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Invested in America

February 17, 2017

Representative Robin Weisz
Chairman, Human Services Committee
North Dakota House of Representatives
600 E Boulevard Ave
Bismarck, North Dakota 58505

RE: SB 2322, an Act to create and enact a new section to chapter 10-04 of the North Dakota Century Code, relating to the financial exploitation of vulnerable adults.

Dear Representative Weisz:

On behalf of the Securities Industry and Financial Markets Association (SIFMA),[1] I would like to provide comments on SB 2322 (expected to soon be sent to your Committee), which would establish a process for securities firms to take additional measures to protect their senior or vulnerable clients. SIFMA has been a strong supporter of state and federal laws to provide additional tools and pathways to partner with regulators to help us further protect our senior clients, while fully complying with existing securities laws and rules. To be clear, SIFMA strongly supports the goal of this bill.

Earlier this month - after SB 2322 was drafted and introduced - the Securities and Exchange Commission approved new rules on this exact issue. Since those rules are similar in many ways and share the same goal, but differ in certain details, firms in North Dakota will be caught between contradictory federal and state rules, which presents compliance challenges and imposes additional costs and procedural burdens. I would like to ask for your consideration of amendments that will align North Dakota's rules with these new federal rules.

SIFMA has been a vocal advocate in the fight against senior financial exploitation for nearly a decade, founded a Senior Investor Protection working group of financial firms that now includes 150 representatives from 60+ diverse member firms, and has worked with multiple states[2] to enact laws which create a reporting pathway from Broker-Dealers to state securities regulators and Adult Protective Services organizations (APS), and permit those reporting firms to place temporary holds on suspicious transactions and/or disbursements to allow time for the state to investigate (commonly referred to as "Report & Hold" laws). We've also submitted comments to both the Financial Industry Regulatory Authority (FINRA) and North American Securities Administrators Association (NASAA) on their respective "Report & Hold" proposals, which seek similar goals but may, in certain instances, have presented operational challenges - especially where the new federal rules[3] and the older state model law conflict.

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[1] SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving retail clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. For more information, visit http://www.sifma.org.

[2] Washington State, Delaware, Missouri, Indiana, Alabama and Louisiana.

[3] Approved by the SEC February 3, 2017.

While SIFMA and its member firms have been working in this space for nearly a decade, over the last few years – in fact over the last year alone – the senior investor protection landscape has quickly evolved. New federal rules were approved this month by the SEC which govern actions by securities firms and provide firms with the ability to take additional actions to protect their senior clients. Incorporating lessons learned from states which have worked to enact laws – from Washington State's 2010 law to present efforts – and the perspectives and expertise from the consumer, aging and industry advocates that have been working in this space, the SEC approved an effective and efficient Report & Hold rule that has received the stamp of approval from the federal government and aging advocates alike. This new FINRA Rule 2165 underwent several rounds of notice and comment rulemaking and significantly evolved between its first release in late 2015 (shortly after the NASAA model was first proposed) and its final approval by the SEC on February 3, 2017.

This new rule is applicable to Broker-Dealers in North Dakota and across the country. As such, we strongly urge the legislature to take note of the robust, 16-month rulemaking process, which included several sets of changes across 4 detailed releases from FINRA and the SEC.[4] Furthermore, by harmonizing any North Dakota law with the SEC-approved rule, the Legislative Assembly can help ensure seamless effective protections of North Dakota's seniors and vulnerable adults.

Specifically, we would like to bring the following areas needing such harmonization to your attention. We've also attached suggested language, which would harmonize SB 2322 with the SEC-approved rule and federal law with a minimum of changes.

