Consumer Federation of America

Statement of Micah Hauptman
Director of Investor Protection
Consumer Federation of America
Press Conference: "Investor Advocacy Coalition to Push SEC for RIA Reforms in Wake of Scathing Report"
February 1, 2024

Thank you, I am Micah Hauptman, director of investor protection at the Consumer Federation of America. I agree with everything the other speakers have said.

Advisers should not be able to use forced arbitration clauses to immunize themselves from accountability for their misconduct. If an adviser uses forced arbitration clauses in ways that effectively deny a client's ability to pursue justice and recover losses that they've suffered, the adviser is placing their interests ahead of the client's, in violation of the adviser's fiduciary duty. No reasonable investor would consent to the use of such a clause.

I also want to add a few points to the discussion. First, as the SEC Investor Advocate's report makes clear, in contrast to state registered advisers and broker-dealers, there is a lack of information about the extent to which federally registered advisers use forced arbitration clauses and how such clauses affect investors. The standard that guides federally registered investors' disclosure obligations in this context, whether the information is material, leaves considerable discretion and flexibility for federally registered advisers to disclose information about the use of these clauses and how such clauses affect clients' ability to pursue justice and recover losses that they've suffered. Because we don't have a complete picture of the scope and extent of the problem, federally registered investment advisers should be required to disclose more detailed information about their use of forced arbitration clauses, which could help inform investors in selecting an adviser, as well as future regulatory action.

Second, it's important to recognize meaningful differences between FINRA arbitration and investment adviser arbitration. I'll focus on three key differences. First, FINRA exercises oversight of the broker-customer arbitration process and has rules in place designed to ensure the fairness of the process for investors. In contrast, investment adviser arbitration is not overseen by either a Self-Regulatory Organization (SRO) or the SEC and the rules, set by private organizations, do not ensure the fairness of the process for investors.

In addition, FINRA rules prohibit firms from requiring customers to waive their ability to bring class actions—in other words banding together when they suffer the same harm. This ensures that investors can hold firms that engage in widespread, systematic misconduct accountable. In contrast, investment advisers are allowed to prohibit clients from pursuing class actions, which could impede clients from holding their adviser accountable if their adviser engages in systematic misconduct.

Third, FINRA rules provide an avenue for investors to bring small dollar claims against their broker-dealer. That avenue exists, in part, because firms subsidize the FINRA dispute resolution process. However, there is no similar mechanism for clients of investment advisers, which is partly why it can be so cost-prohibitive for many advisory clients to bring claims against their adviser when they are harmed.

Advisers who take seriously their obligation to act in clients' best interest should consider the feasibility of using a special forum that allows advisory clients to bring small claims, especially because these clients are often the ones who need to make every dollar count and can least afford to suffer unrecoverable losses.

The last point I'll make is that investment advisers are regulated by either the SEC or by state securities regulators, depending on how many assets the firm has under management. Therefore, in order to provide a comprehensive solution that protects all investors who use an investment adviser, we need both the SEC and the states to act in this space.