act, and its interpretations. Now so long as you verify that it's . . . that the investors are accredited, you're allowed to generally solicit and generally advertise. So, here's some stats: this is from . . . I think from the enactment of Title II . . . yep enactment of Title II, which was enacted in 2013 through the end of 2015 and you can see there's . . . the people that put the slide together aren't very good at arithmetic, but it's about thirty five times more sold pursuant to 506(b) that is the old regime of selling to accredited, sometimes to non-accredited, and relying on less information . . . less than the verification means that the staff has put out CDIs and people are following, but nonetheless thirty eight billion dollars of offerings under 506(c) were concluded. We talked about this last year in contemplating who's going use this rule and I think the one comment I would make, and I would be interested in what you guys think, is that we're sort of thinking well look, who needs to do this? What issuer needs to go out and generally solicit and generally advertise, because that's a hard rule to follow? The answer was, well its people that don't have friends and family with a lot of money, its people that don't have a lot of contacts with rich people that are looking to invest in securities and invest in companies and people that can't afford, or don't know, the intermediary industry that makes its living off of connecting investors and issuers that are seeking capital. The fact that $38 billion is done is not confirmation that . . . that is the categories, but the fact that anything was done, I think, tends to indicate that's what's happening.

Martin Dunn: Where I see it most with (c)'s is people who want to use the internet to access folks and you know they have some kind of platform they're trying to drive investors toward and they can't really stop everything to make sure somebody's accredited before they inform them of an offering, or they have an ongoing offering that under the staff interpretations you can't just throw somebody in the middle of. So that's where I see it more is people with platforms trying to reach out more broadly. This provides them more certainty.

Mark A. Metz: That's what I was thinking too, people that want to be able to use the internet not so much print ads or banners behind an airplane, but the internet. And, it sort of goes to that whole idea of crowdfunding, this is 506(c) offering's become known as accredited investor crowdfunding because the use of the internet.

Peter Sugar: Great. This is sort of a simple slide but it's about Reg. A offerings . . . Reg. A+ is the new development in Regulation A which is a mini registration process the limits were raised dramatically . . . two tiers a $20 million and under . . . and an over $20 and less than $50 million tier two registration are possible . . . registrations are possible. The trends are that people are using this based on increase over prior activity. This slide shows that through October 2015 compared to through October of

2016 – a year later – the number of offering statements publicly filed has tripled. People are actually using it. Again, you can survey those things and see or try to figure out why this alternative versus other alternatives. Some other things to mention about Regulation A+, The JOBS Act talked about IPO on-ramps, the president even used that terminology. Part of the effort of the commission and rule makers has been to try to do accommodations for what we call smaller companies – private and emerging growth companies – that are seeking to raise money and those accommodations, many of them were embodied in it. Disclosure effective initiative where . . . for example two years of financial statements are required of earning statements rather than three in an audited form for a registration statement on these smaller deals. Interestingly, we live in a world where emerging growth companies are defined basically as a business doing less than a billion dollars.

Mark A. Metz: Billion with a “b”.

Peter Sugar: Billion with a “b”. Thank you.

Martin Dunn: They can be pretty emerged.

Professor Spoon: Peter. Do you think that the increase in the Regulation A+ are consistently with people who have previously done 506, or would they have done . . . you know S1’s? What’s going on there?

Martin Dunn: The ones I see, and it’s important to note that even though it’s tripled, it’s still not that big of a number . . . we’re still learning on it. I’ve had a lot of folks call me because they’re interested in it. Because they don’t want to be limited to 506(b) because they want to do general solicitation and they don’t want the hassle of 506(c), plus you remember that with Reg. A you get unrestricted securities and with Reg. D you get restricted. I’ve had a lot of folks come with a lot of interest in it. To be honest with you they kind of peter out after a while because along with the Reg. A+ there’s ongoing reporting, ongoing audits, and you have to factor the long term cost versus the one time cost of do I want to do it. And then you also have to look at is there enough liquidity in the secondary market for it. While that kind of stuff is developing and you’re seeing new . . . not exchanges, but markets for these things. You are seeing some potential for that. But until you . . . we get to a really good place where there’s a good secondary market, I think what you’re seeing is folks interested in doing something, but don’t want to be limited to no general solicitation. And, you’re also seeing it a lot for some reason in the real estate space. It's for people who want to do . . . basically syndicate buildings, you know invest directly in real estate, is you're seeing a lot of those.

Peter Sugar: I would echo that. Also, it seems like the real estate industry is more willing to experiment with some of these new regulations than other established business segments. I do think it is a cost factor to some extent and it is an access factor to the investment market. Even at $20 million or at $50 million it's very hard to attract the broker dealers and underwriters to get a deal done even if you're willing to pay the fee. Anything else, Mark, on A+?

Mark A. Metz: I was just sitting here thinking about the . . . 25 years ago when we used to do IPO's at $25 million or $30 million. No underwriter is going to take that these days. So, can you raise . . . it really comes down to a question is what's the most cost efficient way to raise 25 to 50 million dollars? Is it by doing a Reg. A offering where you have all these upfront costs? Legal costs are going to be close to – according to the research that I did – close to what you'd pay in an IPO and you have the mini ongoing reporting costs for these small companies. Does it make sense to do that or can I use either a traditional private placement with 506(b) or can I put something out on the internet that's going to be much less regulated and then just sell only to accredited investors and go through the verification process that's required. I'm actually surprised from the earlier slide that there's not more 506(c). While I understand the practical issues with the verification that just seemed to me to be a better alternative than some of the Reg. A+ offerings that I'm seeing, but maybe it's the restricted versus non-restricted issue.

Martin Dunn: Well, actually . . . the folks I've talked to about why they're using (b) instead of (c) or Reg. A+ is: one they weren't having a hard time raising money under (b) before. With the notion of it's not a general solicitation if you have a preexisting substantive relationship it or your agent does with the purchasers. I mean go to a broker and they're going to have five hundred people they can point you to. And, so people weren't having a hard time with (b). I view (c) not as easing big companies and what they've had before it's just providing another alternative for folks who . . . (b) wasn't working.

Mark A. Metz: Yeah and for public companies there's no reason to use 506(c) because you can just do a self S3 which has become much easier in the last few years. Sticking with the tried and true, 506(c) versus (c) makes sense. It's the increase in the Reg. A that has surprised me, but we'll see.

Peter Sugar: I think liquidity is a factor and we talk about . . . I'm sorry? Yes please.

Audience Member: Quick question for the panel before you guys leave the subject of Reg. A+. What is your prognosis for whether the broker is going to soften or become more receptive to these types of issues for purposes of distribution and also secondary markets? Do you see that happening or are we at a stonewall here?

Peter Sugar: I think there's a lot of conversation. I'm privy to a bunch of it, at the state level and some at the federal level about thinking through trading markets as Marty said. For all of these types of offerings. One argument for regulation A+ versus 506(b) or C is there's a liquidity discount. It's not just the fact that "oh, people are restricted in their ability to do something with the security," it's economic as well. The need for trading markets and these types of securities is palpable, it's evident. There's an economic cost, so yeah it costs you some money to do the disclosure and pay the lawyer, but there's an economic benefit because you can realize full value without an investor saying well I got to hold this thing. I don't know how long I'm going to hold it. I don't know who I'm going to sell it to. If a broker is not involved, and I think that . . . that's a topic that people are thinking about, talking a lot about and proposing some legislation on.

Martin Dunn: I will say that everybody who has come to me talking about doing a Reg. A+ hasn't had a broker with them. It's been we're going to do it on the internet.

Peter Sugar: Anything else? Okay so, crowdfunding . . . how are we doing on time Elliot?

Professor Spoon: You've got five.

Peter Sugar: Okay good. Crowdfunding, a long road, again I mentioned the fact we talk about these things annually and this has been a very long road. JOBS Act . . . the proposal for rule making and the directive to promulgate the rules, it's been about three and half years. And now we have them in October of last year and we're starting to see what people are doing with crowdfunding. There's some stats that I'll give you if we get to them, if not there's a slide on them in back on the first sixty deals filed, Practical Law, which is I think . . . Thomson Reuters did a study and it gives you some insight on deal size, etcetera. A lot of criticism continues on how the rules were adopted . . . what they contain actually. And, very restrictive in terms of the size of investment per year, the size of an offering. But they have facilitated it with some disclosure rules. The stats that you can look at later, because the slide pretty much contains the highlights seem to indicate that you can inexpensively raise money with a crowdfund and you can do it in compliance with the regulations, so far as we know. The legal fees, for example one of the stats, is they range of $5,000 to $10,000 that's why none of us have ever done one nor are we looking to do any. But kidding aside, portal fees which is essentially the marketing cost are ranging from 3% to 10% and on the offering side if you're looking at the average offering of 60,000 which is what the first 60 deals averaged, by the time you offer and raise . . . by the way of the deals in the 60 day period, 5 closed at the time this report was done. So this isn't a tremendous amount of information or activity to comment on but bringing you up to speed and make a mark on where we are in 2016, any further thoughts on crowdfunding?

Mark Metz: Just the point that I've always kind of poo-pooed crowdfunding as being a useful tool. I've done it doing sitting in this seat several times. But what I've seen coming out of these statistics that you showed on the slide you have on the back is that people are structuring their offering on things that I count as drawbacks on what I consider to be crowdfunding. Having to do reporting, having to come up with come up with financial statements, especially audited financial statements. Having numerous shareholders, voting shareholders, coming out of that when the typical company that is going to do these crowdfunding offerings are very, very small with few employees and the way they are structuring their offerings is that they are keeping it below the threshold that requires financial statements. They're having a limited number of shareholders so that they can terminate their ongoing reporting requirement after the first year. They having, they're basically structuring it, oh the voting securities, they're using non-voting securities so they don't have numerous shareholders holding a hundred shares they just have a hand full of shareholders or no new voting shareholders. So it looks like people are being smart in the way that they are structuring and using the offering to maybe have enough capital in order to do a 506(b) or 506(c) or at least have enough to put a down payment so to speak on the legal fees for Reg A. So it is sort of a bridge financing tool, but I agree, I still agree, that the regulation itself handcuffed the SEC is handcuffed by what Congress allowed them to do. It doesn't really give them much usefulness when you're trying to go forth to use crowdfunding.

Peter Sugar: So maybe it's more of a way to get clients to bridge to the next level of capital raised. You still good Elliot? So we need to wrap up. I just want to touch on a couple of items. I'll do that very, very quickly. There's been an effort and it's ongoing to modernize Rule 147 and you'll all recall that the problem with section 311. Exemptions for local offerings, no limitation on size, no limitation on the number of investors is that it must truly be local. The biggest problem with it is that Congress wrote the statute at a time when there was no internet. In fact the breadth of media was probably different-very different. Generally in other forms as well. 311 depends on offers. And the restrictions apply to offers and one of the restrictions is you cannot make an offer to an out of state person and that means you cannot put it on the internet because you have no control. So now there's been various efforts to minimize the controls and now others have made a strong effort to modernize the rule and take away that limitation and focus on the sales with respect to crossing state lines at least, and some other aspects of the rule and the exemption that are being worked on. I want to touch on one thing that we mentioned earlier which is a big item in my mind and it related to your question which has to do with liquidity and harmonizing 147 and 504 drifts into that area because rule 504 can be an offering of fully tradeable securities so long as you register at the state level. And now there are proposals to permit trading, no limitation on trading, which right now is nine months for an out of state trade immediately. And I come back to the question of the liquidity discount. These things would be much more useful and I think more used if they didn't have those restrictions. If you have questions please raise them. You can raise them now or you can raise them with any of use by email or phone and thanks for your attention.

Professor Spoon: Let us thank the panel.

Panel 4: LARA: Current Regulatory and Enforcement Issues

Professor Spoon: We're going to get started on the luncheon panel. We're going to do the lunch panel now. I hope you enjoy it. Feel free to continue eating. And make sure to get dessert. But the real dessert starts now. with the panel from the State of Michigan LARA and we're very fortunate to have with us three representatives and they're Lindsay Deroja, Linda Cena, Steven Bray. They are going to cover a whole range of issues that are pertinent to the securities in the street. I guess I'll turn it over to Lindsay.

Lindsay DeRoshe: Thank you. Well I wanted to take a minute and thank Professor Spoon and Ray Henney for hosting this event and inviting us to speak. I know I personally look forward to it every year. I'm an MSU alum so I always appreciate the opportunity to see Professor Spoon and I always learn a lot of information from the panelists. Great program.

As Elliot mentioned we are going to be giving a broad overview of some of the different areas of the state securities agencies. We're going to be bouncing around on a number of topics. So if you have question, while we're on that topic, feel free to raise your hand and we'll address it at that point. I'm the investigations manager for the State of Michigan. Steve Brey is the policy specialist in the divisions, and Linda Cena manages the examination and registration area. So, We'll go ahead and get started. Standard regulator disclaimer, the views and opinions expressed today are our own and do not constitute the views of the State of Michigan, the Department of Licensing and Regulatory Affairs (LARA), or the Corporations Securities and Commercial Licensing Bureau.

I'm going to give just a brief overview of the investigation process with the State of Michigan securities. Our investigation authority stems from section 602 of the Michigan uniform securities act. It's fairly broad I think, for two reasons. One it relates to applies to all persons related to, not limited to just registrants. We do a lot of enforcement activity, investigation activities for individuals who are not registered. And then also our jurisdiction in terms of area is obviously not as broad as the SEC, but if the activity initiates in Michigan, for example the issuer raises money from Michigan or if the recipient of the offer is in Michigan we would have jurisdiction of that transaction as well. We get complaints from a variety of sources. We have a complaint form available on our website. For your information, we get a lot of complaints obviously from consumers.

Other state agencies, federal agencies, we work closely with the SEC on a number of matters. Industry representatives, and I want to highlight this area because there are a lot of industry representatives here obviously. Industry representatives are a great source of information for our office.

Because they are in the industry they recognize red flags much sooner than a lot of the investors. So they would be able to spot suspicious offerings. They may seek clients who are solicited by competitors that are not registered or offering investments that are 20% guaranteed, things they cannot compete with. So when they can bring those to our attention those are a great source for our bureau. We also receive, I guess I should say, Investigations can stem from registrant amendment filings so investment advisement representatives and securities agents have a form that is on file with our office and when they amend that document we do review those amendments to identify any disclosure that warrant review whether it is a lawsuit, and internal review with the employer we do look at that information as well.

Types of allegations we see, what you might imagine unregistered activity, omissions or misstatements of material information or offerings, or other dishonest practices of registrants. Generally when we receive a complaint the first thing the investigator will do is reach out to the consumer and interview the consumer to get all the relevant information. Once we have a good understanding of the transaction we will typically reach out to the respondent through the notice to respondent process. We will usually send out a letter with an attached copy of the complaint and that's their opportunity to give their version of the events and defend against the allegations. Once additional information is gathered and the investigator makes a recommendation that goes to the enforcement area within our bureau. If it's going to be an enforcement, or it can be an enclosed non-disciplinary at that point. I wanted to point out in the notice to respondent stage, if your representing a client who receives this document from us or you do receive the document from us, this is a really important time for that person again to tell us their side of the story, but then also under administrative actions of the Michigan Uniform Securities Act the burden to claim an exemption or exclusions from definitions are on the respondent. So this is their opportunity to lay out the exemptions and explain to us why they satisfy the exemption. Because if no exemption is raised, then we're going to assume that they are no exempt and we can proceed with the registration action at that point.

Again, if we make a determination that there has been a violation of the Act that warrants administrative action. The act has certain sections that we may utilize to pursue those administrative actions. Sections 302 and 306 those relate to product offerings and we can issue stop orders. Under section 412 that highlights our ability to take an action on a license, whether that is conditional registration, revoke a registration, do a fine, and section 604 if the activity relates to unregistered people that's primarily where we'll get our authority, that's the authority for a cease and desist order. I wanted to highlight, I'm not sure how many of you are familiar with NASAA? That's the North American Securities Administrators Association (NASAA). That's the group that represents state securities administrators, we work very closely together, we do a lot of training together, we compile information on an annual basis about the enforcement actions that are taken by the state agencies so I wanted to highlight a couple of slides from their most recent annual enforcement report. If you wanted to see their entire report it is available on their website, but some slides that I think are interesting will probably be interesting to you all.

The highest number of enforcement actions by a state agencies are against unregistered individuals and unregistered firms. And then it goes down to what types of registrations are held, but I think its interesting that the highest number is unregistered parties. And then they also highlighted they polled each state to highlight the products that are most problematic in their jurisdiction and I can affirm that these are also things that we see with the Michigan complaints as well: Ponzi schemes, real estate investments, oil and gas investments, internet fraud and affinity fraud are all common areas where we see complaints. And then one last area I wanted to touch on in regards to the investigation area because another area that we cover is the final order monitoring, so if you do have a client that enters into a final order with our bureau that it requires some sort of ongoing reporting, whether it is a conditional registration order, maybe there's been a recession offer that requires some notice filings with our agency regarding the process of that. That all goes to our final order monitoring section so if you have questions on how to comply with those requirements or how to submit the information, you can contact us. And now I'll hand it over to Steve.

Steve Brey: Thank you. I want to start off by thanking Professor Spoon, Ray Henney, staff students here at MSU Law, they put on a phenomenal program every year. I come to it every year since I was in law school here. It's really a privilege to be here and to get to speak with all of you about some of the regulatory issues going on in Michigan. I'm going to cover three areas here. Kind of give a broad overview of our rulemaking under the Michigan Uniform Securities Act, we spoke pretty in depth about that last year and some of the substance of the rules so I'll give more a procedural background on that today. Next I'll talk about the adoption of the administrative order 2016-1 which covers fairness hearings under 202(1)(i) of the Michigan Uniform Securities Act and its companion federal exemption from registration under 3810. Then I'm going to cover some of the procedural issues that go on after we issue a disciplinary order under section 412 or section 614 that Lindsay just discussed.

