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THE ADVOCACY DIVISION OF CONSUMER REPORTS

Submitted via email: rule-comments@sec.gov

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Secretary
Security and Exchange Commission
100 F Street N.E.
Washington, DC 20549-1090

Re: Regulation Best Interest (SEC Release No. 34-83062; File No. S7-07-18; RIN 3235-AM35); Form CRS Relationship Summary; (SEC Release No. 34-83063; File No. S7-O8-18; RIN No. 3235-AL27)

Consumers Union, the Advocacy Division of Consumer Reports[1] appreciates the opportunity to comment on the Securities and Exchange Commission (SEC) proposed "Regulation Best Interest"[2] for securities broker-dealers when recommending investments or investment strategies to retail investors. We also welcome the opportunity to comment on the proposed disclosure form, Form CRS, which would require broker-dealers and investment advisers to disclose to retail investors their standard of conduct, fees, and conflicts of interest.

While the SEC's goal of enhancing protection for retail investors and providing them with disclosures that will enable them to make informed decisions is laudable, it fails to achieve this goal. It is not readily apparent for example, how the proposed Regulation Best Interest would change broker-dealer practices and improve outcomes for retail investors. Rather than adopting an approach that appears to merely rebrand the existing "suitability" rules for broker-dealers as a "best interest" standard, the SEC should implement a robust, enforceable uniform fiduciary standard of conduct that applies to all professional providing investment advice. This standard should genuinely require all securities professional to work in their

[1] Consumer Reports is an independent, nonprofit member organization that works side by side with consumers for truth, transparency, and fairness in the marketplace. We use our rigorous research, consumer insights, journalism, and policy expertise to inform purchase decisions, improve the products and services that businesses deliver, and drive regulatory and fair competitive practices.
[2] Notices were published in the Federal Register on April 8, 2018 (83 Fed. Reg. 21574) and are available at https://www.gpo.gov/fdsys/pkg/FR-2018-05-09/pdf/2018-08582.pdf and https://www.sec.gov/rules/proposed/2018/34-83063.pdf

client's best interest when providing investment advice and require firms to rein in harmful incentives that encourage and reward advice that is not in investors' best interest.

In addition, there is mounting evidence[3] that the proposed Form CRS would increase investor confusion and the potential for investors to make costly mistakes rather than provide the clarity that the SEC intends. Clear, unambiguous disclosures that are understandable to the average investor is paramount to retail investors' ability to make informed decisions about their investments and investment professionals. We caution, however, that heavy reliance on disclosures that purport to implement an apparent flawed best interest standard, will do little to strengthen investor protections. Accordingly, we have concerns that any disclosures that are written to explain this standard to investors will be flawed. Regardless, as the SEC moves forward, it should conduct usability testing of any proposed disclosures and provide evidence that those disclosures will function as intended and that investors will understand their options. Anything less may cause costly harm to investors.

Background

Many retail investors may not have the necessary financial expertise or tools to make critical decisions about how and where to invest their money. Investors may turn to financial professionals, either a broker-dealer or investment adviser, for help in navigating the complex and often confusing world of securities investments. Research shows that many retail investors cannot distinguish between advisers and broker-dealers, the different legal obligations that they owe to their clients, or how those legal obligations may affect their conduct.[4] For example, many retail investors do not understand the various conflicts of interest that arise and how those conflicts may influence investment recommendations.[5] Importantly, many retail investors also lack an understanding of how different professionals are compensated for their services. Research also shows that it is exceedingly difficult to

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[3] See, *Final Report on Testing of Proposed Customer Relationship Summary Disclosure* Submitted to AARP, Consumer Federation of America and Financial Planning Coalition, September 10, 2018, https://consumerfed.org/wp-content/uploads/2018/09/testing-of-proposed-customer-relationship-summary-disclosures-report.pdf. See also, Susan Kleimann, *Making Disclosures Work for Consumers,* Presentation to the SEC's Investor Advisory Committee, Kleinmann Communication Group, June 14, 2018, https://bit.ly/2M064sp; and Consumer Federation of America Comment Letter on Reg.BI, August 7,2018 https://consumerfed.org/wp-content/uploads/2018/08/cfa-comment-reg-best-interest-form-crs-ia-guidance.pdf

[4] Brown, S. Kathi, *Fiduciary Duty and Investment Advice: Attitudes of 401(k) and 403(b) Participants*, AARP Research, September 2013, http://bit.ly/1HO5d5f.