I. Maintaining the State's Current Reporting Status:

- Early in the process, FINRA chose to adopt a voluntary-reporting stance which would allow each state to make an independent decision regarding voluntary versus mandatory reporting status.[5] As such, almost every state that has enacted a Report & Hold law (Washington State, Delaware, Missouri, Indiana and Louisiana) has chosen to maintain their current status. In part, this is due to the significant workload increase and financial impact that mandatory reporting can have – particularly in situations where an overwhelming majority of Broker-Dealers already voluntarily report their reasonable belief of suspected financial exploitation. Moreover, it has been estimated that about 40% of Broker-Dealer reports can be false positives in mandatory reporting jurisdictions. In states which do not impose this mandate (thus allowing further pre-report investigation by firms), false positive reporting is reduced. Should the North Dakota legislature still wish to consider a change to a mandatory reporting stance, SIFMA strongly urges you to undertake a fiscal analysis to determine the impact of such a workload increase for the State's agencies and ensure sufficient resources to address every report you would be requiring under the law.

[4] FINRA Regulatory Notice 15-37; SR-2016-039; SR-FINRA-2016-039 - Amendment #1; and SEC Release No. 34-79964.

[5] FINRA Regulatory Notice 15-37.

II. Moving Away from the use of "Qualified Individuals"

- In their first revision, FINRA decided to move away from the use of "Qualified Individuals" and keep all of the actions, obligations and protections at the firm-level, as opposed to focusing on individual employees.[6] This has two effects: 1) it avoids complications (i.e., duplicative or low-quality reporting lacking relevant information) that can be caused by placing legal obligations on individuals and mandating reporting in a manner that may conflict with internal escalation requirements, thereby undercutting a firm's ability to effectively supervise its employees; and 2) it ensures that the law does not unintentionally limit firms from adopting innovative multi-disciplinary fast-response teams dedicated to senior and vulnerable adult protection that are housed outside of a firm's legal, compliance or supervisory structure.

  Specifically, some firms have established (or are establishing) dedicated multi-disciplinary units which bring together employees from several business sectors to staff a dedicated fast-response team which reviews suspicious activity in the accounts of senior and vulnerable investors. However, because these units are often located within a firm's business unit and don't necessarily consist of "supervisors" (a very specific term in the securities industry), these innovative teams would fall outside of SB 2322's definition of "qualified individual."

III. Time Periods and Procedures Regarding Extensions, and Protecting the Discretion and Authority of Investigating Agencies

- The time periods and reporting procedures were updated by FINRA and the SEC from those reflected in the earlier NASAA model to ensure: 1) a level of harmonization with existing state laws; 2) an efficient process that would effectively protect senior investors and vulnerable adults; and 3) that the Report & Hold rule did not curtail the existing authority of state investigating agencies, such as state securities regulators and APS.

  Specifically, SB 2322 does not provide any investigating agency – particularly the securities commissioner – with the authority to extend a hold beyond 25 business days, when necessary, without a court order. Periodically, particularly complex situations of financial exploitation can arise which may take more than 25 business days for the investigating agencies to resolve; this change would provide better protection for North Dakotans subject to complex schemes, protect the investigating agencies' existing discretion and harmonize with the SEC-approved rule, which recognizes the ability of the agencies to issue such an order.[7] As such, we urge you to adopt both the time frames and reporting procedures in Sections (b)(2) and (b)(3) of the final SEC-approved rule,[8] which are also included in the attachment below.

[6] Note change between FINRA Regulatory Notice 15-37 (initial proposal) and SR-FINRA-2016-039 (second proposal).
[7] FINRA Rule 2165(b)(3).
[8] Contained in SR-2016-039 – Amendment No. 1.

IV. Utilizing a Single Immunity Provision and "Discretion" Standard.

- Finally, in the SEC-approved version, FINRA chose to utilize a single safe-harbor provision that covered all actions taken in accordance with the Report & Hold provision, while utilizing a well-settled legal standard in securities law. Currently, SB 2322 fails to provide Broker-Dealers protection for acting in accordance with Section 7 (dealing with recordsharing), and utilizes a unique legal standard ("in good faith and exercising reasonable care") not otherwise utilized in securities law, which could have significant unintended consequences in the court system.