So starting with rulemaking, I guess last year we covered a lot more of the substance of what the proposed rules would include. At this point we've gotten that rule set and a good chunk of the way through the regulatory process. And made progress towards getting them into place, but we're not quite there yet. We did, Here's an overview that you can find on our website of the status on the rule set. At this point, you can see there's been a request filed for rulemaking. It was approved by the Office of Regulatory Reinvention. The draft rule was sent there and if you notice that was in December of 2015 and it wasn't until April that we got it approved. So a lot of the time that gets taken in this is waiting for other agencies of government to approve what it is we want to do and that can take some time. We did hold a public hearing in September which was not well attended so at this point we are working with the State Bar Business Law section and the securities regulation committee to work through some issue that they saw with it and welcoming public comment from other members of the public and members of the industry that may have input to put into it. It's a long process it takes a lot of approvals as you can see there and we'll talk a lot more about that in a moment.

Once the rules are in final form they will go to the joint committee on administrative rules or the JCAR. After we get through our comment period work with the bar iron out any issues that may exist we'll prepare a report known as the JCAR report, and that will essentially takes all the comments we receive and identifies whether or not we will accept changes reject changes and identify why it is why it is we are going to say yes or no to that change. It's a very thorough process and I think it gives the public an idea why it is what we're doing and why it is what we're doing. Once that is submitted to JCAR, they get 15 session days to object to the rules. Now session days to me are interesting so I figured that I'd pull up the senate session day calendar to identify just how many there are. It's helpful I think to look at the fact that if you were to submit a JCAR report on let's say June 3rd, it would be until November 9th until you've had your 15th session day. So, The process that you go through to try and implement the rules takes time, and it's something that I think we're very cognizant about and we'd like to get done. I know last year

Lindsay made a declaration that we would have them done in the first quarter of 2016. It is on the transcript, I reminded you there is a transcript.

Lindsay DeRoshe: Wow, I made you take that out of the slide and you still bring it up.

Steve Brey: So that being said I'm not going to commit to a date certain here or anything yet, but we are very hopeful and I know it's a priority for the department to have a rule set and a rule set that we can be proud of, that the industry can work with in, and take place ideally in 2017. I'm not going to commit to a quarter, to a month or to a day.

Lindsay DeRoshe: I will, apparently.

Steve Brey: It's on the transcript. Just saying. So our next steps moving forward. Once we get there and we have rule set that everyone can live with or at least tolerate, we'll file the JCAR report. They get 15 session days as noted to either rescind the rules, repeal the authority or stay the rule's effective date for up to one year. They would have to enter these bills into each House of Legislatures to do that to the extent that we clear JCAR without objection then they become final upon filing with the Secretary of State or another day identified by the Department in its rule set. Again, we're hopeful to have these done in 2017. So fairness hearings, this is something that we did this year that I think is pretty interesting and it's another available exemption and a tool in the toolbox for practitioners that are looking for an exemption or registration issuers that can qualify for it. It's an exemption related to securities issued for other securities or partly an exchange for other securities and partly for cash. It's frequently used in bank mergers. I know a spoke with someone I believe from Varnum earlier that was interested in looking at this. He represents banks and thinks that this is something that could really be helpful in his practice. For the millennials in the room or anyone interested in social media, the Facebook and Instagram mergers, that acquisition by Facebook of Instagram was accomplished through using 3A-10 exemption on a federal level and California's fairness hearing provisions. If you just Google Facebook fairness hearing there is a whole bunch of articles on it. That's actually pretty fascinating. It's something you see in the real world quite a bit. So what's our language? Like I said its securities in exchange for securities. So typically you're looking at mergers. and At the state level were looking at 202(1)(i) it's § MCL 451. 202(1)(i). and At the federal level it's a section 38(10) exemption so once a state body whether that's a securities commissioner or it's a court declares the terms of the transaction to be fair the SEC, assuming some other things or not will allow that to be exempt at the federal level. We had a law firm approach us in late 2015 about whether or not they could have a client do this. We said well the exemptions in the statute but we don't have any process for handling this how are we going to go about it. Our leadership was willing to go out and do this, I think it's a credit to our director Julia Dale who's out here. We got innovative in a space that allowed a transaction to happen where their attorneys said that if we can't do this the deal is going to die. And we got together, we figured out between Lindsay, Linda Cena, Kim Brightmeyer who's here, myself. We put together the order, we published it and we've held one of these hearings today. It was close to a three quarter of a billion dollar merger and it wouldn't have happened if we had not done this and again I think it's a testament to our leadership of being willing to go out do this. Ya I kind of already covered that without clicking the slide. SO ya, We've had one fairness hearing, it was approved. There are several others that have either applied or have solicited information about the application process. I wouldn't be surprised if we see a lot more of these going forward. So cease and desist orders issued by the Bureau. Lindsay kind of covered this, I want to circled back some because I get involved in this process as well. Lindsay's staff investigates the complaint and the evidence that they feel is consistent with the violation of the securities act and the file gets forwarded to me, I review it I look at Lindsay's notes, I look at the investigator's notes I look at all the evidence in the file which can sometimes be twenty pages and sometimes it can be ten bankers boxes it just, it really depends on the file. To the extent that I agree we issue an order I draft them and try to do as clear as a job for the members of the bar who are out there representing respondents to understanding what is that we are alleging I apologize if we don't do a better job but I do try. Section 604-4 provides fining authority $10000 per violation or $500,000 for multiple. Enhanced penalties exist if the recipient of the violation is sixty years of age or older or is unable to protect his or financial interests due to disability, illiteracy, or an inability to understand the agreement presented. There's pretty dire consequences for violating the act so I encourage anyone here who is not a member for the bar who proposes to engage in any kind of conduct that falls within the securities act, to hire confident securities counsel. You're welcome lawyers. So, once we issue orders what happens next? Well we require you to the extent that you want to challenge to order to file a written request for a hearing with the Bureau. We get a lot of calls from lawyers and respondents saying, okay we got it, that's not true, we want to settle this and they attempt to engage in settlement conversations with myself, with Lindsay, with Linda, members of staff. Our internal processes do not allow us to engage in those conversations. All we are going to be able to tell you is to submit the request in writing. What happens at that point is that our office through Kim Brightmeyer in the regulatory compliance division will reach out to the Department of the Attorney General and we will have an assistant attorney general appointed to represent our office in the matter. That individual will reach will reach out to the respondent's counsel, respondent, and or both and at that point we can set up discussions to settle.

I would say anecdotally, that happens way more often than not. It's very rare that we go to administrative hearings. We're willing too. We've done it. But it's not the norm. The process for doing it, every order we send out has an address on it to which you can send that request for hearing. It doesn't have to be anything special or formal. It doesn't have to have magic words. I often, tell people when they call, write it on a napkin, I don't care. Just write the file number, because it's on the order, and write-I want a hearing. At that point, the process can really get started, and we can engage in settlement discussions and to the extent that we are not able to do that, we will go to a hearing. Section 412 includes orders on registrants and applicants, so to the extent that someone files an application for registration in the State of Michigan as an agent or an investment advisor representative, and they have a securities fraud conviction in the last 3 years, chances are we don't want them to be a member of the industry in our state or soliciting investors in our state, so we tend to deny that. 412 gives us the authority to do that.

If you look at section 412, there's section 412(1), (2), and (3). Section (1) allows us to take actions on applicants. Section (2) on registrants. Section (3) provides fining authority. And, Section (4) identifies a list of (a) through (n) of circumstances that can exist that allow the administrator to issue an order under (1) through (3) if that makes any sense. We've been doing orders that way for quite awhile and trying to create an environment in Michigan where if things are minor or they don't merit an order under 412, we won't issue it. Or, as someone can probably operate within in the state, but maybe they need some heightened supervision for some reason, we'll do conditional registration orders. And just because you do have something that might trigger 412(4), it doesn't necessarily mean that you need to be kept out because there's also a public interest requirement. That can sometimes include doing a conditional registration. Doing a heightened supervision. Doing something that allows you to continue. One thing we started doing recently, I think it's a big testament to Lindsay for pushing, and again Julia for being willing to do something the bureau hasn't done in the past is posting our orders on our website. Before we hadn't done that. So, if we issued an order, it was out there. The respondent would get it, but it wouldn't necessarily be public knowledge. And I think for an investor protection and perspective it's good. If Joe Schmoe offers you this great investment and he's gotten an order outstanding on him. If you go google Joe Schmoe, that pdf is going to come up it's going to tell you- whoa, maybe I shouldn't give him the money. So, the fact that we're doing this, I think is a great service to the public. And again, it's a great testament to Lindsay for pushing for it.

Lindsay DeRoshe: And I think the other advantage too is for the defense counsel. We also post the consent orders. So, if the action is a result through a consent order, the defendant's counsel can go out there and see what's been resolved in the past. I think it's a good indication of where we might land in settlement terms.

Steven Bray: One of things I would note is that link is terribly unfriendly. So, if you were just like- oh yeah, I'm gonna go check out the orders that LARA issued, it's not very helpful. So, I did some screen shots of how you can get there just going to www.michigan.gov/securities which is much more memorable. If you go there and you see the green arrow that says "disciplinary action reports," then you go to "securities reports," it will bring you to an alphabetical list of all the orders that the bureau's issued. Well, at least that we've issued since we started posting on the website. We didn't do this retroactively due to the expense that would go into it and also the sheer time and effort, but it is a helpful to have and Linda and I went up to the U.P. and did some capital raising seminars, and I talked about this a little bit, and I told the small businesses prospective securities issuers- go look at them. Go look at what other people have done wrong because it's out there. And, it's easy to make a mistake. And, it doesn't have to happen. I think it's a valuable resource for investors for potential issuers, for members of the bar, and something I am happy to see us having on the website. That being said, I will hand it over to Linda.

Linda Cena: Before I start, Steven just went through a tremendous amount of information. Does anyone have questions? No?

Steven Bray: Sorry, I talk fast.

Linda Cena: No, That's okay. So, we're all going to be available, actually you're leaving shortly, but we'll be available to answer any questions that you have if you don't feel comfortable asking them in front of the group. So, my name is Linda Cena and I am happy to speak last. I would like to cover a little bit about what we have been doing this past year on the outreach side. We heard this morning about all the different types of ways you can raise money. From Reg A+ to the Reg Ds to the 506(c)s. All these different things. And, you can only begin to imagine the calls that we get at the state. I can think of one in particular was a young woman who called and said- I am starting two businesses. One is a personal business, and then I'm starting a Chamber of Commerce for a particular type of ethnic background. And, she said, people have been giving me money. And, I'm raising money. And, I'm starting these businesses. And she goes, I explained to my dad over dinner last night what I was doing. And, he said, have you talked to the securities division at the state. Have you looked into anything? She had no clue what she was doing might be wrong. And, she called me and said- what do I do? And of course, my response is very similar to most of us will say- you really need to hire a securities attorney. Securities law is very complicated and you're not just starting one business, you're starting two. And, they're two completely different types. And she said, I can't afford a securities attorney. She goes- what can I do to learn about how to start a business because I'm putting all my money into my business. I don't have the money to hire an attorney to help me at this point. And that's when we sat down with leadership. And, I'll echo what they said about LARA leadership being very wonderful to work with on this issue. So, we came up with the idea of let's put together some seminars, and let's do a roadshow. And, that's when we came up with the roadshow for understanding your options for raising capital. And, we had a lot of partners that we worked with in this and they were very helpful. And, probably one of the most important ones that helped us would be the state bar. The attorneys, they gave up their time to come out and speak at these seminars. Our attorneys, as the young woman said on the phone- I can't afford an attorney, but watching these people, go up to these attorneys after they spoke and talk to them was priceless. So, it was an excellent thing to see. We did four seminars in the Lower Peninsula. And we did, yes, we did a road trip through the U.P. We had four seminars in the Upper Peninsula, and I listed all the speakers that donated their time, and there's several of them here today. So, I want to tell you it was great. It was just wonderful to see. And it was wonderful, the reviews that we got after we did this roadshow, is I can't believe, I can't believe the state is actually doing this. This is something we would spend thousands of dollars on for this type of training if it was offered through someone else. And, you gave it for free. So, thank you to everyone that participated in those roadshows. It was great. So, as a result, it's never quite done.

We did the roadshows and it was excellent. Very well attended, as you could image. So then, we had the idea that could we put this in a webinar version so that the people that could not attend the seminars could actually see them and hear them. And so, that's when we put together the webinar series. So just when the attorneys thought they were done volunteering their time with us, we called them again and said- are you willing to volunteer one more time? And, we picked six of our main topics that were probably the hottest topics that we had in the seminar series. And these are now available. I'll go back, just so you can see. If you go to that link again, go to Michigan.gov/securities, and skip all the rest of the stuff, as Steven said, and go right there to investor education and you'll see our webinars. So, we put together six webinars. These are available on the website. They are outstanding. I can't think of the word Steven used the first time he listened to them. We've been getting the reviews- love, love, love. We've been getting reviews… we actually have a different law school here that's been using it in their programs for their students to watch. We have law firms that I have heard from that are using it for newer attorneys that are coming on board. We've heard from accountants that are using it. They're really being used, and we're very excited to have that. The first one that we have out there is "crowdfunding." And, that was done by Shane Hanson and Rick McDonald. And, that was excellent. It will take what you heard this morning in your session and expand it in detail. Shane does an excellent job, and Rick, of covering both the state and federal crowd funding. And, speaking of crowdfunding, I thought it was interesting the numbers this morning. We have had in the last year, five state crowdfunding filings. So, it is not taking off, but what I do credit crowdfunding for, is it has made more local businesses aware that there are ways to raise money. I think it has broadened their... I think they look at crowdfunding and they start looking into it, and then they see other things they can do, and I think it has really helped them with that. So I think that crowdfunding has been really important in helping new businesses start. They just may not use the crowdfunding.

Steven Bray: I would echo what Linda is saying on that too. It gets people in the door and makes them aware of the fact that securities laws exist and crowdfunding gets a lot of news and gets people to go speak to an attorney. At least look up the fact that there are laws related to issuing investments in your company and just getting them in the door and looking at whether there is something else available out there which is entirely possible. It's pretty invaluable, so I would credit crowdfunding for that quite a bit too.

Linda Cena: Absolutely. And then, our second webinar was on Reg D. Craig Habit, I believe he's still here, was part of that. And, he did an excellent job on that. We have had, I just thought I would share the numbers with you. We've had 1,500 Reg. D filings in the past year. And, very few of the Cs, as we talked about earlier. A little program we do, just in case you're not aware of it, and you might get a letter because sometimes firms call us panicking. If we run a report, every month on all 504 and 505 filings that come into Michigan and we send them a letter that asks them what exemption they're relying on at the state level because not everyone realizes that 504 and 505 is the federal exemption, but we don't have a corresponding state-level exemption. And, we don't do it to go after them. We do it before they're even, hopefully, even out there selling. And, I can think of five or six, off the top of my head, of firms that called and said "oops, we forgot about the state side of the offering." And then, they start searching and they'll find some kind of exemption they can use at the state level, so if you get one of those letters, I know that we had one, there was an attorney that called and said "how did you even know we were doing this?" Because they didn't know that we ran the report. So, that's more to help the new companies that are starting out to try to keep them online.

We had Reg A+. Michael and James Carey did that. That's an excellent presentation going into a lot of the components of the Reg A+ offering. We had seventeen Reg A+s this year. Compared to, I believe, one or two the year before. It is really, we're getting a lot of calls. And as you can see, we had a lot more Reg A+s than we did crowdfundings. So we're seeing the Reg A+ start to grow and we're getting a lot more communication from people who are thinking about using that. The next one we had was called *Legal and Structural Basics*. If anyone is trying to learn how to start a company, what to do, what are the basics, it's a great presentation by Jeffery Labine from Miller. He covers whether you should do a C Corp or an S Corp. It's what you should do before you even walk in the door to see your attorney. And, it is a great presentation. Recommend that one. *Funding Your New Company* was fun as you can see we had Angels, we had ventures, we had a broker/dealer. And, we had Michael Gibson from Kerr-Russel, who monitored that, and it was great to hear all the different ways that new companies can get funded and what you want done before you go to that level. Great webinar. And last, but not least, was a fun one—*How to Stay out of Trouble* by Ray. Ray Henney did a great job with that on explaining to people what not to do so that you don't get in trouble. So, highly recommend the webinars if you have any, we always make fun of ourselves, any interest in learning this area because we're all sort of security nuts here, but we can make fun of ourselves, don't we? Things that some people don't find interesting, we find thoroughly intriguing. But, if you would like to learn about that, I would recommend checking out the webinars.

Lastly, for another outreach, we did something called *Senior Safe*. We had some talks this morning. I heard people talking about senior issues. We know that the registrants, the broker/dealers, the investment advisors firms are the ones that see clients on a regular basis. And they've seen them sometimes for 20 or 30 years. They've been their clients. They may note things they may see changes in their behavior. They may see things that other people don't see because they've been working with them for so many years. So, we put together a training. And, we had broker/dealers there. We had compliance officers there. We had SEC firms. We had state firms. We had registered investment advisors from, as I said, from both SEC and state. It was a great turnout. We had probably seventy-five people at our first one. And we had, the SEC came in and spoke. We had our opening speaker was a prosecuting attorney that gave some really good tips on what to look for. The Securities and Exchange Commission was there. We had the Adult Protective Services, and, after listening to their presentation, I would never want their job. We had the Aucks on Aging. We had the 60 Plus. We had an elder law clinic come in. We are going to continue this. It was very well received. We're going to do another one on December 8th in Troy. So, the compliance officers that came, there were many from some of the large firms in Michigan, and they said they are immediately going to go back and run this program for their staff. So, we gave them, they had binders, they had material, they had everything they would need to go back and work with all their brokers, or all their investment advisor reps and run these senior safe programs and teaching their reps how and what to look for. So, it was a very informative.

