Center for American Progress

Consumer Federation of America

MEMORANDUM

TO: **Interested Parties**
FROM: **Center for American Progress and Consumer Federation of America**
DATE: **June 3, 2019**
SUBJECT: **Securities and Exchange Commission's Rulemaking on Conduct Standards for Broker-Dealers and Investment Advisers and Form CRS**

When Congress adopted the Dodd-Frank Act nearly a decade ago, it gave the Securities and Exchange Commission (the Commission) a clear directive to improve protections for vulnerable investors in their dealings with broker-dealers and investment advisers. It gave the Commission all the authority it needed to adopt a strong, uniform fiduciary standard of care for broker-dealers and investment advisers backed by tough restrictions on harmful practices.

This mandate didn't emerge from thin air. Between 2001 and 2010, the real wealth of the average middle-class American household fell a stunning 49 percent, and many groups still have not fully recovered from this loss. Moreover, conflicts of interest in the retirement industry are costing working and middle-class families—knocking *more than a quarter* off of the returns over a 35-year period. To put that in concrete terms, a family that saved $10,000 today would in 35 years only see that grow to $28,500—losing out $9,500 to the costs of conflicted advice. With millions of working families at risk of being unable to retire securely, ensuring that families are not paying unfair and conflicted fees is more important than ever.

The Obama Administration acted to protect retirees, but the Trump Administration has let a flawed court decision strip back those protections. In response to a range of voices, the focus of rulemaking shifted to the Commission. However, after years of study and deliberation, and amid mounting evidence that investors lose tens of billions of dollars a year as a result of conflicted advice, the Commission is poised to vote June 5th on a set of rules that—incredibly—do more to weaken protections for investors in their dealings with investment professionals than to strengthen them. This is a betrayal of the "Mr. and Ms. 401(k)" investors Chairman Clayton pledged to protect when he undertook this rulemaking.

1. The SEC is poised to dramatically weaken its long-standing interpretation of the fiduciary duties that investment advisers owe their clients under the Investment Advisers Act.

The SEC has maintained for many years that investment advisers, as fiduciaries, are required to place their clients' interests first at all times and cannot disclose or negotiate that obligation away. The Commission's new guidance, if it follows the general approach in the proposal, sends the opposite message, that there is little short of outright fraud that advisers cannot disclose away in compliance with their fiduciary obligations. This disclosure-based approach will do nothing to protect investors from the conflicts of interest that are increasingly common in the advisory accounts at firms that are dually registered as broker-dealers and investment advisers.

Arguments that disclosure is all the Commission can require under the Advisers Act's implied fiduciary standard are no excuse. Congress gave the Commission all the authority it needed in Section 913(g) of the Dodd-Frank Act to adopt a strong, explicit fiduciary standard for advisers backed by tough restrictions on harmful conflicts and anti-investor practices. The Commission made a deliberate and conscious choice not to use the authority Congress gave it to protect vulnerable investors.

Moreover, based on a review of the comments letters, while most advisers support a strong fiduciary standard, some in industry are actively pushing the Commission to lock in an even lower standard under the Advisers Act. Any steps that affirmatively reduce the protections that investors rely on with respect to investment advisers would be an extraordinary betrayal of the mandate that Congress set out for the Commission.

2. **The SEC is poised to adopt a weak new best-interest-standard-in-name-only for broker-dealers that will mislead investors into expecting protections it does not deliver.**

The SEC is poised to adopt a new standard of conduct for brokers that it calls a best interest standard but that largely reflects existing requirements under FINRA suitability rules. The SEC has refused to specify that brokers would be required to recommend the investments and investment strategies they reasonably believe represent the best available option for the investor, which is what investors reasonably expect from a best interest standard.

Although the Commission claims the rule is intended to prevent brokers from placing their interests ahead of their customers' interests, it is likely to be fully satisfied through compliance with disclosure, care, and conflict obligations that do not include any such prohibition and affirmatively muddy the waters regarding the "best interests" of the customer. The conflict obligations impose an undefined requirement to "mitigate" financial incentives, but it doesn't require that mitigation measures be reasonably designed to prevent the broker from placing its interests ahead of the customer's interests, and it doesn't prohibit firms from creating incentives that encourage and reward advice that is not in customers' best interests.

Here again, Congress gave the Commission authority to adopt a strong, pro-investor standard, but the Commission chose not to use that authority to protect vulnerable investors.

3. **The Commission is poised to adopt a new pre-engagement disclosures that will not reduce investor confuse or increase their ability to choose the type of investment professional or account that is best for them.**

The Commission set a modest goal for this rulemaking – to reduce investor confusion and enable investors to choose the type of investment professional or account that is best for them. It appears likely that it will fail to achieve even that modest goal. Testing of the Customer Relationship Summary, as originally proposed, showed that it failed to provide investors with a basic understanding of such crucial items as the nature of the services being offered, the legal obligations of the broker or adviser, and the conflicts of interest that could bias their recommendations.

Instead of fixing those shortcomings, the Commission appears poised to give firms greater flexibility to develop their own disclosures. The inevitable outcome is that inconsistent disclosures will make it difficult for investors to compare firms, and that at least some firms will take advantage of the greater "flexibility" to sugar coat issues, like conflicts of interest, that they do not want investors to understand. As a result, investors will be no better able to make an informed choice among different types of accounts and providers than they were before the rulemaking.

This is inconsistent with Congress' directive to the agency to "facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with brokers, dealers, and investment advisers, including any material conflicts of interest."

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In light of these myriad shortcomings, it must be a top priority for a new SEC in a new Administration to reopen this rulemaking in order to adopt the strong, pro-investor standards that Congress intended and that investors so desperately need and deserve.

For more detail, see:

Consumer Federation of America, "The SEC's 'Best Interest' Bait and Switch," June 3, 2019, available at https://consumerfed.org/wp-content/uploads/2019/06/CFA-Best-Interest-Bait-and-Switch.pdf.

Consumer Federation of America, "SEC Proposal Fails to Live Up to its 'Best Interest' Label," August 7, 2018, available at https://consumerfed.org/press_release/sec-proposal-fails-to-live-up-to-its-best-interest-label/.

Christian Weller, Center for American Progress, "Proposed SEC Rules Protect Brokers' Profits, Not People's Retirement," Forbes, Dec. 11, 2018, available at https://www.forbes.com/sites/christianweller/2018/12/11/proposed-sec-rules-protect-brokers-profits-not-peoples-retirement/#5de7d82752f1.

Carmel Martin, Andy Green, Brendan Duke, eds., Center for American Progress, "Raising Wages and Rebuilding Wealth," September 2016, available at https://www.americanprogress.org/issues/economy/reports/2016/09/08/143585/raising-wages-and-rebuilding-wealth/.

Joe Valenti, Center for American Progress, "A Secure Retirement Demands Limiting Conflicts of Interest," April 6, 2016, available at https://www.americanprogress.org/issues/economy/news/2016/04/06/134883/a-secure-retirement-demands-limiting-conflicts-of-interest/.