[5] See *e.g.,* Jeremy Burke et al., *Impacts of Conflicts of Interest in the Financial Services Industry,* RAND Labor & Population, Working Paper, August 2014, https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/proposed-regulations/1210-AB32-2/impacts-of-coi-in-the-financial-services-industry.pdf

design disclosures that effectively educate investors of critical differences between broker-dealers and investment advisers[6].

Regardless of whom they turn to and how they pay for advice, the vast majority of retail investors reasonably expect that the advice they receive will be in their best interest and untainted by conflicts of interest.[7] Unfortunately, existing rules do not match retail investors' expectations.

The primary reason that lower quality products are often recommended to investors is that those products typically compensate brokers and their firms more than available alternatives. The higher payouts that are used to compensate brokers and their firms are recouped by often hidden, indirect fees that are charged to the investor and reduce the value of their investment. In short, current rules allow firms to pay their brokers more to recommend inferior products that are very profitable for the brokers and the firm, but not in investors' best interest. Given such regulatory leeway, firms structure incentives for brokers to make inferior and in many cases harmful recommendations. In far too many instances, brokers act on the harmful incentives that their firms create to investors' detriment. [8]

As drafted, it is not clear how the proposed Regulation Best Interest fundamentally changes this paradigm. While the proposed rule presumes to create a "best interest" standard for broker-dealers, it appears to preserve the status quo, rather than meaningfully changing current broker-dealer practices. For example, the proposed Regulation Best Interest would not require brokers to recommend the best of the available options to their customers. In addition, firms would continue to be allowed to implement compensation practices and other incentives that encourage brokers to recommend higher cost, lower quality products and services. As a result, it's likely that investors would continue to receive conflicted advice to their detriment.

Consumers Union asked consumers to share their experiences in seeking advice from financial advisers. Here's what Jeanne from MA, shared:

> "I invested a large part of a $70,000 inheritance with a private financial adviser recommended by a family friend. I know absolutely nothing about investments. He constantly changed the investment each time paying himself a fee, I too late realized.

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[6] Hung, Angela A., Noreen Clancy, Jeff Dominitz, Eric Talley, Claude Berrebi and Farrukh Suvankulov, *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers*, RAND Corporation, Santa Monica, CA, 2008, http://bit.ly/1OrrZ3v. *(RAND Study)*

[7] See, RAND Study. *See also* Testimony of Mercer E. Bullard, President and Founder, Fund Democracy, Inc. and MDLA Distinguished Lecturer and Professor of Law, University of Mississippi School of Law, before the Subcommittees on Capital Markets and Government Sponsored Enterprises, and Oversight and Investigations, Committee on Financial Services, United States House of Representatives, *Preserving Retirement Security and Investment Choices for All Americans*, September 10, 2015, https://financialservices.house.gov/uploadedfiles/hhrg-114-ba16-ba09-wstate-mbullard-20150910.pdf

[8] See, Burke, Jeremy, Angela A, Hung, Jack W. Clift, Steven Garber, and Joanne K. *Yoong, Impact on Conflict of Interest in the Financial Services Industry,* RAND Labor & Population, Working Paper, August 2014. https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/proposed-regulations/1210-AB32-2/impacts-of-coi-in-the-financial-services-industry.pdf.

> When I finally learned that he had moved from the Massachusetts area to Florida, he had earned more money than I had."

When asked about his financial adviser, Dan from Idaho told us:

> "A financial "adviser" put me into investments that were not in my best interest, and I lost money on them…I was told I would get an 8% return, when in fact I will never recover the principal invested."

Arthur from WV said:

> "The issue I have is that there is no recourse, no accountability for bad advice/recommendations in this field… They [financial advisors] should have to forfeit their fees if they lose for their clients".