Audience Member: You have a notice on your website, I would very much be interested in attending.

Linda Cena: Oh excellent.

Audience Member: Of when you might have, or, just details about what time and where at.

Linda Cena: Yes, if you go to our website, if it's not there it will be there shortly. You'll see on that same website, we talked about www.michigan.gov/securities. If you look down, you'll see that we have the investor education there. You can look at it there.

Steven Bray: I will also note that this has been a pretty broad national and international effort from the last year or so from the North American Securities Administrator Association (NASAA). If you go to www.serveourseniors.org, there's a boatload of information that NASAA compiled and put together that is state specific across the country.

Linda Cena: We did ours the first week of October, and there were eighteen others states that did one that same week. So, it's a real joined effort with the other states. Okay, we have probably two minutes left, and I don't have a slide for this, but I did want to give you a two-minute review of our exam program before we close out.

The exam program is going robustly right now, I would say. We have both investment adviser exams that we're doing in the broker/dealer branch offices. Currently, let's give numbers because I saw that the SEC gave numbers earlier. Security agents, we have 164,000 licensed in Michigan. Broker/dealers—1,773. IARs—12,550. IAs—583. And, of course, the IARs, keep in mind they would be both with state firms as well as a SEC firm would also have to also have to register their IARs. If they fall within our definition. We have six examiners. I will point out, Jason Jurtege. Jason, wave. Our examiners have been with us for years, so they are very experienced. Most of them are either accountants or attorneys. And, they have a lot of background in the securities industry.

When we got ready to embark this year on something new which was a branch office, a more in depth branch office exam program, we again reached out for some help. And, I know, Larry Alcus is here. We thank him for coming in and talking. And I know Dean and Dawn came from Warner-Nacross and spoke. Our goal is when we go into a firm that we know as much or more than the firm so that we don't have to have any hand-holding when we're in there. I spent twenty years in industry before I came to be a regulator. One of the worst things was when the examiner came in and I had to spend the first day helping them along. So, our goal is that our examiners are trained, and they're ready to go. And usually the reviews we get back, and the comments and notes I get back from the registrants are "thank you, thank you, thank you." You're examiner was wonderful. He taught me a lot, or she taught me a lot, it was a very helpful experience. So, as I say, we have six examiners, and they currently right now have averaged about forty exams so far this year. So, we get out on quite a few and we're very excited. I think right now, we're... I mean, there's no one we haven't examined unless your brand new. So, we do a cycle. It could be anywhere between three to five years depending on the risk level of your firm.

So, I don't really have anything else. Do you have any questions for me on the exam program? Or anything we discussed. Excellent, then with one minute to spare.

Professor Spoon: Let's thank the panel. . . . Before the next panel appears, we have a special presentation that Ray is going to do.

Raymond Henney: Thank you. Joanna would you like to come up here? So, Hongiman every year does a securities law writing competition, and it was established to create interest in securities law among law students and to promote knowledge and scholarship of the securities laws. The competition is open to all students of Michigan based law schools, and the winner receives a $1,500 cash prize.

We're proud to announce that this year's winner is Joanna Howard, a 3L from the University of Michigan. Joannna article is entitled *Constitutional Challenges to SECs Administrative Law Judges*, which is really a cutting edge topic. Joanna, congratulations. Thank you so much.

The competition will be open again next year. Submissions are due on July 15th; I'm sorry June 15th. It's open to any law student Michigan based, and it can be an article that you're going to have published or submitted for publications. Joanna's is going to be published in one of the Michigan Law Reviews. So, we encourage here to think about maybe submitting for next year. Thanks Joanna.

Panel 5: SEC Enforcement Update

Raymond Henney: Well, Joanna's the perfect introduction to our next panel, which is SEC Enforcement. Part of the discussion is about the administrative law proceedings and administrative courts. Gentlemen, you may want to come up. We have a great panel this afternoon. In fact, if you've been at this seminar before, a somewhat infamous panel, and I'll explain why it's infamous in a minute.

First, we have, in the center, John Birkenheier, who is an enforcement attorney of the Chicago office of the SEC. To his right, on your left, is David VanHavermaat who is in the Los Angeles regional offices, an enforcement attorney. And then, the more notorious is my partner, Richard Zuckerman, who is a practitioner frequently in front of the SEC and represents individuals in front of the commission in criminal matters.

David Van Havermat: Here, on behalf of John and I, are our views, and not the views of the commission or its staff, and they will disavow any knowledge that we were even here. Leading into the discussion of administrative proceedings, the big development has been changes in the rules that govern the administrative proceedings. And, the commission has revised its rules periodically. It was basically time to do it last year. They haven't been revised since 1995. And, the rule amendments were designed to provide greater flexibility to participants and to the administrative law judges (ALJs) but still maintaining the ability to resolve matters equitably and fairly. If you were here last year, you probably heard me talk about things like- there are no depositions in an administrative proceedings, and the hearings take place very quickly, four months after the order is served. Both those have actually changed, and there are some other changes I'm going to go through as well.

The timing is probably one of the more important changes that has occurred. In the past, what would typically happen is an administrative proceeding would be set by the commission in terms of when the initial decision had to be issued by the administrative law judge. It was a period of either 120, 210, or most cases of contested proceedings, 300 days. And, that was the deadline for the ALJ to actually issue an opinion. That meant preparing for the hearing, conducting the hearing, the post hearing briefing, and then taking a couple of months, at least, for the administrative law judge and his/her staff to issue an opinion. That meant, that even if you had a 300-day period, your hearing wasn't going to go nine months after you're served with the administrative order. It was typically going to go within four months. It was a very compressed schedule. The rule changes now make that more flexible. From the time of service, the initial decision is now governed by the time of all post hearing briefing is completed. So, instead of having to be issued within

300 days of the commencement of the action, it is solely dependent on the conclusion of the post hearing briefing.

The administrative law judges are granted some flexibility and largely the trick is dependent upon the complexity of the action as to when the hearing takes place. For what would be the bulk of the cases that would be of interest, again, that would be a 120-day period after the briefing. The administrative law judge has the flexibility to conduct the hearing between four and ten months after service of the order instituting proceedings. There's also more flexibility for administrative law judges to obtain extensions from the commission. The ALJ that is working on the matter can essentially, as a matter of right, now file a document with the commission to get an extra 30 days. The chief ALJ can seek additional time for matter that warrant it for because of complexity or other reasons. One of the principal reasons, I believe, for the extension in time, particularly in these 300-day proceedings is that the rules now allow depositions in administrative proceedings. Previously, although there was a provision, it was rarely, if ever, used. There were allowances made for witnesses that were unavailable, due to illness, imprisonment, things of that nature. But now, the rules do allow, again in these... the more complex matters only, these 120-day proceedings for a limited number of depositions to be taken by each side. And, that's an important distinction to note is the depositions that are allowed, it's not per respondent. So, if you have three respondents in the matter, there're not all allowed to take the prescribed number of depositions. It's per side. So, the way it's set up is if it's an administrative proceeding with one respondent, the sides are allowed to take three depositions each. And, then can apply to the administrative law judge for up to two more. If there are two or more respondents, the sides are each allowed to take five depositions and can apply for up to two more. The process for seeking those two additional depositions is filing a motion. It has to be done no later than, I believe, 90 days before the hearing is scheduled to take place. It's a very abbreviated schedule and very abbreviated brief. It's limited to seven pages. Seven page opposition. No replies. It's a very stream-lined process because they don't want to delay their proceedings. I think what is yet to be determined is how frequently these will be allowed because these rules just went into place it was what, September 27th, something like that.

So, they've only been in existence for a matter of weeks now so we don't have a whole lot of guidance on it. But in order to get these additional depositions a side would need to show compelling need and that could be perhaps done through things like an unusually complex matter, a large number of experts, new theories that are developed through the course of the proceeding that haven't been anticipated and things of that nature. The depositions are limited to fact, expert, and documents, custodian witnesses, there is no provision for anything like the 30(b)(6) person most knowledgeable, importantly for us there is no provision to depose witnesses whose only knowledge of the matter comes through investigating or litigating the case. So if you're going to try to depose John or I you're probably going to be out of luck.

Richard Zuckerman: I heard that but I don't believe it.

David Van Havermaat: Well you're welcome to try it.

Richard Zuckerman: I'll put this in context in a second.

David Van Havermaat: There is some guidance in the authorize and release to these new rules that has language to the effect that the commission thinks the situations where these additional depositions will be needed will be relatively rare, so it is something that we will discover over the course of the next months and years how likely these additional depositions are to be granted. And to put it in context, the commission . . . you know one of the things you might be thinking is, well wait a second, in federal court I get at least ten depositions I can probably get more if I need to, isn't that a disadvantage. And the commission's view on that is, and again this is through the adopt and release, is that these depositions aren't designed to create the records, they're designed to supplement the record, because again what you have in the situation of administrative proceeding, the investigative staff has conducted an investigation where they likely have testimony has documents and one of the great protections to respondents to administrative proceedings is that within seven days of instituting the proceedings the division's required to turn over all of its non-privileged documents that are received from third parties, all its testimony transcripts, all of its exhibits. So there is already a record there and it's not something that's just in possession of the division once this is instituted. A couple of other provisions that are noteworthy, the new rule 220c deals with answers to the order instituting proceedings. In the past respondents have been required to state in their answer whether they will be asserting any affirmative defense such as statute of limitations, res judicata. The rules now have been amended to include what's called any avoidance or affirmative defense based on reliance of counsel, accountants, auditors, or other professionals. And in the adopt and release, the commission's made clear, I believe, that this is not meant to include only the discrete categories where reliance on counsel is claimed as an affirmative defense where you satisfy all the factors of full disclosure to counsel asked for advice, got specific advice that what you were planning on doing is legal, but also very likely to encompass the categories of cases where there is reliance on presence of counsel or reliance on other professionals to perhaps affect a respondent's scienter or anything else that's relevant to the proceedings. Summary disposition motions are something else that's new. In the past there has been, or there had been, a provision that sometimes would allow for summary disposition motions with the approval of the administrative law judge. Those were generally disfavored unless it was a purely legal issue. The commission's view has been that if there is a contested proceeding it makes sense to put witnesses on the stand, to judge their creditability, and things of that nature so the administrative law judge can make the determination.

Now there are three types of motions, the first is the motion on the pleadings, which can be filed fourteen days after a party has answered. That's essentially the same as a motion to dismiss in federal court. It's the argument that even assuming all the facts and allegations are true and even drawing all inferences against the moving party, which will in most cases I'm guessing be the respondent, that the respondent is still entitled to dismissal of the case as a matter of right. Those will, I think, very rarely be granted, but I think I would expect a large number of them to be filed, for this reason. When an administrative proceeding is instituted, the document that goes before the administrative law judge is the division's order that sets out all the allegations. Now that were going to have a longer time, up to ten months, between the time of service of the order and the hearing, if I'm a respondent, I'm going to want to get something in front of my judge to say "your honor what the SEC divisions enforcement put out there is not the whole story, there's a lot more to it." The motion for the judgment on the pleadings is not limited to the seven pages that I described for the additional deposition motions. Thirty-five pages plus the fifteen page reply so I can also foresee a lot of situations where respondent's counsel is anticipating that they will need to seek additional depositions, don't want to rely on their seven pages that they're going to get to do so, and want to tee that up early on with the administrative law judge.

There's also revised provisions for motions for summary disposition, there is a good cause standard that the commission has said in its adopt and release that granting motions for summary disposition will be comparatively rare. And that does require leave of the administrative law judge to file. And then finally, there's a motion for ruling on the law, ruling as a matter of law after the division's case in chief, again I think that that will be a very rare case where the division has put on its case, the respondent makes a motion to the ALJ that their entitled to essentially a directed verdict and I think that the commission has said as much, that it'll be a very rare situation where that will happen. Finally evidentiary issues. In the past the ALJ's treatment of hearsay has been essentially to let, in most cases, everything in, but if there is hearsay or other evidence that doesn't bear indicia of reliability, to give it very little or no weight. Or at least that's the perception. I can't speak for the administrative law judges, but at least that's the perception that has been out on the street. But, in the revised rules it specifically states that hearsay can be admissible if there are sufficient indicia of reliability.

There are other provisions that try and bring the rules more in line with the Federal Rules of Civil Procedure, specifically governing expert witnesses. The requirements that are of what's to be included in expert witness reports and things of that nature and the non-discoverability of draft reports to experts similar of what's in Rule 26. That's a nutshell of the amendments to the proceedings. Again I think the intent here was to make it more flexible for all parties involved. But the commission does still have a desire to have a forum where the division can go and seek relief faster than we would be able to do in district court.

David Van Havermaat: So Richard this solves the problem right? You're perfectly happy with all these new rules aren't you?

Richard Zuckerman: I'm always happy with what the SEC does, as well as the DOJ.

David Van Havermaat: Thank you.

Richard Zuckerman: You're welcome. That's the best you'll hear today. So let me put this in context for you so as to why the SEC woke up one day and decided to be so charitable. Before 2010 nobody cared about ALJ proceedings, essentially. In 2010, in Dodd Frank, Dodd Frank instituted, I think it's 929 capital P small a (929Pa). A section which said, okay ALJ proceedings will be the same as a proceeding in the federal district court. And the SEC will go either way it wants to go. The main distinction between, there are two distinctions, between the ALJ proceeding and the federal district court. One is the limitations on discovery before the changes were made that John talked about. And the other was that you don't get a jury trial in front of an ALJ, but you do get a jury trial in federal district court. And so as Dave, or as John and I were talking before the talk, some bright light somewhere decided that ALJ . . .the whole ALJ issues was ripe for litigation. And so there was a tremendous amount of litigation involving whether or not an ALJ proceeding is constitutional and I think we're going to get into that somewhat? Or not?

David Van Havermaat: Yes.

Richard Zuckerman: Okay, so there were lawsuits in most of the major circuits. Not in the Sixth Circuit. About whether or not, and we'll get into the weeds about what the various people alleged, and I think that if you step back and looked at the arguments they were . . . you know the briefs were ninety pages long and there were amicus all over the place, but I think you could say that they were losers and the SEC was going to win anyways although they would have to slug it out. But the government reacts differently. The losses brought to the attention of the public what was perceived to be an unfair proceeding. And so even though the government may win in front of the judge I think, because I have experience with this from the DOJ, sometimes the government says "you know we better fix this" because the worse thing is not winning, the worse thing is having Congress intervene. And we don't want congress to come in and start legislating a whole bunch of stuff and because their being lobbied to do so you know by the ABA and these other types of advocacy groups. And so what we're going to do is we're going to tinker a little bit to make it appear more fair and maybe that will settle everybody down and maybe Congress or somebody who is lobbying behind our back will now have no one to talk to because congress will say well the SEC has fixed this and go away. So you now have a better proceeding. It's not like trying a case in federal district court, but its better. And if you do any kind of work in this area you have to understand as John has, I'm sorry I keep saying John, as Dave has said, you got to understand the various things you can do and get away with in the ALJ proceeding versus the, you know, the much better forum of federal district court.

The question of course is, which they won't answer, is where did they decide to go? The cases that you read about that are ALJ cases are not minor cases. They have involved significant industries, they involved in one, in several cases high visibility people, big companies, and so I don't know if they go . . . how they pick to go one place or another and I'm sure they'll tell us in a second. It doesn't seem to be rooted in either the amount of money or the industry or the person, to me it's kind of all over the field. So I think that's the context in which all these nice things were done. To me they were done to prevent congress from legislating because there's a lot of heat being raised in the various courts across the country.

David Van Havermaat: Well let me just address that a couple ways. First administrative proceedings are not new at all. You may have heard the insider trading case *Dirks* which is actually going to be . . . it's very relevant to something John is going to speak on in a few minutes which is insider trading development. That actually arose first as an administrative proceeding, so it's not a new development. Yes, Richard's right that there have been changes in the law in 2010. Congress gave the Commission the authority, and I think that this is the primary driver of why more proceedings did go in administrative proceedings as opposed to district court, gave the Commission the ability to seek penalties against non-registered persons in the administrative proceeding forum. So the driving force behind this isn't because we decided oh we have a great home field advantage or something like that it was because a change in the law. Speaking to the perception of unfairness I will tell you that, yes there have . . . for a while there was an increase in the number of cases going to the administrative proceeding forum largely because of the Dodd Frank Act changes. Our more difficult cases are usually brought in federal court these days. There are factors that the commission has set forth as to what we will look at to determine what forum is appropriate, but those factors are very fact dependent. Things like the availably of desired claims, for example if you have a case with a relief defendant you have to go to federal court because there is no provision in administrative proceedings for that. Whereas if you're seeking control personal liability, that has to be done through an administrative proceeding because that's not going to be taken care of in a district court. Whether one of the parties is a registered entity. That's historically been the purview of the administrative proceedings and also costs and time effectiveness. One of the things that we will frequently have is a situation where we bring a case in district court against an individual, he's found liable, and one of the missions of the Commission is to protect investors and one of the things that the Commission likes to do in that situation is make sure that the individual who's been found liable for federal securities law violations in district court isn't back out there working as a broker-dealer or associated with an investment advisor. District court can't do that, so we have to go into the administrative proceeding forum and get what's called a follow on administrative proceeding that frequently involves a lot more briefing, a lot more time to essentially re-litigate what was litigated in federal court. So part of the rationale is, are we going to conserve efforts and conserve resources by instituting something as an administrative proceeding and not in district court?

