



Consumer Federation of America

AFR Americans for
Financial Reform

Whose Side is the SEC On?

How to tell if the SEC's new standard for brokers and advisers really helps consumers

The Securities and Exchange Commission (SEC) is scheduled to vote Wednesday on a long-awaited proposal to raise the standard of conduct for broker-dealers when they make investment recommendations. Depending on how it is drafted, the proposal could require advice that is in the best interests of savers and retirees, or it could preserve the ability of financial firms to profit unfairly at their customers' expense. Tens of billions of dollars a year in Americans' hard-earned savings are at stake.

As explained further below, any truly consumer friendly standard must: (1) require brokers and advisers alike to act in their customers' best interests; (2) stop companies from encouraging brokers to act against their clients' interests; and (3) stop financial professionals from marketing themselves as trusted advisers unless they actually have to meet the best interest standard appropriate to that role. In evaluating the SEC proposal, we'll be asking the following questions.

Does it impose a true best interest standard on brokers' investment recommendations?

When people turn to financial professionals for help with their investments, they expect those professionals to recommend the investments that are best for them. But that is not currently the case for brokers who operate under what is known as the "suitability" standard that leaves them free to recommend the products that are most profitable for them, rather than those that are best for the customer, as long as they are generally appropriate. Knowing they can't fight the simple principle that professionals should put their customers first, financial firms have publicly claimed to support a best interest standard, while working feverishly behind the scenes to avoid any real obligation to do what's best for their customers. Toward that end, they've sought to rebrand brokers' existing suitability standard as a "best interest" standard that is "appropriately tailored for the broker-dealer business model" and redefine terms associated with a fiduciary standard, such as "duty of care," as compliance with existing – and inadequate – rules of FINRA, the industry's private self-regulatory authority.

In evaluating the SEC's proposed new rule, we'll be looking to see whether it provides the best interest standard investors expect and deserve or simply tweaks the existing suitability standard, as industry has sought. The critical question: what will brokers be prohibited from doing under the new standard that they are permitted to do under the existing suitability standard? Specifically, does the new standard require the broker to recommend the best available investment option, taking into account the needs of the investor and the characteristics of the investment? Anything short of that is not a true best interest standard and should not be labeled as such.

Does the clarified standard for investment advisers also include a clear requirement to act in clients' best interests?

Investment advisers have long been held to a heightened standard under the Investment Advisers Act of 1940. But that standard is the result of judicial and staff interpretations of the Act's

anti-fraud provisions, rather than a statutory requirement. Over the years, the SEC has been reluctant to bring enforcement actions under the Act that impose obligations beyond disclosure, and disclosure has been shown time and again to be ineffective in protecting investors. A best interest standard does not mean much unless investment advisers have to change their behavior, not simply change the fine print of their paperwork. In evaluating the SEC proposal, we'll be looking to see whether the clarified standard for investment advisers includes an explicit obligation to act in the customer's best interests that cannot be satisfied through disclosure alone.

Does the new standard for brokers and advisers include limits on conflicts of interest?

Raising the standard of conduct without reining in the practices that encourage violations of that standard is likely to produce only minimal improvements in broker conduct and the treatment of investors. As long as financial professionals continue to be paid and rewarded for making recommendations that profit the firm, instead of those that are best for the investor, they are likely to act on those incentives. While the SEC Chairman has made clear that he does not intend to impose the strict limits on conflicts of interest included in the Department of Labor's pro-investor fiduciary rule for retirement accounts, there's still room for improvement over the disclosure-only approach to addressing conflicts advocated by industry.

In evaluating the SEC's proposed new standard, we'll be looking to see whether it takes any steps to rein in industry practices that encourage and reward harmful advice. In particular, we'll be looking to see whether the SEC is willing to take even the most basic step of prohibiting firms from intentionally creating incentives – such as sales quotas, sales contests, and paying bonuses to reward the sale of particular products – that encourage financial professionals to base their recommendations on their own financial interests, rather than the customer's best interests.

Will the proposal enhance investors' ability to make an informed choice among different types of financial professionals?

Years of research has shown that investors cannot distinguish between brokers and investment advisers, which is a crucial fact to bear in mind. The Commission is proposing to require brokers and advisers alike to provide customers with a brief written "relationship summary," which is presumably designed to help alleviate that confusion. But disclosure alone cannot solve this problem if it is not backed by restrictions on the ability of brokers to market themselves to the public as trusted advisers and to label their sales representatives as "financial advisors," "wealth managers," and other similar terms. In evaluating the SEC proposal, we will be looking to see whether the agency places appropriate restrictions on the misleading use of such titles and whether it proposes to test the new disclosure document for effectiveness in conveying key information to investors.

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The SEC has the potential to save investors tens of billions of dollars by requiring brokers and advisers alike to act in customers' best interests. The weak, disclosure-based standard industry has been lobbying for would do more harm than good, by creating the false impression that investors are protected when that is not the case. Investors will be watching Wednesday's vote closely to see whose side the SEC is on.