V. Expanding Investor Protections by Allowing Transaction Holds

- Finally, SIFMA believes that it is important that the protections of any Report & Hold law be expanded to include temporary holds on transactions, in addition to disbursements. While placing a hold on disbursements allows firms to mitigate the most readily apparent consequences of financial exploitation, customers can still face significant negative impacts from both underlying and stand-alone transactions. Exploitative transactions can trigger significant tax consequences (i.e., due to the liquidation of certain securities), fees or other negative financial implications for the Specified Adult. Moreover, a bad actor (for instance, someone misusing a power of attorney) may be able to use their position to undertake trading schemes for their benefit, at the cost of the Specified Adult's interests, exposing the client to significant financial losses (such as new investments in options or penny stocks). Currently, 1/3 of states with a Report & Hold law have chosen to extend these protections to all transactions, and FINRA has stated an interest in expanding the national rule to focus on transactions in the future.[9]

Thank you again for your efforts on behalf of North Dakota seniors, and we look forward to the opportunity to work with you to address these issues and better protect investors in your state. If you have any questions or if there is any further information we can provide, please contact me directly at (212) 313-1317 or mgibson@sifma.org.

Best regards,

Marin E. Gibson
Managing Director & Associate General Counsel
SIFMA
State Government Affairs

[9] SR-FINRA2016-039.

Appendix I:
Proposed Language Harmonizing SB 2322 with SEC-Approved FINRA Rule 2165

[…]

2. If a broker-dealer or investment adviser reasonably believes financial exploitation of an eligible adult may have occurred, may have been attempted, or is being attempted, the broker-dealer or investment adviser may notify the department of human services and the commissioner.

[…]

4.[10] a. A broker-dealer or investment adviser may delay a transaction or disbursement of funds or securities from an account of an eligible adult or an account on which an eligible adult is a beneficiary if:

(1) the broker-dealer or investment adviser reasonably believes the requested transaction or disbursement may result in financial exploitation of an eligible adult after initiating an internal review of the requested transaction or disbursement and the suspected financial exploitation; and

(2) the broker-dealer or investment adviser:

(a) Provides written notification of the delay and the reason for the delay to all parties authorized to transact business on the account, unless a party is reasonably believed to have engaged in suspected or attempted financial exploitation of the eligible adult, within two days after the requested transaction or disbursement;

(b) Notifies the department of human services and the commissioner within two days after the requested transaction or disbursement; and

(c) Continues its internal review of the suspected or attempted financial exploitation of the eligible adult as necessary.

b) The delay of a transaction or disbursement authorized by this law will expire not later than 15 business days after the date that the broker-dealer or investment adviser first placed the delay on the transaction or disbursement of funds or securities, unless sooner terminated or extended by the commissioner, the department of human services, or a court of competent jurisdiction, or extended pursuant to part (3) of this Section.

c) Provided that the broker-dealer or investment adviser's internal review of the facts and circumstances supports the broker-dealer or investment adviser's reasonable belief that the financial exploitation of the vulnerable person has occurred, is occurring, has been attempted, or will be attempted, the delay of a transaction or disbursement authorized by this law may be extended by the broker-dealer or investment adviser for no longer than 10

[10] Paragraph 5 in current draft of SB 2322.

business days following the date authorized by part (b) of this Section, unless otherwise terminated or extended by the commissioner, the department of human services or a court of competent jurisdiction.

5.[11] A broker-dealer or investment adviser shall provide access to or copies of records that are relevant to the suspected or attempted financial exploitation of an eligible adult to the department of human services and to law enforcement, either as part of a referral to the department or to law enforcement, or upon request of the department or law enforcement pursuant to an investigation. The records may include historical records and records relating to the most recent transaction that may comprise financial exploitation of an eligible adult. Any record provided to the department of human services or law enforcement under this section is an exempt record under chapter 44 - 04. This section does not limit or otherwise impede the authority of the commissioner to access or examine the books and records of a broker - dealer or investment adviser as otherwise provided by law.

6.[12] A broker-dealer or investment adviser that exercises discretion in compliance with this law shall be immune from any administrative or civil liability that might otherwise arise from such actions.

[11] Paragraph 7 in current draft of SB 2322.

[12] A combination of paragraphs 4 and 6 in current draft of SB 2322.