And finally on the fairness issue, I will say that the record historically, I think there's this perception out that that the SEC has, the division has this great home field advantage in APs. The numbers just don't bear that out. Last year we had actually a perfect record in trials in district court whereas in administrative proceedings it was good, but it wasn't perfect. And if you look historically and include summary judgment motions, both forums, both for a, I think you'll find that roughly 80% of the cases that the Commission has brought or the division has brought as APs have resulted in favorable outcomes. So to the extent that there's this perception out there that we choose APs because it's a home field advantage, that's simply not the case. The reason we've identified and because we have administrative law judges that are well-versed in these issues, obviously federal district court judges, we have nothing but the greatest respect for, but you have an ALJ who knows the particular jargon of an industry or has seen a number of similar cases before there are reasons that might make sense to bring it thought that forum than through a district court.

Raymond Henney: Richard, could you just briefly touch upon the challenges to the forum and insider trading in John's presentation

Richard Zuckerman: Do you want me to talk about ALJ challenges now?

Raymond Henney: Right.

Richard Zuckerman: This can't be brief. The . . .

Raymond Henney: Come on Richard you can do it. Come on Richard, go ahead.

Richard Zuckerman: Alright. Well, if you want to see a pretty good baseline case, about the challenges to the ALJ proceeding itself, there's a case called *Bebo* out of the Seventh Circuit. How the SEC was to conduct ALJ proceedings and it's a really good case for the SEC because it raised all of these preliminary challenges that we shall talk about briefly and Bebo lost, went to the Supreme Court cert denied. So the preliminary challenges seem to be moot. Just as an aside on the substantive challenges where the merits got actually litigated, they won in the D.C. Circuit so I think this hoop-de-do is probably dead and buried unless the Supreme Court wakes up one day and wants to tinker, in some respects it isn't really clear. *Bebo* was trying to get, it's a her, she was trying to derail the proceedings before they got started. So what she did is she sought in the district court to enjoin the SEC from proceeding with an ALJ proceeding because it was unconstitutional in a variety of ways.

I think she raised a Due Process challenge, an Equal Protection challenge, a Take Care Clause challenge, an Appointments Clause challenge. I'll try to highlight those in a second. But that court decided that because, even prior to the amendments they were talking about, because Congress had legislated a fairly detailed procedural scheme as to how the SEC was to conduct ALJ proceedings and gave the loser a right to appeal albeit to a court of appeal, not a district court. The courts concluded that in essence that congress had preempted any other avenue from which you could, in which you could, challenge or do what the ALJ wanted to do. In other words, she said you can't do this to me I got to go to district court and have a jury trial. The court said no. Congress has decided that ALJ proceedings are run a certain way and they've given you a right to appeal, it's a very detailed scheme, and I think they language they used is "fairly discernible intent" by Congress to make you go this route even though the SEC has the unfettered right to have initiated a suit in the district court.

So basically, what was decided in *Bebo* is that you can't derail this upfront. You've got to go through it, if you lose then you can raise all of these challenges on appeal to the court of appeals, in this case the Seventh Circuit. So what are the challenges? Well, the ALJ's are unconstitutionally appointed because they violate the Appointments Clause. The Appointments Clause is part of the Constitution and it says that if you are an Inferior Officer of the United States, then you can only be one step away from the President who has the unfettered right to remove you. So if you are an Inferior Officer and you are an ALJ working for the SEC, then in order to be duly appointed you had to be appointed by the Commission. And ALJ's were not appointed by the Commission. They're appointed through the civil service bureaucracy, although every ALJ is probably across all of the ALJ's that exist pursuant to the APA, are probably all appointed the same way. Then she argued that these people were Inferior Officers because of all the power they had. Although they're not labeled an Inferior Officer they are in substance and therefore their appointments are unconstitutional, why should I, Ms. Bebo, have to go through all of this unconstitutional proceeding? Please enjoin the proceeding.

The other argument or one of the arguments she raised was an Equal Protection Clause argument, which . . . I mean you take labels and attach them to facts and sometimes it's like a square peg in a round hole. The SECs unfettered right to decide whether I go to the ALJ or I go to district court and exercise my Seventh Amendment right to a jury trial, I'm not being equally protected. So therefore this is an unconstitutional proceeding on that basis alone and therefore you should enjoin that. There's some other crazy stuff here that she raised, but around the country where you have these challenges to the proceeding itself, and she tried to cast it in terms of not a procedural deficiency, but a structural one. If you Shepardize structural deficiency it usually comes up in the context of a criminal case, you know where the judge doesn't allow you to pick jurors or something like that. By using the words structural deficiency she was trying to get the courts to decide that if you have a structural deficiency as opposed to a procedural one then you shouldn't be forced to go to the proceeding at all. But she lost. And then she lost in the Seventh Circuit and the Supreme Court denied cert. So one could assume from that that if anybody raises these arguments, these upfront arguments, you know the SEC will just point to *Bebo* and say they lost, the Supreme Court didn't want to hear it. Now what the court did was it didn't decide anything other than—I don't have jurisdiction to hear a challenge like this to derail the proceeding because the Congress has legislated this fairly detailed scheme, this is what Congress wanted to do and the proper place to handle this is not upfront. The proper place to handle this is if you lose, then you can appeal. And then somebody, some court of appeals might buy your argument, I, the district court and the Seventh Circuit, am not going to . . . I'm just going to rule I don't have jurisdiction because, not his words mine, I've been preempted. You have no right in the district court, Congress says do not put the district court into this process at all, it's the ALJ, it's the court of appeals, and it's the Supreme Court, I'm not in it, Congress has been very clear about that to me—good-bye. And so they lost. If you go to the backend, where the court decided well is it unconstitutional? Are they Inferior Officers? Is there an Equal Protection argument? There is a very thorough case in the District of Columbia Circuit which says, you know, no, this is okay. And the SEC will cite that. And so you have this ramp-up of litigation all across the country. You have cases are still out there, but to me it's that it was an issue *de jour* by the way. And whoever thought of it created a lot of legal fees. So God bless him.

Raymond Henney: With that positive note, we'll switch to insider trading, John you want to tackle that subject?

John Birkenheier: Yeah, well, sure.

Raymond Henney: There is such a thing?

John Birkenheier: There is. You have to read very carefully in case law, there is. You know, this is one of those issues where for the purposes of this program that if you come every year you'll see that the law developed very slowly with regard to important issues and the issue in particular here right now is—what exactly is a personal benefit or the type of personal benefit required to satisfy the element, establish a liability for a tipper in insider trading? To sort of review where we had been in the past, *Dirks* back in the early 80s, said that there's no violation by a tipper unless the tipper discloses the corporate information, or the principal's information, for a personal benefit as opposed to for a corporate purpose. In saying that, the court in *Dirks* said. . . gave examples. They said that personal benefit could be a *quid pro quo* or, and that word "or" is very important it turns out, or a personal relationship, such as giving a gift of the information to a friend or a relative.

So the law pretty much followed that and was fairly flexible about what was needed to satisfy that personal benefit requirement until 2014 when in *United States v. Newman,* the Second Circuit held that the personal benefit really had to be a concrete pecuniary benefit. Even in a case where the information was tipped to a friend or a relative, there had to be either an immediate pecuniary benefit or an expectation of a pecuniary benefit. That sort of, you know, set the securities enforcement world on end because a lot of people viewed that as being a significant narrowing, if not almost a, reversal is the wrong word, but a reversal for a lack of a better term, I mean of *Dirks* rather. After *Newman*, two circuit courts disagreed. The Ninth Circuit in *U.S. v. Salman*, and just this past spring I think, the First Circuit in *U.S. v. McPhail*, both declined to follow *Newman*. They said *Dirks* said what it said and meant what it said and *Newman* either didn't mean to go so far to say that a gift of information to a relative or a friend was not a sufficient personal benefit or if that's what the Second Circuit means, we respectfully disagree with them.

Incidentally, those of you, I'm sure some of you are familiar with *Salman*, but some of you who aren't, just a quirk in the way the judges when they take senior status get to pick the cases that they are assigned to, the opinion of the Ninth Circuit in *US v. Salman* was written by the District Judge from New York, Rakoff, who had been, who was sitting by designation in the Ninth Circuit. So I guess he was telling his bosses that they were wrong, although he did it politely. The *Salman* case was a classic relative tipping case. There was an insider with an investment bank, a brother to whom he tipped the information, and then a third fella who was well-known to both of the brothers and in fact, the tipper sort of on a parallel path coincidentally married the second tippee's sister, so they were brothers-in-law during the course of all of this. Just to complicate the facts. But the, you know, the arguments that the defense raised that following *Newman* that the tipper did not get any pecuniary benefit whatsoever from tipping his brother, let alone from his brother's tipping the third fella and the brother and the third fella both traded. The government argued, "look you know, you give a gift to a friend that's just like doing the trading yourself and giving the proceeds to the relative." The Supreme Court—cert petitions were filed by the government and Newman and by *Salman*, the defendant in that case. The Supreme Court did not grant cert in *Newman*; it did in *Salman*. There were heavy briefing by the whole world of amicus curie, including all of the industry groups you'd expect and Occupy the SEC didn't know that they filed amicus briefs, but their amicus brief was actually pretty good. And then in the meantime, *McPhail* came out, as I mentioned earlier. Oral arguments were held before the Supreme Court about two and a half weeks ago on the fifth, so I would expect a decision sometime in the next three or four months.

Richard Zuckerman: If you read the transcript of the oral argument, Ms. Shapiro who is advocating on behalf of the petitioner, got clobbered. Her argument was basically, "insider trading is not *per se* literally a violation of the securities law." She can't find that it showed beyond a, you know, you cannot insider trade, it's euchred into the securities laws through the 10b statute as some kind of fraud on the market place. But, the argument that if an insider discloses confidential information to someone, I hate to take the SEC's point, but the argument that an if insider discloses confidential information to someone, and that person trades on it, that it is not cognizable. It seems peculiar if, in order to be cognizable, the tippee has to somehow reward directly and tangibly the tipper. It just doesn't make any sense. If you read the transcripts, I was curious as to why the government didn't actually argue for strict liability.

If you read out all of the examples that were given in the back and forth with the justices, you'd expect an answer to one question. Maybe the government thought this was too much to say that once somebody discloses, inappropriately discloses, confidential information that results in a trade, everybody is liable. That seems to be the most sensible. The only exception in the transcript that made some sense is if you call a buddy and you're supposed to go out to dinner with him or her and they say they can't I'm working on a big Google matter, maybe the light goes off. And maybe you should buy Google, may you should sell Google, or maybe you should do some research online to see whether or not Google was, there has been discussion about if Google is buying some company and then go out and buy stock or some options in that company. That is probably, that was discussed as an exception to insider liability, or tipper-tippee liability because there was no intent to do anything. It was just somebody shut their mouth off with no intent and to give somebody something. But I think the government is going to prevail and *Newman* went too far and I think the government is going to prevail in *Salman*.

David Havermaat: I just wanted to add a couple of things to the issue of the personal benefit. In addition to what John said about this issue being before the Supreme Court now and the disagreement between the circuits. Courts that have tried to rein it in have looked at this language of there has to be meaningfully close personal relationships of the expectation of essentially a *quid pro quo*. Even last year, there was a case that had just come out with one, I forget whether it was the tipper or the tippee, made this very emotional speech at his brother's wedding who he had tipped you know is that meaningfully close? There have been a couple more cases that have come out this year. One involved a couple of roommates. Issues that the district court judge felt were significant enough to put into his opinion were: that they drank beer together, they did drugs together, they played video games together, to show that there was this meaningfully close relationship, that they were more than roommates. Like one negotiated for a reduction in the rent, things like that. So, I don't say that for amusement; I say that because those are going to be relevant topics for discovery and insider trading cases and of course, probably not surprising to learn that one other matter that the *Spivak* case recently involved a romantic relationship between the tipper and the tippee. So really, nothing is going to be off limits. Again, there is uncertainty because of what the Supreme Court is going to do, but I think going forward, I'll be surprised if that goes away. I think the nature of the relationship between a tipper and a tippee is always going to be at the forefront and it can involve some uncomfortable questions in discovery.

Richard Zuckerman: Two minor points. One is what are the arguments that was made about narrowing the scope of the liability to a tangible quid pro quo is because insider trading is not part of the statutory scheme, it's been kind of legislative, I mean judicially built into that based on arguments from the SEC, and therefore, the court should invoke the Rule of Lenity, which is really a criminal concept that narrows statutes that are vague and uncertain, not sure it has real meaning in civil cases other than the fact that this is a penalty provision. And the other thing that's interesting is the conservatives on the court, and the Supreme Court, really I think have previously scratched their heads about whether or not the whole insider training thing is a judicially-created statutory scheme. So, you might think the conservatives, because it's not theirs, somebody read it in based on an argument that was made years ago about the scope of liability under 10b and 10b-5. At least JusticeThomas, and perhaps I think the late Justice Scalia, they kind of scratched their head about whether or not there is any such thing in the essence of the specific legislative granted power, but I think this court, and I do think the SEC is going to prevail here in some respect. And I don't understand why it's not strict liability other than this casual conversation that, you know, inadvertent casual conversation.

Audience Member: How come he didn't argue strict liability?

Richard Zuckerman: I mean, can you say? Well, I think. In the solicitor's office, but that's a different story . . .

John Birkenheier: You know, Dave and I were not, I think the short answer, which goes a little beyond what we can say because we were not a part of discussions, so we don't know. But one argument that has been made by the government that comes pretty close to that is you look at *Dirks* like their disclosure for government, I mean corporate purposes. Well, what if it's disclosed for anything other than a corporate purpose, isn't it necessarily the same as for personal purpose?

Richard Zuckerman: Well, I think that's strict liability. I think if you go tell somebody something that doesn't have the right to receive the information, you know, I think between the tipper and the tippee, it's pretty clear. To me, you get more attenuated from strict liability as you go down stream because you can have seven level remote tippees.

John Birkenheier: Well and that may be what *Newman* was about also because the tippees in *Newman*, there were two different tips involving two different issuers. One was they were third and fourth level tippees, so they were a long way removed from the original information.

Richard Zuckerman: That's not a good fact pattern in the Supreme Court.

Professor Spoon: I think one of the reasons why they wouldn't go to strict liability is because insider trading is based on section 10b. It specifically requires intent.

Raymond Henney: You have to have scienter. You have to have scienter.

Professor Spoon: You have to read intent out of insider trading because it's based on 10b.

Raymond Henney: Richard? We're going to move off of insider trading so we can move on to other topics and Richard will hold a class on insider trading after this is over for anyone who wants to stay.

Richard Zuckerman: And pay.

Audience laughter

Raymond Henney: So Richard, you're going to talk about statute of limitations and course of action?

Richard Zuckerman: This is two minutes, maybe three.

Raymond Henney: You committed to three minutes, so that's it. I've got it right here Richard.

Richard Zuckerman: I can do that. So this is a pretty good case to look at, if the SEC is coming after a client of yours with an injunction. And the issue in this case, there are a couple of them, but the primary issue is—is statute of limitations applicable to the SEC's attempts to enjoin your clients? And the question is you know, does the five-year general federal civil statute of limitations in § 2462, I think that's the right number, in Title 28 apply to injunctive relief? And so you get the issue first is does this § 2462 apply to equitable relief or just legal relief, and an injunction is equitable relief sometimes. What, how do you apply this? And if you read *Graham*, and this comes up a lot. If you read *Graham*, there are a couple takeaways that are very high level.

One is if what the SEC is trying to get from you *equitably* is some form of penalty for what you did in the past, then the five-year statute of limitations applies. So you may get into, and then you get into the usual issues about when it's triggered. Which I don't want to get into. If what, because I don't have enough information to get into it today, so if the SEC is looking to stop you from doing something prospectively without tying it to what you did retroactively, then it's equitable relief and the five year statute does not apply. The other takeaway from this case is basically in a footnote. Is the ability of the SEC to get one of what I would call their usual "obey the law" injunctions. Like, you agree that you will not violate law in the future. That usually or was most of the SEC's injunctive general language. Those are called "obey the law" injunctions, and they are not enforceable. So some people sign off on them because they know they are not enforceable. Then there's a question if you made it enforceable by signing off on it, but if you're faced with, you know, a settlement of a large case where there's some disgorgement, there's some penalties; that you're going to have to pay. The five-year statute may apply because they're penalties applied retroactively for prior acts or conduct, but the question is if the SEC is going to enjoin you from doing things in the future. Be careful of the language. If it's obey the law language, tell the SEC to go away, maybe they will maybe they won't, maybe it'll throw the settlement out the window. But, *Graham* is a pretty good case for talking about the whole concept of injunctions and statute of limitations. Was that three minutes?

Raymond Henney: No, it was longer, but . . . Let's move on to David to talk about the whistleblower and the SEC enforcement actions.

David Van Havermaat: Sure. And just one follow up point to what Richard said is the, yeah it's going to be four minutes. There is a recent Tenth Circuit case, *SEC v. Kokesh*, I think that's how it's pronounced, that basically says *Graham* is wrong. So, the SEC obviously, we understand that *Graham* is out there and is something that we will deal with. I can't comment further than that because it's pending litigation. But, I will say there are other circuits out there, the D.C. Circuit, the First Circuit I believe, have prior to *Graham*, come out with opinions that are contrary to *Graham*.

Richard: E. Zuckerman: I gotta blame our librarians. I had them shepardize this case, and I saw *Kokesh*, but the annotations thought, that I read, said followed, so I didn't read it. So, what's our librarian's name?

Raymond Henney: Richard, in fifteen more minutes will be naptime, so just hang on okay? David, we only have fifteen more minutes, and we have two very important topics. And I'm sorry to burden you on what is really a very important topic for anybody who advises on what we were saying, private or public information.