Section 913(b)(2) of Dodd-Frank required the SEC to conduct a study to evaluate, among other things, whether there are legal or regulatory gaps, shortcomings or overlaps in regulatory standards in the protection of retail customers relating to the standard of care for broker-dealers and investment advisers. Section 913(g) further provided that the Commission may promulgate rules to provide a uniform fiduciary standard for broker-dealers and investment advisers that is the same as and no less stringent than the Investment Advisers Act[9] standard, which requires that advice be provided "without regard to" the financial or other interest of investment adviser. In 2011, the SEC Staff issued a study recommending the establishment of a uniform fiduciary standard for broker-dealers and investment advisers under the framework that Congress set out in Section 913(g) of Dodd-Frank. We strongly support rulemaking under Section 913(g), as it will provide consistency, clarity, and strong protections to investors.

Proposed Regulation Best Interest, however, would create a different, weaker rule for brokers than the one that Congress gave the SEC the authority to establish in Section 913(g). We oppose the SEC's regulatory approach and believe the SEC should issue the stringent standard allowed for by Congress. We offer the following recommendations.

Best Interest Standard

The proposed Regulation Best Interest falls short of providing a clear, strong uniform fiduciary standard of conduct for brokers and advisers who provide retail investors with personalized investment advice.

- Regulation Best Interest Fails to Provide a Clear, Strong Uniform Fiduciary Standard

The standard of conduct for broker-dealers should be the same as and no less stringent than the Investment Advisers Act standard. Further, the SEC should take the full authority granted to it by Congress, and establish a standard that requires that the advice is provided "without regard to" the financial or other interest of the broker-dealer or investment adviser.

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[9] See, 15 USC Section 80b-1.

While the proposed rule purports to raise the suitability standard to the best interest standard, it fails to establish a clear uniform standard that is no less stringent than standards required by the Investment Advisers Act. It gives firms too much discretion in determining what is required and what is prohibited under the rule. It also fails to articulate how the standard differs from the suitability standard under FINRA.

Additionally, the proposed standard only applies to a narrow set of investment recommendations. For example, it appears that a broker's advice that an individual takes a lump sum distribution from a defined benefit pension plan would not be subject to the new best interest standard.[10] This is the type of advice that when given by an investment adviser, would be subject to a fiduciary standard. This outcome perpetuates the confusion and potential harm now faced by retail investors because the professionals they turn to for investment advice may be governed by different laws and therefore held to different standards. Moreover, the SEC has provided no evidence that Form CRS (discussed below) would address this confusion and in fact, there is evidence to the contrary. For example, recent independent investor testing has found that investors are confused, and may even be misled, by Form CRS.[11] They do not understand a variety of critical differences between brokerage and advisory services and in some cases, believe the brokerage account provides them with stronger protections than advisory accounts. Simply put, a flawed rule will result in flawed disclosures.

Also, by calling the proposal a "best interest" standard without actually delivering on that commitment, the SEC risks exposing investors to even greater harm because they will be led to believe that they are protected under Regulation Best Interest. Relying on this new investor protection may cause investors to be less vigilant when interacting with broker-dealers. Some investors may choose to work with broker-dealers instead of investment advisers because they may believe that the brokerage model provides more protections for them. A uniform fiduciary standard should be clear and apply in the same way to all professionals.

- Conflicts Should be Expressly Avoided or Mitigated

Despite purporting to require brokers to put their customers' interest first, the proposed rules do not adequately address conflicts of interest that may compromise a broker's recommendation to the disadvantage of the investor. As aforementioned, some broker-dealers steer investors into excessively high costs and low performing investments that drain the investor's savings while at the same time, increasing the broker's profits. Faced with this conflict of interest, brokers often have strong incentives to work against investors. To further illustrate, if a broker-dealer is paid based on the products she sells, and selling one product makes the broker-dealer an 8 percent commission instead of another product that makes the broker-dealer a 3 percent commission, the broker may rationalize recommending the product with the 8 percent commission. Moreover, if the firm is pressuring the broker-dealer to hit specific sales quotas and bases the broker's compensation and bonus on

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[10] Fred Reish, *Interesting Angles on the DOL's Fiduciary Rule #95,* FredReish.com, June 19, 2018, http://fredreish.com/interesting-angles-on-the-dols-fiduciary-rule-95/