David Van Havermaat: Yeah, so I don't know if Elliott remembers this, but I think one of the first times that I came here, I think maybe the very first time, I was supposed to be on one panel and I got an email literally as I was on the runway saying, "Hey, can you also do a presentation on whistleblower?" I think I responded something like, "Sure, I would love to." And in my head I was thinking, "I know we have a whistleblower program, but I don't know a whole lot more than that." Well times have changed a lot because it is really a fundamental piece to the SEC's enforcement program. Just recently, the whistleblower program passed $100 million; it's up to $111 million now that has been awarded to thirty-four/thirty-five recipients. The quality and the quantity of the tips that we've received have both gone up dramatically. I expect that will continue to do so. Just as an example, of the top ten monetary awards since the inception of the whistleblower program, which I think was near the end of 2011, if I recall. Six of the top ten were announced this year. So, it is clear that this is ramping up, and I expect it to only continue to do so.

Very briefly, the requirements are that a whistleblower, who can be anybody, with exceptions of certain people that had high levels of culpability or attorneys that are covered by privilege or government employees or things of that nature 48:00. It can be any person, you have to voluntarily provide to the SEC in writing, original information, and that can be anything from things that you know, derived from sources that you know, it can even be independent analysis that's based on public information. I think there's one whistleblower award at least, of I think it was $700,000, where someone did analysis of information. He was an outsider and it led to a successful enforcement action, which is the third prong leading to successful enforcement action. That doesn't mean that you have to be, if you're a whistleblower, have to be the instigator of an investigation as long as you provide substantial contributions to the success of the SEC's actions. You can qualify as a whistleblower, and there have to be monetary sanctions that exceed a million dollars. And that can include penalties, disgorgement, or any other form of monetary sanctions. And if the whistleblower is qualified, he or she receives an award of ten to thirty percent of the amount collected.

There are a number of factors, I won't go into detail because we're running out of time, and the SEC has put out some guidance on these. The significance of the assistance provided. You're more likely to get a substantial award if you sit down and do things like put together a spreadsheet of what was going on and help go through documents, and I believe there have been cases where, in insider training, key words or code words had been used, and the whistleblower would describe what those code words were, things of that nature. Culpability is a significant factor that would decrease an award. It doesn't mean that if you're culpable that you're ineligible. There are, if you're senior management that was responsible essentially for the violation in the first place, there are statutory provisions that do disqualify you. You may want to look into our cooperation program as opposed to our whistleblower program at that point. Unreasonable reporting delays I think a substantial number of the reports that come out do state, "you knew this, you sat on it for a long time, you still get an award, but we're going to reduce it because had you come forward sooner, you would have saved other investors from suffering harm."

There are confidentiality provisions where the identity of a whistleblower, or the status of a whistleblower, is protected. There are exceptions to that though. There are some times where in discovery in federal court or in APs, we need to disclose a whistleblower or the fact of the whistleblower's status as a whistleblower. Normally as you know in federal court, you're going to have initial disclosures, we typically won't hide the identity if it's a recipient witness, we will list that's person's name, address, and other information but not necessarily identify him or her as a whistleblower. As it goes on, if that person is likely to become a witness in the proceeding, it becomes more likely that we may need to disclose it. But the bottom line is the SEC does recognize the importance of confidentiality, and in fact, you can look at the orders that are issued on the awards. There is so much redaction that it's difficult to figure out exactly what went on, but that's for good reason because the Commission doesn't want someone to be able to get an award and say, "ah it was that person who tipped them off."

Speaking of that, there are a couple of other things that had been in place but had additional developments in the last year. One is anti-retaliation. Which simply means that an employer cannot take any adverse employment actions against a whistleblower. As the number of whistleblower cases continues to rise, I expect the anti-retaliation cases will rise again. Last year, I know we talked about Paradigm Capital, which involved, I believe, a trader who was marginalized and essentially constructively terminated. The firm paid . . . the strange thing there is the firm consented to an order that said, "Yes the whistleblower, basically what the whistleblower alleged was right. We had engaged in some, I think it was improper principal transactions." So, it's settled to that and the anti-retaliation provisions as well by paying a penalty there.

The development in that area is that just three weeks ago, the Commission brought a second whistleblower retaliation case involving a casino gaming company. The whistleblower raised concerns regarding the company's accounting and brought his concerns to senior management, then to the SEC. So the company, which had given him great reviews up until then, stopped giving him good reviews, changed his position, changed his responsibilities, and eventually fired him. The noteworthy thing about this case was that the company agreed to an order that they pay $500,000 for violating the anti-retaliation act provisions. But this was a stand-alone anti-retaliation case where the order doesn't say that they violated the provisions that the whistleblower says they did. Because to qualify for the anti-retaliation protections as a whistleblower, all you need to do is have a reasonable basis, a reasonable belief that the information you are providing is relating to a possible securities law violation. There's no requirement that the SEC bring an action based on what you did. The money, you may be wondering, doesn't go back to the whistleblower; it goes to the general fund. But, the whistleblower is probably in good shape because there are provisions that allow a whistleblower to go to federal court to seek reinstatement, double back pay and plenty of other reliefs. So, the whistleblower does have the ability to profit by that as well.

And finally, even if you're representing an entity or you're general counsel thinking "that's crazy, I would never. Of course I'm never going to retaliate, so I'm safe." You're not necessarily safe because the other area in which there are additional cases brought involves restrictive language. In severance agreements, in confidentiality agreements, it's not uncommon to have see provisions that say things like "the employee will not disclose any confidential information to any third party." A couple of these cases dealt with situations where, I think they were in severance agreements. Where the employee was, had to sign off that he wouldn't accept any whistleblower money if it was presented to him. The Commission didn't view those very kindly, and I think when we were here last time, there was one case that involved the restrictive language. There have been several more, including I think it was the Blue Links matter. There's actually some good language in there if you're looking for something to put into a severance agreement. Obviously I can't give you an assurance that it will work, but it's something that the Commission has looked at and has approved in this order. So, even if you're not representing an entity that is going to be taking other retaliative actions against an employee, it is important, I think at this point, to review severance agreements, employee agreements, confidentiality agreements to make sure there's nothing out there that's going to chill an employee's ability to come to the SEC to report possible violations.

Richard Zuckerman: I have, actually, a legitimate question.

David Van Havermaat: That's changed.

Richard Zuckerman: Yeah, that's changed. Assuming a whistleblower is whistleblowing, and also may be a fact witness, maybe, and even if the person wouldn't be and there was retaliation would you consider an obstruction referral?

David Van Havermaat: I mean it depends on the facts. We do refer obstruction cases. Again, I can't comment on that more because it really depends on the situation. We certainly might do that.

Richard Zuckerman: But it's not off the wall to think that if you have a whistleblower that's retaliated against, it might wind up with an obstruction referral, depending on facts?

David Van Havermaat: It wouldn't shock me.

Richard Zuckerman: Okay.

David Van Havermaat: And just the one other think I forgot to mention is the relationship between this and the cooperation program. The cooperation program, we're not going to speak specifically on. But with more and more whistleblowers coming forward, I think that really puts the onus on a violator, especially on a company. It's more of a gamble if you don't come forward because there can be a disgruntled employee, disgruntled former employee, how often do you see that, that comes forward and says "hey you know what? When I was there I saw some funny stuff going on." So, the cooperation program does give significant credit. I know we're running really late on time, but just very briefly. The insider trading case that involved the two roommates—they both entered into cooperation agreements. One of them breached the agreement. The other did not. The one that didn't breach, the SEC consented to an order that he pay a penalty of the amount of his ill-gotten gains. Which was about $7000. The one who did breach, by essentially conveniently forgetting things during his trial testimony. Had he followed through with his obligations in the cooperation agreement he would have had a roughly $2500 penalty. The judge, at some point this year, issued an order saying that he pay $980,000 in penalty. So, there's a significant benefit. It's pretty rare that you can see what would happen if you cooperate and what would happen if you don't, but here, I think, is a pretty concrete example.

Raymond Henney: Thanks so much David. Well John, we only have a few minutes left. But actually this is perfect because you can create animosity and risk and fear among the compliance officers and attorneys and then leave.

John Birkenheier: Okay good. You know we were originally thinking of this last section being about secondary liability, but then it became apparent that maybe it was better to focus it on potential liability by compliance officers. I think that there is from time to time, and I think within the last year, that there have been public comments indicating this perception that the SEC has somehow changed its focus and is actually looking for cases or is going about bringing more cases against compliance officers, and that really isn't true. It's important, and I understand why, especially to people who aren't in compliance fields it's a very important issue, and a very sensitive issue. But it really isn't true. I think that it helps to put the whole answer to the question in perspective to deconstruct enforcement actions that have been brought against compliance officers.

First, there are almost no cases that have been brought against CCOs and, people who are only CCOs. I think that in the investment advisor space over the last eight to ten years, there have been only five such cases. When overall we've probably brought a total say between 7,000 and 8,000 cases, so we're running at somewhere like around, I don't know, two tenths of a percentage or 2 thousandths of a percent rather. If you throw in broker-dealers, I imagine they're probably more than five, but not many more, so it might be probably ten or twelve total, like I said, enforcement tally of about, between 7,000 and 8,000. Second also, the cases or the enforcement actions that are brought against people in the compliance area, fall into three main buckets. There is either a case where the defendant is actually affirmatively involved in the wrongdoing, alright. Or the case where, this is rare, well all of these situations are rare, but where the compliance person is trying to obstruct the SEC, either in an examination or investigation. Or where there has just been a wholesale breakdown in the supervisory procedures within the firm. So there aren't many such cases, and they're rare cases, and the situations are pretty narrowly drawn too where those cases are brought. I'll add too, that I think that the whole mix of facts is complicated when the CCO has a dual role because there are just times where that makes their decision-making as a compliance officer more complicated.

Now, sort of moving beyond the subject of the compliance officers, there are other grounds for secondary liability in the Securities Acts, all of which I think are worth noting. First, control person liability, anyone who runs any kind of enterprise and is responsible for the actions of subordinates for violating the law, or the enterprise itself that is violating the law, that control person can be held liable to the same extent as the control person or enterprise that they control and that is section 20(a) of the Exchange Act. Companion provision, Section 20(b) of the Exchange Act, violations of the Exchange Act, you can't do directly, or indirectly rather, something that you could not do directly. So if you take Janice and think about the logic of Janice who makes a statement, you know, Richard as the owner of a broker-dealer firm, can't write a fraudulent script and give it to Dave and me, his sales people, and have us make the cold calls and read from the fraudulent script. Aiding and abetting, you know, that's available in under all the statutes now. I think that for the longest time it wasn't in the Securities Act, but it's now available under all of them, and then, of course, failure to supervise for the line supervisors.

Raymond Henney: Thanks so much. Can we give a round of applause for our very helpful panel. Very appreciative of you being here, thank you.

Panel 6: Securities Litigation Developments

Raymond Henney: Thanks so much. We're delighted to continue our seminar with a presentation on developments in securities litigation. We have a very distinguished panel that we're very excited about. We have Clarence Pozza, Rocky Pozza:, from the Miller Canfield firm. We have Marc Newman: from the Miller law firm, and we have Tom McNeil: from the Dickinson Wright firm. Rocky, are you going to start us off? Thanks so much.

Clarence Pozza: Elliot and Ray, it's great to be back at Michigan State on a nice Friday afternoon with all of you. And I'm delighted to be with Marc and Tom today. I feel like I am the leadoff hitter. I just have to barely get to first base because they'll then knock it out of the park following me. So today we've divided it up and I'm going to start with a little post *Omnicare* work, specifically the *Sanofi* litigation, *Tongue v. Sanofi*, there was a second case, *In re Sanofi*. Let me move ahead, and you know what I also want to . . . I should have said hello to Joe. Joe has such a great history with this institute and great to see you and so many other friends here. So, *Sanofi*. *Omnicare* in 2015 was the big news on opinion liability. Wnd cases are now starting to come out applying *Omnicare*, and *Sanofi* is probably the most significant. It's a Second Circuit Court of Appeals case, so the leading circuit for securities law. I think, and writers think, it's the most significant interpretation of *Omnicare* since *Omnicare*. It applied *Omnicare* to statements under the Securities Exchange Act. Not just registration statements under The Securities Exchange Act of 1933 but it applied to The Securities Exchange Act of 1934, 10(b) and 10(b)(5) cases, and the significant point and I am going to layer this a little bit and then have Marc and Tom come in, because I'd like to make this practical for those who are actually drafting complaints or motions to dismiss.

A main takeaway from *Sanofi* is that an opinion from an issuer or a maker of the opinion need not disclose all the facts that may be counter to the opinion. And we'll get into that in a moment. And of course the opinion should fairly align with the information known to the speaker. Now those are very broad, simple it seems, but now we're going to layer a little more.

In *Sanofi* there was a drug, and the FDA had strongly urged what was called the double blind test. *Sanofi* went with a single blind test and the FDA really frowned on this double or single blind, although it was still possible to have a drug approved on a single blind test under certain circumstances, and ultimately *Sanofi* was successful in getting this drug approved. The plaintiffs in the *Sanofi* litigation essentially said that the failure to make this FDA preference to a double blind test, available as part of the opinion was an omission and ultimately the Second Circuit held that *Sanofi* was not required to point out that the FDA took a counter position. Not every single fact opposite to the opinion had to be laid out. Okay, now, *Sanofi*, though, went on, as *Omnicare* did, to talk about factors that would be reviewed by the Court in deciding what to do on a motion to dismiss. The *Sanofi* case was a 12(b)(6) motion to dismiss. The sophistication of the plaintiffs was a factor, and would be a factor, and in *Sanofi* most of the plaintiffs were sophisticated funds or investors, so that was a factor that cut against the plaintiffs, but that was a first factor.

The second factor was the context must be examined to evaluate the statements, and the context includes the text of the statement, hedge language, disclaimers, conflicting information, customs and practices of the industry, and other factual points. Now here is where I'd like to drill down a little bit for practitioners. The plaintiff in drafting this complaint, as in *Sanofi*, had a wealth of FDA publicly available information. Now in many cases that may not be present. The defense, in opposing the motion to dismiss, takes what the plaintiff has said and starts offering the context, the hedges, the disclaimers. But if you read *Sanofi* the opinion is really fact intensive. The Court goes on for pages reciting facts about this drug approval and so I'm going to turn it over, I'm going to ask Marc and Tom a question. Do you think, and Marc you in drafting a complaint, Tom on the defense side, that what *Sanofi* and *Omnicare* have done is moved 12(b)(6) towards a Rule 56 summary judgment as Avern and Cohn has said would happen over time. Do you think that? And then secondly, Marc in drafting the complaint would you offer some practical information on what you do to provide some of this information that makes it tougher to get an issue complaint dismissed.

Marc Newman: Really it's not, this didn't start with *Omnicare*. This has been a really consistent theme that the current Supreme Court has started dating back to *Iqbal* and *Twombly* standards that really allow courts to weigh competing inferences in a complaint. Which really is violative of Rule 56, I mean, or that's at least intruding into Rule 56. Can a District Court start weighing facts in a complaint? That's why we have trials typically. But that is what's happening, and certainly with the holding of this court and other courts you're seeing, and defense it's a pretty common strategy now for defendants to really go outside the four corners of the complaint in bringing motions to dismiss through various tactics.

We talked about one thing earlier was, you know, motions for courts to take judicial notice, of whatever information is in the public domain. So a lot of disclaimers, for example, that may be disseminated by the company, through all types of disclosures, public disclosures, so you're seeing defendants really try to get that in before the court on a 12(b)(6) motion.

Clarence Pozza: Tom?

Thomas McNeil: You know, the securities practice, I've been looking for where the equilibrium is or the set point, and I really think the combination of the 9(b) fraud particularity standard in *Iqbal* and *Twombly* have really moved the needle towards the defense, and maybe not fairly so. So think about these cases, which are omission cases from the plaintiff's perspective. How is Marc supposed to plead that the maker of the statement subjectively did not believe the statement when made? Really, how are you going to do that without having access to discovery? And particularly, even in a situation when there is a large administrative record you're still going to have some problems with that. So, I think I start out with an advantage on the defense side on the case law. But what Rocky has pointed out is, there's something really weird going on, on the defense side.

If we're going to have this fact intensive evaluation of the case that's sort of a mini 56 up front, the defense is at a disadvantage in this one respect: What can you use in a 12(b)(6) motion? You can use anything that's referenced in the complaint, any document, or it's not disjunctive, or is disjunctive, it's not conjunctive, or anything that is central to the plaintiff's claims. Alright, but if we're going to mix up all these facts, as we do in *Sanofi* and we have pages and pages of facts, how do I as the defense lawyer get into the record the kind of facts in a mini 56 this is starting to look like? So I think there's actually a little bit of disadvantage in terms of access to the information in a 12(b)(6) motion. I think the one standard to come out with is it only can be used if it's in the complaint or it's central to the plaintiff's claims.

Marc Newman: Well that's everything.

Thomas McNeil: Well in my view it is everything. Right, we're trying to get it in.

Clarence Pozza: That's a disadvantage. I mean they find a way to get it in.

Thomas McNeil: So, what does that mean? It means that securities cases, like a lot of other big cases are becoming judge-specific, so the Eastern District of Michigan, my home, twenty-three judges, might matter what judge gets this case in terms of what material I get in and what the standard is with respect to your pleading.

Clarence Pozza: I think that's true in almost every securities case is it's partly the luck of the draw. If you tend to get a conservative judge, a federalist society judge, they're going to be more inclined to go beyond the pleadings and allow the defense to get in a lot of this ancillary evidence. Whereas a more liberal-oriented judge will not and will only look at the four corners.

Thomas McNeil: Just one more time and I'm going to give it back to you. It's really fun to look at you as an audience so we say, "Okay it is really going to turn out to be judge-specific." And all the practitioners out there go, "Yep." You know, I can see the heads nodding, right? And you look at the law students who go, "Are you serious! It's judge-specific? That ain't right."

Clarence Pozza: I think it really depends on the skill of the advocate. The quality in this room is not the judges.

Thomas McNeil: You can see why Rocky is our moderator.

Clarence Pozza: Marc mentioned, how long is the GM complaint?

Marc Newman: So I brought as an example, cause one of the things that I'm going to talk about is how the consumer scandals that we're seeing evolve into securities fraud lawsuits. One example that I referenced is the GM securities. The ignition case, the faulty GM ignitions, which is a big scandal, I'm sure most people are familiar with. And it created a huge consumer class action that's pending in New York. There's also a securities component to that because when it became public that GM had knowledge of the existence of these defective ignition switches, the stock price tanked. That case recently settled for 300 million dollars that went to the shareholders. That complaint is roughly 575 pages long, and this binder contains it if anyone wants to see it. And essentially what we as plaintiff's lawyers will do to meet these extremely high pleading requirements is spend weeks and weeks combing through the public record.

What you see a lot of securities fraud plaintiffs' firms do is hire private investigation firms to try to track down, for example, former employees that have knowledge and try to find out, you know, what subjective intent did the company have, what types of things were discussed within the company that would put the senior management on notice, that would create an inference of scienter? That is, scienter is intent to commit fraud. Did the company know the statements were false when they made them? Or alternatively were they reckless in disregarding the truth and making the statements? And that's a difficult standard, and it goes back before *Iqbal* and *Twombly*. In 1996, Congress passed over a Bill Clinton veto the Private Securities Litigation Reform Act (PSLRA), which was a Republican bill to really make it more difficult for shareholder class actions to proceed. It created a heightened pleading standard, which is you have to plead, we call it Rule 9, which is pleading fraud with particularity. It's Rule 9 on steroids. And the result of that is these cases typically you'll see several hundred-page complaints.

Clarence Pozza: So Google, Marc indicated that Google is really one of his best friends because all of this information, and if you think, for the younger folks in the room those of us who grew up in a pre-Google era, where you used to have to find paper copies and go to the print and get research reports on paper, none of this was in a database. You couldn't access it, it really has changed. Tom any other observations on what the defense can do to counter, go outside the four corners of the pleading, the complaint, to kind of get at these kinds of fact-intensive things that would help the court?

Thomas McNeil: There's a minority test, that's starting to emerge. And it's going to be interesting, it hasn't made it to the Sixth Circuit yet. It'll be interesting to see how this plays out. But it starts with, for those of you who are practitioners, it starts with a decision from Judge Cleland, so you see where this might be going. It's to put a third element in the test, which is anything that's in the complaint, anything that's core to the plaintiff's claim, or anything else I think is important. I'm liking that anything else that's important. So it has not gained a lot of traction, but it's one judge's way of trying to figure out if we're going to do a mini 56 how can the defendant level the information plane so that it can be decided on that basis? I mean, I will tell you as a defense lawyer, I think *Iqbal* combined with PSLRA has unfairly set the equilibrium point.

Marc Newman: That's was why it was vetoed.

Thomas McNeil: So I feel your pain.

Clarence Pozza: So in *Omnicare* what happened after the Supreme Court sent it back. This is very interesting. The U.S. District Court. This was August 24th a few months ago.

Marc Newman: And *Omnicare* came out shortly before our presentation last year. It was a case under The Securities Act of 1933 section 20 claim for in a plaintiff's . . . opinions that were issued by the company were false and misleading and it went all the way to the Supreme Court. It was a Sixth Circuit opinion. There was actually two competing circuit cases. There was *Fate,* and there was, out of the Second Circuit, *Omnicare*. The Sixth Circuit was more favorable; the Second Circuit was defense-oriented opinion. So, when it ultimately came back, the district court actually sustained the complaint, finally. That was a case that may have been filed in like 2003, just to give you an idea. And so they finally got their complaint sustained after thirteen years of litigation.

Thomas McNeil: But, wait a minute, think about that for a second. The Supreme Court sends the case back down saying we think these pleadings are insufficient. Now what should a District Court do in this? Right? You would think the District Court would say, "The Supreme Court says they're not sufficient, I guess they're not sufficient." But the system, the Judge determined that the pleadings were sufficient. Should they bring that?

Marc Newman: I think that *Omnicare* actually compelled that finding. I mean the circuits were split on how do you determine, you know, what is the standard for determining whether an opinions that are issued by a company are subjectively false and the Sixth Circuit had a test that very frankly from what the Supreme Court ultimately found. The Sixth Circuit had affirmed the . . . had sustained the complaint as well, although on different grounds, so when it ultimately came back to the District Court, that Court sustained it. I suspect that you're probably going to see a settlement in that case.

Clarence Pozza: It was Judge Bertelsman in Kentucky. So that was August. So the motion to dismiss was denied. So, what we're doing here is kind of looking at how this plays out practically because we have all of these pronouncements from *Omnicare* and *Sanofi* and there are three other cases cited in the slides that relate to post-*Omnicare* issues on opinions. But the reality is this still is a battle even with the legal standard in the trenches over information and what appears to me and I think confirmed by the two Cabrera's sitting here that this is an increasingly factual intense investigation in the beginning even on a 12(b)(6). It's not just here's the complaint, they didn't do x, y, and z. They didn't plead it, out it goes, or they did do it and it stays. And this goes way, way, way beyond, and so I think for creative lawyers you're going to have a lot of opportunity to work with this . . . what I see is a big trend in 12(b)(6). So again, now back to the law, *Omnicare* doesn't impose liability because of an issuer failed to disclose information that ran counter to the opinion. But again, *Sanofi* is a FDA drug case with a ton of information going both ways ultimately the drug was approved, you had sophisticated plaintiffs. So, failing to disclose information that ran counter at some point it tips against the issuer or the maker of the statement. Where the maker didn't disclose information that ran counter and that's where this factual investigation really starts coming in.

Marc Newman: Can I make a quick point? You know it's funny that the plaintiff is sophisticated is a factor because the plaintiff in all of these cases are sophisticated and that's by statutory design. Congress set up the scheme of the PSLRA so that effectively, the class representative, the lead plaintiff, is the biggest loser, if you will. That is whoever was holding the most shares at the time that suffered the most losses. They're all sophisticated investors. They're typically pension funds, states, state pension funds. You're not talking about mom and pop who own, you know, ten shares of General Motors stock. You're talking about, I think we have Ontario, New York State Teachers Pension Fund was the plaintiff in the GM case. So, in my view, that opinion really should be—you have publically traded companies often, you've got so many analysts looking at the stock, there's so much information in the marketplace today, and rather than the plaintiff being sophisticated, the issue should be, how much information can the market really digest, and whether that that information is being withheld from the market.

Clarence Pozza: Okay. And that's true now, and in *Sanofi*, the additional factor, the funds identified, did a lot of drug investing, pharmaceutical investing, some of them. So they actually were even more of an estate fund, they were kind of in this space. So, not to relive *Omnicare*, but this description from *Omnicare* on opinions, even if sincerely held and otherwise true as a matter of fact, may be actionable if the speaker omits information. The omission of which makes a statement misleading to a reasonable investor. I mean there's still room out there and I think even though these cases, *Sanofi* upheld the dismissal of the complaint. There's still plenty to deal with and talk about on the plaintiff's side.

Alright, we've talked about those fairly well. Here are three cites to cases post-*Omnicare*, you may want to look at them. They kind of discuss one, the Eleventh Circuit case actually ignored *Omnicare* and it went back to its previous standards on opinion liability, which is interesting, I would like to know why, maybe they just thought their standard was better than the Supreme Court. And then lastly, you know, this broad pronouncement, issuers must be forthright with their investors, but securities law does not impose on them an obligation to disclose every piece of information in their possession. That goes back to this theme, I think is there, you know what they're omitting and how important it is in the context and the customs and industries creates this factual brew that a skilled attorney can work with both on the plaintiff's side or on the defense side. So, that's post-*Omnicare*. I hope I got to first base, and now I turn it over to Tom. Right? I think. Or Marc, I'm sorry.

Marc Newman: So, in the interest of time since we've already used up a big chunk. I'm going to fly through my slides really quick. So, I want to talk a little bit about, as I said, you know, we see a lot of these consumer-related scandals becoming . . . they're highly politicized, you see Congress holding all kinds of hearings on, for example, with what's going on with Wells Fargo right now is a perfect example and you know a lot of that direct harm in a lot of these cases are the consumers themselves.

Wells Fargo is running around and has hundreds of people opening fake credit card accounts. You know if you held a credit card account that was started without your consent, you may have a consumer-related claim, and what you're seeing is a spinoff from that now of the people that held the shares in the company that committed these wide scale frauds and how is it that the stockholders or bond holders are harmed by that because the information the stock markets are so sensitive today to any bad news coming out. So when it is released that Wells Fargo you know was engaged in this practice their stock price tanks almost immediately. Large investors who are holding potentially hundreds of millions of dollars of Wells Fargo stock, you know, they could lose a hundred million dollars of value in a single day, potentially.

So I talked already a little bit about General Motors and I will touch on it again. Typically, there's two kinds of securities fraud cases or claims that we bring on publically traded companies, both under the Securities and Exchange Act of 1934 which was §10(b)(5). That's really any false statements made publically by the company, whereas The Securities Act of 1933, as Rocky indicated, is really false statements that are made in connection with the issuance of securities. So, and you're seeing both claims often asserted in the same case because companies now are issuing constantly new securities. They'll issue new series of bonds constantly so if they're issuing bonds at a point in time when they're making false statements to the public generally, then you're going to typically see both types of claims. I'm not going to cover the General Motors case because they already did. If you're interested in seeing the 575 page complaint you're welcome to. It's up here.

Volkswagen, which made a lot of news last year, Volkswagen of course it was disclosed by the EPA, in Ann Arbor they discovered it, that Volkswagen had installed defeat devices in these supposedly fuel efficient diesel vehicles. Now, Volkswagen, as you may know, is not an American company, it's a German company, and the U.S. Securities laws only protect shares, or trades, that are made on a U.S. based exchange. So, if you're buying even General Motors stock on a foreign exchange, Canadian exchange, Japanese exchange, you're out of luck. There are some cases pending in the U.S. right now relating to the Volkswagen scandal. Bondholders, for example, there's a bondholder case. There may be, I think there's shareholder cases as well, but I'm not certain that Volkswagen's actually traded on any U.S. Exchanges. But, there is, in fact, a bondholder case where the bonds were bought on the U.S. Exchange. And you know, the types of allegations that you see in these complaints, the plaintiffs will comb through for weeks, the public record, and when you have, you know, Congressional hearings and you have a lot of stuff in the public record about what the EPA did, I mean it's just a treasure trove of information.

Then in connection with the issuance of the quarterly financial reports, the annual reports, that are all publically filed. Companies also hold, typically hold earnings calls to boast—here's how great we did this year and in connection with Volkswagen, you know, statements that they repeatedly make are, for example, how they have a high priority in providing fuel efficient vehicles. You see in a lot of complaints plaintiffs will allege, companies very often say, you know, we're in full compliance with all of the laws in the U.S. They'll make broad blanket assertions like that so if it comes out that, in fact, they're not in compliance with the law, that easily triggers a plaintiff to allege that the statement was false.

Raymond Henney: For a lot of companies that's required disclosure, an item on the schedule. This isn't them trying to **. . .**you know, I mean, it can be a tough spot.

Marc Newman: Sure, of course. And that's why scienter is often so important because what you see is a company says "at the time we said we were complying with the law we thought that we were." So now as a plaintiff's lawyer I've got to go and try to round up as much evidence as I can to put in a complaint that gives an inference that they knew what they were doing or at least they were reckless and not knowing. Tom will talk a bit about where you really get into problems is when lower-level employees, you know, there might be a huge fraud to the subsidiary and the question is did the parent corporation detect what was going on or were they reckless in failing to you know, see the red flags? Something like that, that's really the most, often the most, contentious issue that's litigated, unless when I had Wells Fargo, so, and these cases just got filed. They're all probably within the last sixty days so there's certainly been no motions to dismiss yet. There's not even an amended complaint yet. So, typically what you see is a lot of competing plaintiff's proofs of file kind of bare bones complaint and someone gets control of the case and then they'll spend weeks and weeks drafting a large complaint. There's a consent order with the U.S. Consumer Financial Protection Bureau, which I don't think has much power anymore do they? But they did in September. And Wells Fargo had admitted essentially signing up customers for credit cards without their consent and the CEO recently stepped down. Something like 3,000 people were. . .

Thomas McNeil: 5,000.

Marc Newman: 5,000 people were laid off.

Clarence Pozza: 900.

Marc Newman: Okay.

Clarence Pozza I'm a shareholder.

Marc Newman: Okay and you're probably . . . have you checked the price of your stock? You're also going to be a class member.

Thomas McNeil: I want to see when Rocky is a class rep but that's a whole other story.

Marc Newman: I should tell you that you the first thing you've got to find out is did you purchase your stock during the class period, because if you just held your stock you don't have a cause of action.

Clarence Pozza: I will tell my boss I bought it before and after.

Marc Newman: Some of these allegations that you see in the current complaint, or one of the current complaints, is they're really touting their cross-selling efforts between divisions and how important it was to their revenues and to the growth of their company. It turns out that really they're quote unquote cross-selling was all fraudulent, so that's probably the types of allegations the plaintiffs are going to focus on.

Clarence Pozza: Alright, Ray I'm going to keep us on time, how much have I got?

Professor Spoon: Oh you know, 10 minutes.

Thomas McNeil: Oh were never going to take ten minutes. We're going to rock-and-roll. We've got to get to Gary, we've got to get to Joe. If you wouldn't mind bringing up my screen. That would be great. How many of you remember Chris Burman in the late 2000s on ESPN the three fastest minutes in football. I'm going to give you the three fastest minutes in securities cases here in Sixth Circuit. We all know that the Sixth Circuit is sort of a sleepy circuit when it comes to securities there are no *Omnicare* cases in the Sixth Circuit this year. And the six cases I want to talk about, rapidly, are not earth shattering cases. So when I come to conferences what's the one thing I want to walk away with? I want a collection of the cases, I want to know what the new case law is and I want to know what applies to me. I'm going to give you that. So . . .

Marc Newman: We think.

Professor Spoon: So, we can't open your PowerPoint?

Thomas McNeil: So, this is the sheet I'd like you to go to.

Professor Spoon: There's a copy of it in your packet.

Thomas McNeil: This sheet very cleverly is a fit football fan and I say this in difficulty.

Marc Newman: Oh don't go there.

Thomas McNeil: As a Notre Dame guy. Michigan State all won now it's all good.

Marc Newman: We're still good there. We're still good.

Thomas McNeil: Pick six from the Sixth Circuit. Take a look at it. The first two cases *Doshi* and Vendaly are not cutting any kind of new ground. If you have a scienter case or a material misrepresentation case, you need to know those cases and you need to be able to use them. Apart from that, no breaking of new ground.

Skipping to the bottom of that sheet. *Lay v. United States*, this is a nice reminder. The Investment Advisor Act is still well and good. The 1940 Act is still a basis for cause of action for fraud. That's a reminder Mr. Lay went away for a long time and the Sixth Circuit agreed. You'll see the opinion. With respect to the *Stein* case, it is one of the most technical statute of limitations and statute of reposed cases I have seen with intermixing of tolling. If that's in your case, you want to look at that. If it's not in your case, do not read it. It will give you a headache. Okay.

Now, the case that I think is actually the most significant for us as practitioners at a trial court level is, and again, the plaintiff, the sophisticated plaintiff, is *Ohio Public Employees Retirement System*. It's the third case on the list there, and I want to throw it real quickly to the two of you to talk about this a little bit. When you look at motions to dismiss the focus is always going to be the quality of misrepresentation or the omission and is there scienter associated with that. It's been pretty sleepy across the United States as to whether loss causation is a 12(b)(6) argument. Or is it really a 56 argument once all the discovery is in. What I think is actually the most interesting thing about the Ohio Public Retirement Plan is the district court dismissed the case on loss causation at the motion to dismiss phase. That's pretty amazing. Now the Sixth Circuit reversed and it's interesting for why it reversed. The Sixth Circuit has been a holdout circuit on the "materialization of the risk" theory. So, it kind of runs like this. It's an omission case; people don't say anything.

The plaintiff will say that the stock is overvalued because accurate information is not out there, but nobody knows that. So then what happens? There's a corrective disclosure. And in this case, financial statements were proven to be false and they had to be restated, not once, but twice. That's a bad thing for the defendant. So, now the disclosure is made and the stock drops. And the claim here, the materialization of the risk is, once there was a corrective statement and the stock price dropped, there must be inferentially a correlation between the two. That's good enough for loss causation. The Sixth Circuit had never applied that before. It had mentioned it, but now it adopts it. So I think that's a development. It's a nuance. The more important thing I think is, is loss causation a 12(b)(6)?

Marc Newman: Well, it clearly is in the sense that, there was a Supreme Court decision back probably ten years ago. Was it *Dura Pharmaceutical*?

Thomas McNeil: *Dura Pharmaceutical.*

Marc Newman: *Dura Pharmaceutical*. Where the plaintiffs had really just broadly alleged that as a result of all these fraudulent statements the plaintiffs suffered financial damages. Well that's clearly not a sufficient way to plead loss causation in what's now become a heightened pleading standard under the PSLRA. *Dura* really set the stage. *Dura* made it very clear what plaintiffs need to allege. So, I have not seen loss causation brought as a 12(b)(6) since then. Well, there certainly were.

Thomas McNeil: When is the last time you filed a motion to dismiss on loss causation?

Marc Newman: A while ago.

Thomas McNeil: Me too.

Clarence Pozza: But, loss causation I think it's important to get it set up in a case and get the court thinking about it. If possible.