[11] See, *Final Report on Testing of Proposed Customer Relationship Summary Disclosure,* supra, https://consumerfed.org/wp-content/uploads/2018/09/testing-of-proposed-customer-relationship-summary-disclosures-report.pdf.

hitting specific sales goals for that product, it creates conflicts that even the most ethical broker-dealer would have difficulty avoiding. Many consumers may not know that their investment is being drained because of these conflicts.[12] And, even if they were aware of conflicts of interest, it is unlikely most retail investors would be able to gauge effectively the nature and extent of various conflicts. The SEC has provided no evidence that its proposal will fundamentally address this problem.

While the proposed rule requires firms to mitigate conflicts of interest arising from financial incentives, the proposal largely defers to firms on how they should do so. It even suggests that if firms consider adopting FINRA's best practices, they will satisfy this obligation.[13] Further, while the proposal suggests that certain types of financial incentives might be avoided entirely, such as sales quotas, sales contests, trips, and prizes, it does not explicitly prohibit them. Instead, the proposed standard leaves open the possibility that these incentives could be appropriate in certain circumstances which undermines the best interest standard and virtually ensures that such practices will persist. Without adequate safeguards, investors will remain at risk of being harmed by conflicted advice that may be a direct result of skewed incentives and, sometimes, just plain greed.

Furthermore, we agree that firms should bear responsibility for adopting, maintaining and enforcing written policies and procedures to address conflicts. However, the provision would be more meaningful and provide greater investor protection if firms were explicitly required to adopt and implement written policies to ensure that conflicts do not improperly influence or taint a broker's recommendation. Policies and procedures are needed to avoid or mitigate conflicts before they can unduly influence recommendations and harm investors. In addition, the SEC should explicitly restrict certain practices, such as sales quotas, sales contests, bonuses, for steering customers to the investments and accounts that are most profitable for the firm, and other incentives that are likely to taint recommendations to investors' detriment. Investors are entitled to reliable, objective advice to make informed choices about their investments, and the professional's financial incentives should not undermine the quality of a professional's advice.

Moreover, while firms should be free to pay their advisers more to sell certain investments, those differential payments should be based on neutral and objective factors, such as the amount of time necessary to research and implement the investment strategy.

- Restrictions on the Use of Titles Need to Be Expanded

The best interest proposal also restricts standalone broker-dealers from using the terms "adviser" or advisor" as part of their name or title with retail investors. While this is a step in the right direction, it does not go far enough, and there are significant loopholes that would

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[12] See PIABA, *Major Investor Losses due to Conflicted Advice; Brokerage Industry Advertising Creates the Illusion of a fiduciary Duty: Misleading Ads Fuel Confusion, Underscore Need for Fiduciary Standard* (March 2015), https://piaba.org/sites/default/files/newsroom/2015-03/PIABA%20Conflicted%20Advice%20Report.pdf

[13] See, *Report on Conflicts of Interest,* FINRA, 2013 at 2, " FINRA expects firms to consider the practices presented in this [Best Interest] report, and to implement a strong conflict management framework. If firms do not make adequate progress on conflicts management, FINRA will evaluate whether rulemaking to require reasonable policies to identify, manage and mitigate conflicts would enhance investor protections".

render the proposed restrictions meaningless.[14] The SEC should prohibit the use of other titles that improperly suggest an advisory-type relationship, including but not limited to, financial consultant, investment consultant, financial planner or wealth manager by those who are not subject to a fiduciary standard when providing recommendations to investors. Also, the SEC should restrict misleading marketing along with misleading titles.

Form CRS Disclosures

The purpose of Form CRS is "to allow investors in making an informed choice when choosing an investment firm and professional, and type of accounts by providing them with clear and sufficient information to understand the differences and key characteristics of each type of service." Although Form CRS focuses on disclosures that are critical to an informed choice among different types of financial professionals and different kinds of investment accounts, we are concerned that those disclosures are not likely to be understood by average investors, especially financially unsophisticated investors. They could increase investor confusion and the potential for investors to make costly mistakes rather than provide the clarity that the SEC intends.