Marc Newman: Where it really comes into is class certification because class certification motions in securities cases heavily focuses on something called the "market efficiency hypothesis" and whether plaintiffs are entitled to a presumption of reliance based upon the stock price. And in order to be entitled to that presumption you have to show that securities are trading in an efficient market and this has become an extremely complex and expensive process in class action litigation with both sides hiring several experts in big cases to prove whether or not the stock is traded in an efficient market. The primary test is, there's several complicated factors, but really the most basic way to look at it is, does the stock react both positively and negatively to news coming out about the stock. Under current case law, the defense can actually introduce evidence of the lack of, you know, market movement, if you will. Negative loss causation.

Thomas McNeil: Right.

Marc Newman: As evidence that the stock is not traded in an efficient market.

Thomas McNeil: I'm going to come back to that point when we start talking very quickly about M&A cases and how they become securities cases. My point on this is, I intend to stir the pot and see if loss causation can't be a 12(b)(6) issue.

Marc Newman: Don't.

Thomas McNeil: See you next year. So, if I'm invited back, I may not be. Alright, the other thing, the sixth of the six cases is this *In re* bank of South case. It comes out of the Middle District in Tennessee. The District Court Judge certified a class. The defendant appealed on an interlocutory basis, which the court took and then slammed the Middle District of Tennessee Judge, Judge Campbell, saying you made no findings, you didn't even certify what the class was. It's a pretty ugly opinion and it's one page. Now think about this. Class certified at the district court level, interlocutory appeal, one-page opinion sending it back down. I think it's significant just for the procedural issue. Alright that's my pick six.

So here's the thing I wanted really to talk about, and we'll keep it tight. It's the very last slide in my materials. Looks like this, emerging trends. I want to talk about two. Private equity firms across the country have become extremely active in diversifying their portfolio, including in Michigan by buying automotive supply companies. Principally tier one. The theory on this is the private equity firms are financial buyers, they're not strategic buyers, they're not competitors that are buying a competitor, they're not vendors or suppliers. They're somebody from the outside who doesn't have that much experience in the automotive industry and the big fight in the case, these M&A cases, the buying of a company, did the new private equity owners just run the company into the ground because they didn't know what they were doing? Or did the sellers of the company, the sellers shareholders, lie through their teeth in selling the company for the highest possible price? That is the fight. And Marc and I have done battle with each other for twenty years on public investor cases. That's where we've really cut our teeth. Rocky, a lot of your work is in the same area. Rocky and I are just finishing off, Rocky has finished a case, and I'm on a follow-on case, with the same private equity firm that bought different companies. And we're going to talk a little bit about that. It's becoming a trend. So, back to loss causation. We don't have the same situation as GM, Wells Fargo, or Volkswagen. There's not some huge administrative record. All we have is private equity buys the company. The sellers are gone. Except that they bought the company. They bought all their records, they bought all their email, and all of a sudden the plaintiffs have a significant advantage by having the company records and here I am on the defense.

Clarence Pozza: They don't need any discovery right?

Thomas McNeil: They don't need any discovery, they just bought the company.

Clarence Pozza: And you don't have them anymore.

Thomas McNeil: I don't have them unless my client stole them, in which case I can't say anything about that. It's got to go back to the company. So, now I'm back into the bind I said at the beginning with Rocky, what can I use? It's in the complaint. It is core to the plaintiff's claims. Or, my Judge Cleland exception, which is I think it's important. Right, because I know this information, but I don't have an email and he didn't plead it in his complaint. So I think there are some funny things going on in the M&A world and I think we're going to see some more securities work coming out of that. So, the other thing I want to say about M&A cases, and this is for a show of hands, how many of you among the practitioners have encountered representation and warranty insurance. Show of hands. Almost nobody.

Four hands. This was my first. I was a rookie on this. I saw this for the first time in the case I have now. Think about this for a second. The plaintiff, they're not plaintiff and defendant yet. They're buyer and seller. Seller wants, seller doesn't care, and seller is walking away. Buyer wants some protection. So the strategy here on the transaction is they've bought the company, the transactional documents will say if there are any breaches of representation in the warranties there's going to be an escrow from the sale proceeds that's going to be set aside and that's going to be our basis for recovery for any kind of claim unless it's fraud. It's a cap on anything unless there is fraud. So, there's a negation about how much will be set aside in the escrow.

In my case, it was a 270 million dollar purchase, 14 million dollars was set aside. But, they also agreed, and the question is, is this the new normal—is this the new standard of care? They sat down, the buyer and seller, and negotiated representation and warranty insurance. Now this seems a little weird because, you've got the buyer whom, or the seller, who might be offending here, who might be committing a fraud, right, but they're buying insurance, and the insurance is going to be for the buyer of the company, and the seller and the buyer will split the premium. So in my case, we had fourteen million dollars worth of escrow money, and on top of that, insurance of twenty-five million dollars, cost four million dollars to buy it, split 50/50 between the sellers and the buyers. Now it seems to me there are a whole lot of policy considerations and potential for collusion as it relates to that nice pot of twenty-five million dollars above the fourteen million dollars, is it really above the fourteen million? We're not so sure. When cases come to settlement everybody is looking for pots of money that can contribute to a resolution that will make the case go away. All of a sudden, the rep and warranty insurer has bought a place at the table. You've got the sellers, you've got the buyers, you've got D&O insurance, and you've got the escrow, and now you have rep and warranty insurance.

Who goes first? What's the deductible? Does the escrow have to be exhausted before you get into the insurance proceeds? The answer is: there is no standard policy out there in the market place yet. We don't know. It's on a policy-by-policy basis. And so there is massive confusion in the settlement of M&A cases, because of all these factors that have now been created by rep and warranty insurance. And you just finished up a case where this became a factor. Do you want to talk about it a little bit?

Clarence Pozza: And, I will be mindful of a confidently agreement, but there are certain things in the public record, in a motion, that I can address. In our case, the rep and warranty insurer case went first. And Judge Lawson, in essence, stayed discovery in the main securities action, breach of the M&A agreement. It was both plead as a securities case and a contract case, he in essence stayed discovery in that so the rep and warranty insurance issue could go forward to an arbitration. There was nothing that required that. What Tom is suggesting is this is brand new. So, if you're out there this is in formation and if you're involved in a transaction or litigation, you have an open field in front of you. In our case, the rep and warranty insurers went first. There was a settlement, and then the buyer came back to proceed against the seller for what they viewed was still an amount of damage that hadn't been compensated for. And, so all of this, I had never had a rep warranty insurance case before, this was all new, and in our case, an interesting piece, and again this is in the public record, the rep and warranty policy covered eighty-four million of the eighty-seven million purchase price. With the escrow being three million. So, the entire purchase price was either covered by the three million escrow, or a huge rep and warranty policy.

Thomas McNeil: Now, you probably can't get that insurance anymore. That would be surprising.

Clarence Pozza: When I saw it, I thought this is quite interesting. The dollar for dollar, and ultimately, we argued to the Federal Court that the buyer had the obligation to exhaust the eighty-four million, and by settling the rep and warranty case for less than that and I can't disclose the amount. What I am disclosing is in the motion filed publicly with the U.S. District Court. That essentially, we were done. They made a choice, they should have gotten more, and we were done.

Marc Newman: As the seller. No liability against the seller.

Clarence Pozza: I represented the seller. There were multiple representations for sellers. Brian, who is in the room, had one of the parties. So, it was a fascinating issue, and the court didn't have to get to it because the case settled. But I would have loved to have seen the result.

Thomas McNeil: So, we raise it here. Because M&A securities based litigation is on the rise and rep and warranty insurance issue became available in about the middle of 2014. Those securities cases are now coming out in public, and this is going to be an issue. So, watch for it, and we'll talk about it next year. Thank you.

Audience Member: Tom, can I ask you a question?

Thomas McNeil: Of course.

Audience Member: Do you think that the rise in those kinds of cases is because of the buyers, the buyers are people who are raising money in the public and if they have a company that fails that they bought, they did due diligence and it fails, they had to explain it to investors?

Thomas McNeil: So, it's a pool of money, and you have investors in there as a pool, that are private typically, yes, there is a little bit of CYA that we didn't make a bad decision, we must have been lied to. I think there is that issue.

Clarence Pozza: In our case, the company didn't fail. I mean sometimes this is a big battle over price. And if I . . . Brian, a comment?

Audience Member: It was the first time I had ever seen it too, and it was very interesting to see how it played out. I agree with the comment that you'd probably never be able to get that policy issued again. It was pretty clear that the insurer regretted issuing it in the first place.

Raymond Henney: Thank you so much gentlemen. We really appreciate it.

Panel 7: Securities Arbitration Developments

Raymond Henney: So our final presentation has to do with securities arbitration developments. And we're very pleased to have this distinguished panel of our FINRA representative, Felicia Fox. Who is a senior attorney with the Department of Arbitration. Gary Saretsky, who is a very prominent, mostly defense-oriented practitioner at his firm Saretsky, Hart, Michaels & Gould, and finally, sort of the dean of the claimant's bar in the arbitration field Joe Spiegel, Joe.

Joseph Spiegel: Here.

Raymond Henney: Oh, he's sneaking up behind me.Two things, the Cubs are ahead. Which is very important. Secondly, Anthony Troven, passed way in March. One of his real passions was the Michigan State College of Law Securities Clinic. And, what I'd like to introduce to you, and what we're going to try and do over the, you know, next six to twelve months because FINRA stopped funding the clinics all over the county, we are going to try and get funding for the clinic, and we're going to attempt to have it called the Michigan State College of Law Anthony B. Troven Jr. Securities Clinic. And, if you want any information about that I will be working with Gary Saretsky and a number of other practitioners. It's been a fabulous program, and the students loved it. It really gives them a leg up in getting a job.

Gary is going to talk about elder law issues, and then Felicia is going to talk about FINRA issues.

Gary Saretsky: Hi everyone. Elliot, thank you, for having me. Ray, thank you, appreciate the opportunity. It's kind of refreshing for us. For Joe, Felica, and I, to follow the litigation development group, that they take always such a very scholarly approach to securities litigation. Our topic of course is securities arbitration work and securities arbitration is, I think, probably by virtue of my personality and Joe's personality has become kind of the ugly stepchild or the rebel section of the securities law seminar that we have. Because, as we all know, the law doesn't apply in theory in arbitration so what are we doing at the Midwest Securities *Law* Institute? I'm not really sure about that, nonetheless, since most securities disputes are resolved in arbitration it seems very important to us to have a voice here. Between Tom and Rocky and Marc, you heard some terrific practitioners talking about developments.

I'm going to spend a little time talking about elderly investors or senior investors. There's a FINRA conference in Washington D.C. going on right now, dealing with elderly investors. Felicia is going to talk about FINRA arbitration rules, developments, and proposals. Joe is going to take a couple of hot topics. He is going to talk about the supervision of registered reps and customer accounts by the securities industry and the impact of the Department of Labor's new fiduciary duty rule. So, as I was preparing for my presentation, one of my favorite associates, Max Emmeritt, came in the office to talk to me and he said, "What are you working on?" and I said, "I'm working on this elderly investor thing." And Max said, "Well, I'm really sorry that someone took advantage of you Gary." And I just want to say, Max, I'll never forget that. Thank you so much for that compliment.

So, who is an elderly investor? And the answer is you look to state law to see who an elderly investor is. In the upper left hand corner you'll see that there is a Michigan civil statue, there's a Michigan criminal statute that defines what an elderly investor is, but in the center of the slide you see the common themes are typically it's an investor sixty to sixty five years old, who is venerable and subject to abuse, for one reason or another. It may be due to a physical infirmity, an emotional disability, but the common theme is that there is the exploitation of a vulnerable person, an elderly person, and the law seeks to protect people from that. So, is sixty to sixty five years old elderly? Anyone here want to guess what percentage of people sixty five and older use social media? Any guess? 10, 20, 30 percent?

Audience Member #5: Seventy percent.

Gary Saretsky: It's close to 60%. More than 60% of people sixty-five and older are on Facebook. So, my first provocative question for you is, are our laws, which are obviously well-intended, outdated? Is sixty to sixty five truly older? Now the PEW research center did a survey and they made a determination of when old age begins. Anyone want to guess when old age begins?

Sixty Eight. So, we have a situation where we have an aging population, well-intended laws, intended to protect them, but we might need to rethink how old an elderly investor really is. What is elder abuse? Comes in many forms. Physical, emotional, neglect, it can be abandonment, but what we're talking about here is exploitation. The taking and misuse of property, the concealment of funds or assets. Why are the elderly subject to abuse? There are frequently a combination of factors, again as I said, it could be declining health, but largely it deals with mental. Cognitive impairment, dementia and preying upon older people because of their fear of economic dependence. Why is financial exploitation such a concern? I think that this kind of reveals what's going on in our lives and what the reality is. The average life expectancy in 1776 was thirty-five. Today for a child born in 2016 the average life expectancy is eighty years old. So, what's really interesting is when you look at this chart here, you'll see that in 2013 we had 44.7 million Americans that are sixty-five or older. By 2060 that number will more than double to ninety-eight million. Of course, because women have the good fortune to live longer than men, more of older people will be women, and by the time we look at the population of eighty-five and older that's expected to triple in the next two generations.

So, we have a much older population, we need only look at our presidential election this year to illustrate that point. Donald Trump, if elected would be the oldest president ever. Hillary Clinton if elected, would be the second president oldest president ever. And, no one has made a serious challenge to their mental faculties or their physical stamina. I said serious challenge. Emphasis on the word serious there without tipping my hand. We have a problem. We have an aging population, our elderly have better healthcare and are living longer. Yet, we have well-intended laws, and of course FINRA out there, seeking to protect the interest of investors. So, I think one of the interesting things, and we'll talk about it a little bit more as we go along, the interesting thing is that FINRA, of course, seeks to protect elderly investors by providing elderly investors certain opportunities. Felicia, do you want to touch briefly on how FINRA seeks, in the arbitration venues, to protect the elderly?

Felicia Fox: Sure, thanks Gary. We started in 2004 a program to help expedite cases for elderly and seriously ill investors. And we have been improving upon that every year since. Even the task force that was one of their recommendations that we again re-visit that, and we are continuing to do so. So, I see this as a three-prong approach in processing these cases. So, we have what can staff do, what can arbitrators do, and what can parties do to help move these cases along. So as far as staff, we try and handle cases as soon as possible. We get the list out to parties faster. We encourage the parties to return them faster. We give the arbitrators less time to respond and accept the cases, all in the hope of handling the cases faster from the get go, and that will spur things along. Parties, we give parties options that they can stipulate to that will further expedite the case. They can agree to dates, they can agree to only have arbitrators who are available on those dates. Various other options that parties can select. As far as arbitrators, arbitrators are encouraged to schedule the cases faster, to have these cases heard within six months of the initial pre-hearing conference, which is faster than for a normal case where we recommend nine months. We also encourage arbitrators to select discovery deadlines that will expedite the matters and return rewards in all decisions faster, as well as, using the portal, and electronic means to deliver those orders for us. So, we can get those out to the parties faster.

Gary Saretsky: So FINRA by its words and conduct, its rules and policy, is encouraging its arbitrators to be sensitized to the needs of senior claimants, to press for expedited hearings and there is now a FINRA hotline for senior investors. All of these are positive developments, because it's important to protect and care for the elderly. So, I ask you what is the average age of a FINRA arbitrator? Who would like to guess?

Audience Member: Seventy.

Gary Saretsky: Sixty-nine, Michael. So, the very people that we're asking to protect the interest of investors might have an interest in protecting those investors. I don't know what the percentages are but I'm guessing there's not a very high percentage of twenty to thirty year old FINRA arbitrators. I haven't run across many.

Raymond Henney: Gary, with respect to FINRA, depositions are really discouraged, except in these types of cases. You can have a deposition at a nursing home, you can have a deposition to preserve testimony, especially with what I call super seniors, anybody over eighty, anybody out of ill-health, and the arbitrators have been sensitized to allowing the preservation of testimony.

Gary Saretsky: Good point. And law enforcement has become increasingly more protective of the elderly, this slide illustrates what the FBI's thinking is. Senior citizens are especially vulnerable because they have nest eggs, they're polite and trusting according to the FBI, they're ashamed to admit that they've been scammed or taken advantage of, they may be poor witnesses, and they may be susceptible. Joe, you've had some involvement recently in criminal prosecutions regarding scam artists, haven't you?

Joseph Spiegel: The State of Michigan has become very aggressive on prosecuting what we would call scam artists or people engaged in criminal activity. Simply because of taking advantage of what we call seniors, unsophisticated individuals, and the penalties, the criminal penalties range anywhere from three or four years up to nine or ten, or even twelve or fifteen years in prison. One person got twenty years. One of the things that I think people don't realize is the amount of money, the trillions of dollars that are being held by people who are over sixty-five to eighty years old. And you will find as a practitioner, when someone comes into your office, that's a super senior, you have to have the talk. And the talk is a very difficult talk, have you told your children, about this problem. And it's been my experience, and it was Tony's experience too, 99%, no. The super seniors have not told their children what has happened or what's going on in their financial lives. So, I'm going to throw it back to Gary. What would you advise a broker dealer, RIA, or a broker when they're confronted with these problems?

Gary Saretsky: Well, we've suggested a number of best practices for brokers and brokerage firms, I'm going to skip forward. Joe was just going to ask if you wanted to talk about, for example, Ponzi schemes, as a common type of financial fraud situation.

Joseph Spiegel: Ponzi schemes are the most prevalent where there is criminal charges. And, they are both under securities fraud and under racketeering. And, generally speaking, there are certain elements. There is an affinity, a group, a religious group, a social group. Next, thing you have is someone who started out possibly thinking it was going to be okay, suspending disbelief. All of a sudden, he's taking from one pot, and in addition they are lining their own pockets, and I think that's probably one of the key factors. The analysis by the state investigators, the FBI, and the SEC is invaluable in the prosecuting of these individuals. Once that threshold of, not just the misrepresentations, but the lining of their own pockets at the expense of the victims, it's incredibly important to the juries that hear these cases, and the juries are very sensitive to the abuse of these elders. And their testimony is very compelling. But again, it is something that starts possibly in real estate, or promissory note cases. Where someone may start with a thought that it could be okay, and all of a sudden it spins out of control, and they won't tell anybody, and all of sudden the money's gone.

Gary Saretsky: Joe, I'm going to answer your question because it was a very good question. I just want to give the context to the question, though, because brokers and brokerage firms become unwitting tools in abuse committed by, frequently, known and trusted friends or family members. And this relationship of trust and confidence can serve to disarm a person. And, so, we defending brokers and brokerage firms, run into familiar situations, where there are powers of attorney that are presented to us, giving a family member, a trusted friend the ability to control an account, or a trustee designation, a letter of authority, something like that. So, Joe asked, what can and what should brokers be doing? What they should do is really adopt a policy of stop, look, and listen. Stop thinking about accounts of the elderly as requiring the same type of oversight and supervision that you would give to any account, because it's not only humanitarian, it's not only appropriate, but it's the law at this point, that the interests of the elderly be watched carefully. Flag the accounts of the elderly. Know the senior customer, his or her family circumstances, etc. Look for the warning signs. The warning signs include, physical deterioration, cognitive deficits, changes in behavior, or living conditions. That, in and of itself, is a great thought and approach, but you should stop and ask yourself, as we do the securities industry, are we really trained, educated, qualified to be making physical assessments of people, physically and cognitively? It's a tough question. And then finally you need to, the industry needs to listen to customers. Listen to family members and listen to what the customer, the senior is looking for and wants. There are a number of red flags. We've already, kind of, briefly touched on these, but where you have a broker, who's a beneficiary of an elderly customers account, or a broker is serving in a functioning in a dual and conflicting capacity, for example as not only the broker of record, but also, you know, serving as, you know, a trustee, an authority over the account.

What is FINRA doing beyond? There are a number of proposals. I encourage you to look at, I don't want to monopolize the time that we have. I want to give Felicia and Joe an opportunity, but I want to just briefly touch upon some developments. FINRA notice to members 15-37 references two different rule amendments that have been proposed. An amendment to rule 4512 which would essentially allow firms . . . excuse me, a senior to designate a contact person and that trusted contact person would not be obligated to, but could, report incidents of abuse. So that's a positive proposal, and if handled well it can protect senior investors. The other rule proposal, 2165, this would effectively encourage a qualified person, such as a brokerage firm supervisor, compliance officer, etc., to intervene where there is a questionable disbursement or trade that might seem incompatible with a senior investor's investment objectives or risk tolerance and would permit that qualified person to place a temporary hold on a disbursement, for example, allowing further time for investigation and protection of a senior investor. NASA, which is the state securities regulators, which applies state law, has a model act proposal that model proposal goes even beyond that which FINRA has proposed in the sense that FINRA's proposal doesn't obligate brokerage firms to intervene, the model act, actually if you can see in a second, the third bullet point, key features, second point under, mandates certain reporting. So, even greater protection. And, lastly, you can see that, to date, 19 states have adopted elder laws. Four more are on track to adopt, and it is clearly the trend. It's clearly a development and it's something that all of us that care about human beings and that care about older investors need to be keenly aware of.

Joseph Spiegel?: Excellent. Felicia?

Felicia Fox: Well, thank you everybody. Elliot, Ray, thank you so much for inviting me back and to all the faculty and staff here at Michigan

State and the students for putting on such a great program. I do want to give the same disclaimer that all the other regulators did, that any opinions I may give today are mine, and not necessarily those of my colleagues at FINRA.

So let me talk about another recommendation that the FINRA task force made. And if you'd like, you can see the whole report, as well as FINRA's response to the report, on the FINRA website. But there was a suggestion that FINRA take some action regarding phantom experts. So by way of background of the code, rule 12514 requires that parties at least 20 days prior to the hearing, provide documents and a list of witnesses, including experts, to the other side. These witness lists are provided to the arbitrators. The arbitrators, in turn, will run conflict checks. Sometimes the witness lists that are provided list experts that have not actually been retained, and this practice has a number of adverse consequences. So, phantom listings can lead to arbitrator recusals that are not necessary, and when we do have to replace an arbitrator at the last minute, it causes disruption to the case. It can also lead to attorneys hiring rebuttal witnesses. . . rebuttal experts, and increasing fees, as well as leading to increased time estimates for the hearing. The phantom witness phenomenon also compromises the integrity of the process, and that is something that we are looking to avoid. So, best practices clearly dictate that parties avoid listing phantom experts. We have noted in our initial prehearing conference script, as well as in our hearing notice letter, that parties are not to be doing that, and we've also included an article in our neutral corner addressing that as well.

One recent rule change that I want to mention, is that involving award offsets. This is effective Monday. The SEC did approve a rule that where arbitrators are ordering two different decisions, one on a claim and one on a counterclaim, that they will be offset, and the party who has to pay the larger amount will pay the net difference. This comes into play mostly in promissory note cases where we see an employment-related counterclaim. The panel may be issuing an award on each claim, on the promissory note claim, as well as the associated person's counterclaim, and in theses cases, often the note claim might have a higher award amount than the counterclaim, and for whatever reason the associated person may not be paying their share of the award. So that led to confusion. Did the member have to pay before the associated person paid? Well, the new rule provides for offset and we're hoping that provides clarity as well as decreasing the amount of post-award litigation.

Joseph Spiegel: Gary, you've had some experience with that.

Gary Saretsky: I've had a lot of experience with that. This rule change is a very positive development. Because for those of us who have, for example, prosecuted claims against registered reps who have taken large promissory notes up front, or incentive compensation up front, when they've left one firm for another, will frequently sever their employment or have their employment severed, prior to the expiration of repayment of that loan. So large balances can be due and owing on those loans and those brokers may be unable to repay those loans, or they may have spent the money or they may be leaving the securities industry, and there was for many years a paralysis when arbitrators rendered awards. The awards would say that the brokerage firm, you know, would recover, let's say, 500,000 dollars on their promissory note claim, but we were going to give the broker 100,000 dollars on his or her breach of contract . . . breach of employment contract claim. And so it became a problem because the broker would not have the money to repay but would want to collect the 100,000 dollar award that he or she had received, and there was no effective way for the broker . . . for the brokerage firm collecting that money to enforce the award. This rule change prevents that type of gamesmanship and I think it's a great idea.

Joseph Spiegel: And you're dealing with large dollar amounts. Some of these loans are in excess of a million, two, even three million dollars, and Felicia, why don't you talk a little bit about it because it kind of ties into that expungement and the simplified . . . well first of all, on a note case, how many arbitrators do you need?

Felicia Fox: Well, generally we have an expedited procedure for promissory note cases. So, when a broker-dealer files a claim for a promissory note case, they're assigned one arbitrator. Now, if the associated person . . . and then it would just be heard on the papers . . . but if the associated person answers, then there would be a hearing. If the associated person answers and files a counterclaim over 100,000 dollars or for unspecified damages, an additional two arbitrators would be appointed to hear that, so there would be three in that scenario, with a hearing. You know, I've got a lot of rules, but you can find those on our website, there are various pending rules with the SEC right now. Joe?

Joseph Spiegel: Expungement.

Felicia Fox: Okay, I was going to give a whole chronology, I'm not going to in the interest of time. But, let me tell you where we are now. So, we've got variance guidance and updated guidance posted on the website. Please take a look at that, any practitioners, if you are filing or defending expungement cases, take a look at that, it's significant. In September of 2015, the board did authorize FINRA to actually file proposed amendments to rules 12805 and 13805 to codify those best practices and the expanded expungement guidance. As of January 1, 2016, parties requesting expungement are asked to provide additional information, so that's now on the website. Additionally, based on the taskforce recommendation, FINRA is proposing to amend the rules 12805 and 13805 to provide that FINRA will be notifying state regulators of all requests for expungement relief. So that's where we are now in a nutshell.

Joseph Spiegel: Be aware that there's two ways of going about expungement. The defense lawyer, assuming that the defense lawyer is representing both the firm and the broker, and the broker is not named. In the answer, the respondent will ask for expungement of the claim from the broker's record even though he's not a party. So, you can do that at the end of the hearing or if the matter is resolved, with that panel. If you wait, you can waive that panel and then file another expungement proceeding with a new panel. What has to be kept in mind is, and I have a little handout I'll give away, Royal Alliance Associates, a case out of California, the panel didn't let one of the parties talk. And, as a result of that, when the party seeking to have the award confirmed, the trial court, because you need to have the arbitrator award confirmed by a court and then you send it on, the trial court wouldn't confirm the award. In fact, vacated the award simply because the process was unfair. So in the scripts, and in the neutral corner, and in the rules, arbitrators are now trained to be sensitive to allowing evidence to come in. Now, Felicia, in a simplified hearing, do you have to have a hearing to have an expungement? 25,000 dollars or lower, no hearing on the papers, how do you get expungement?

Felicia Fox: However, if the respondent has sought expungement in the answer, again it has to be in the answer, in this case because there's no hearing, there's no opportunity to orally request that unless it was in that pleading. So, when the arbitrator is considering the claimant's claims on the paper submissions, and they see that there is an expungement request, and they think that might be something they might be interested in granting, because to grant it you need to hold a hearing. To deny it, a hearing is not required. So if the arbitrator might want to consider hearing expungement arguments, they will have to call a hearing. The hearing would just be limited to expungement, FINRA would have already received the decision on claimant's case, however, that's not published to the parties until the expungement question is resolved because that's all going out in one decision.

Joseph Spiegel: Gary, what's your experience with expungements?

Gary Saretsky: So, let me provide a real world example of an expungement situation. And it's a situation that my associate, Lisa Sara who's here, and I are working on together. So expungement is of course, a rule that FINRA says should be granted sparingly, that it's extraordinary relief; there are good reasons for the regulation of expungement, of course. Investor protection is primary, and the integrity of information on the publically disclosed CRD (central registration depository), which is the databank of all information on brokers and brokerage firms, that should be accurate. But you have a situation where we are defending . . . we are representing a broker who was the subject of a customer complaint by an elderly investor who misunderstood the brokerage firm documents and statements that he had received, and he issued a complaint letter to his brokerage firm complaining that his broker had engaged in unauthorized trades in his account. And after that letter was presented to the broker and the brokerage firm, and it was investigated, it was pointed out to the elderly investor that no, there wasn't a new trade . . . new unauthorized trade put in your account, you transferred your account from one brokerage firm to another, you had forgotten that you had made the purchase at firm number one, it was merely transferred to firm number two, so your complaint against the broker at firm number two, that he had engaged in an unauthorized trade, is inaccurate. So, that elderly investor said, "Oh my gosh, I'm so sorry, I made a mistake." But yet, that complaint remains on the broker's CRD. And that broker's been in the securities industry for 30 years, and unless he takes the step to seek to expunge that complaint from his record, then every prospective client, every prospective brokerage firm that he seeks to conduct business with will see that he was the subject of a customer complaint. And so, the expungement rule and the processes surrounding it are very real to the securities industry. And, you know, Tony Trogan and I used to fondly argue with each other. He used to call the, you know, expungement basically . . . he was in the business of selling expungements when he would settle cases. And that's really not what was going on. There are sometimes good reasons for claims being expunged. Sorry to go on, Felicia.

Felicia Fox: No, and Gary's right. But it's important that the customer does have the opportunity in these situations, to appear, to have notice of what's going on, because sometimes a broker will just file a case for expungement, name the broker dealer as the respondent, and the customer's not involved. So the guidance provides that the broker provide the customer, in the underlying dispute, with notice of the arbitration of the statement of claim, as well as the hearing, so that customer and/or his attorney, her attorney, has the opportunity to appear and present their case. They can appear in writing, they can just submit something on the papers if they don't feel like they want to appear, if it's too much, they don't want to pay their attorney to appear, for whatever reason, but they can appear in writing, in person, by phone, by video, and in Gary's situation, they don't always oppose it. I mean, I've seen the situation that Gary's talking about. They might appear and say, you know what, my bad, I didn't understand what was going on, this really should be expunged. Conversely, they might appear and say oh no, this really happened, this should stay, I don't want this to happen to anybody else. Or, the customer might not appear at all. So, we see all these scenarios, but the most important takeaway is the customer has an opportunity to present their side of this issue.

Joseph Spiegel: The portal is going to be in effect, maybe in the spring?

Felicia Fox: The effective date has not . . . well no actually that's still under review by the SEC. So it's going to be sixty days and then ninety days before so, after approval.

Gary Saretsky: Explain what the portal is.

Joseph Spiegel: Let me explain. In federal court and state court you file electronically. FINRA had a portal similar to electronic filing in the state and federal system and that is going to become mandatory in the spring. So, if you want to file your statement of claim, your answer, your motions, your discovery, it will be through the FINRA portal and there's all sorts of information about that.

Felicia Fox: It would be mandatory for all except unrepresented customers.

Joseph Spiegel: Right. I'm going to switch topics because I don't know how much time we have left. Five minutes. Alright, supervision. Culture, conflicts of interest, and ethics. While firms may have their own definition of firm culture, we use it here to refer to the set of explicit and implicit norms, practices, and expected behaviors that influence how firm executives, supervisors, and employees make and implement decisions in the course of conducting a firm's business. The supervisory system has to reflect this type of culture that the firm has. It's got to be in writing. So my question is: you file a statement of claim against a firm, is that something that has to be produced in discovery?

Gary Saretsky: Okay. Does a complaint . . .

Joseph Spiegel: A complaint's filed. The whole business of a sweep letter, and the firm has replied, and it has its culture, and all it's supervisory. The letter . . . the specific letter that is in response to the establishing communicating implementing cultural values that came out in February. It has all sorts of specifics that the firm has to do and it has to put it in writing. Right?

Gary Saretsky: Yeah. I would think if it's a customer complaint that complains of the firm's culture and a lack of supervision that that's something that's likely going to be required to be produced. But, if it's an internal communication between a firm and FINRA regarding its . . . the firm's culture, and FINRA's perspective that the firm should be looking to enhance its culture through a variety of steps, I would think that that would hopefully, probably, wouldn't be required to be produced. You don't want to disincentivize a brokerage firm, or any business that's seeking to make improvements by penalizing them for producing documents responding favorably to a regulator's suggestion.

Joseph Spiegel: Somewhat similar to internal investigations, when are those produced, when are they not produced. I highly recommend targeted exam letters. The list, it's on the FINRA website, there is one that came out in July: Conflicts of Interest. There's another one that came out just in September: Unit Investment Trust Rollover Review. That's a particular product. Unit investment trusts have to be rolled over and it can cause some problems. So the sweep letters are important. Briefly, on fiduciary duty. I think the fiduciary duty issue is going to compound itself with respect to such things as annuities, variable annuities, variable life policies. The insurance companies take the position that an annuity is an insurance product even though almost all the insurance companies have a subsidiary, which is a broker-dealer, which distributes the product because the underlying product has mutual funds. There is a recent Illinois case that I totally disagree with.

I'll give you the citation on this piece of paper, you can come and get it, *Barres v. Sterns*. It takes the position that a fixed annuity of that particular type was an insurance product. What does that mean to the practitioner? You have a senior citizen, they're purchasing an annuity, the annuity is a variable annuity, maybe a variable whole life policy. The first year's . . . the first commission is probably almost a hundred percent of the first year's premium, it could be 100,000 dollars. Now, that's not disclosed in the documents and all of a sudden the children find out about this annuity and they don't like it and they want to rescind it. The insurance companies won't do that even though the people haven't died, so you've got a lawsuit. You have to file two things. You have to file against the broker, if it's a FINRA broker, but you also have to file a lawsuit in court, because the insurance company is not going to agree to the FINRA arbitration.

Speaking of that, one of the really interesting issues that I think, and Mr. Newman touched on it, the Wells Fargo case. How many of those thousands of people that got involved in these credit card and open account have an arbitration provision? I'll bet you, at least 80 to 90 percent were also Wells Fargo customers. What does that mean? Well, there's an interesting article in the ABA. The CFP . . . the Consumer Protection Board is really going to take a bite out of arbitration one way or another. Somehow, someway, people are going to file a class action against Wells Fargo. Well, how can you file a class action against Wells Fargo when you have an arbitration provision? So that is going to be an issue that's going to be teed up. And, in that regard, if you take a look at FINRA notice 1625. The customer has a right to request FINRA arbitration. However, there's a case out of the Second Circuit, 2016, *Credit Swiss versus Tracy*, which specifically held that if there is a forum selection provision in an agreement, even though it's a FINRA person, that agreement trumps the FINRA arbitration rule. So, there are going to be some really really interesting issues coming up in the next year or so. God willing we all come back, some of these will be fleshed out. Finally, keep in mind, this is just a practice tip, two practice tips: ask for interest in your awards. The interest. . .

Gary Saretsky: We as respondents all always do, we never get it though Joe, never.

Joseph Spiegel: Ask for interest from the day the loss occurred. *Cant v. AG Becker*, as well as post-interest. Interest is can be a lot of money. And then, finally, I think we all have to be cognizant of the fact that personal jurisdiction is necessary for a FINRA subpoena to be issued and enforced by a court of law. And you're going to have to deal with every different federal court in the country because the administrators in the courts handle it all differently. It's very difficult sometimes to get a FINRA subpoena issued outside your little jurisdiction. I want to thank Ray he's done a great job. A phenomenal job. Mr. Posner.

Audience Member: If old age starts at sixty-eight and the average FINRA arbitrator is sixty-nine, that means the protector arbitrators of the elderly are subject to the same potential cognitive inaudible.

Gary Saretsky: Thank for listening to me and understanding my point Jeff. I really appreciate that.

Felicia Fox: And I have to contradict Gary's point because I think he's just making that up in his old age.

Professor Spoon: This brings an end to our conference this year.