We support efforts to raise investor's understanding and reduce the complexity of information needed to make investments. Complicated and confusing information disclosures can lead financially unsophisticated investors to make less than optimal decisions, especially for complex retail investments. Moreover, any disclosures contemplated must incorporate commonly recognized principles of effective disclosure.

As the SEC considers whether to adopt Form CRS, we offer the following comments:

- First and foremost, while we support simple, understandable disclosures, we caution against placing too much reliance on disclosure to protect investors. Heavy dependence on "enhanced" disclosures based on a flawed rule will do little to create a safe market for investment advice and to protect investors from conflicts of interests. A clear, strong reliable standard of conduct for all financial professionals is required to protect retail investors in the securities marketplace.

- The SEC should further consult with disclosure experts on the design, formatting, content, and presentation of the information disclosed on Form CRS before the form is finalized. In general, Form CRS should be short, simple, with well-defined terms that can be easily understood by the average investor. Legalese and technical jargon should be avoided. As currently proposed, Form CRS is complicated for the average investor to read, understand and use.[15] Moreover, the form fails to clearly define the

[14]See,http://www.investmentnews.com/article/20180915/FREE/180919942/sec-advice-rule-contains-a-huge-hole

[15] See, Rennekamp, Kristina, *Processing Fluency and Investors' Reaction to Disclosure Readability,*, Journal of accounting Research, Vol.50, No. 5, 2012, pp 1319-1354.

difference between the best interest standard of conduct for broker-dealers and the fiduciary standard applicable to investment advisers. Should the SEC refuse to adopt a uniform fiduciary standard under 913(g), it must clarify the difference in the nature of the services. As the brokerage industry has repeatedly argued in legal proceedings and as the SEC itself has acknowledged in the proposal, unlike an investment adviser, a brokerage relationship is not one of trust and confidence.

Moreover, a brokerage relationship is a sales relationship whereas an investment advisory is an advice relationship. Investors need to know and understand these critical differences. Refusing to provide this information to them will perpetuate the harms that they currently face.

- The SEC should continue testing the usability of Form CRS. The testing would provide insight into whether the form serves its intended purpose and when investors need to receive the disclosures in order to incorporate them into their investment choices. In addition, the SEC should publish the results of its testing, including feedback on possible iterations of the form, for public comment before the form is made final. Publishing testing results help evaluate whether the disclosures convey investment information in a way that average or financially unsophisticated investors can understand and use it to make informed choices and whether further changes to the form are warranted. Testing will also help evaluate the sufficiency of the proposed best interest standard and whether more is needed to make the standard of conduct for broker-dealers and investment advisers consistent. At a minimum, the SEC must clarify the differences in the standard of conduct for broker-dealers and investment advisers as discussed above.

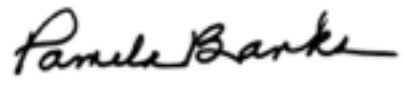
- Under the SEC proposal, delivery of the disclosure could be delayed until "the time the retail investor first engages the firm's services in the case of a broker, and at "the time the firm enters into an investment advisory agreement with the retail investor," in the case of an investment adviser.[16] As a result, delivery of Form CRS will in many instances come after the investor has already decided who to hire and the type of account to open. The SEC should require that Form CRS be given at the first interaction with the investor before the investor selects a financial professional and well in advance of a recommendation is made. Giving the investor the disclosure upfront before the investor makes decisions, facilitates informed choices about the financial professional they choose to engage, the account preferred, the fees and other costs that may be incurred, and the standard of conduct owed to the investor. Also, to further facilitate informed choices, investors must be given sufficient time to review and ask questions about the disclosures.

Conclusion

[16] Form CRS Release at 138-140.

As discussed above, the proposal falls short of providing a true uniform fiduciary standard for brokers and advisers and, it does not adequately address the conflicts of interest that may compromise broker-dealers' investment advice. As a result, it is not clear how the proposal would change broker-dealer conduct or improve outcomes for retail investors. Moreover, it is axiomatic that a flawed rule results in substantively flawed disclosures that, in this case, will do little to strengthen investor protection. The confusing and complicated proposed Form CRS disclosures would risk perpetuating investor confusion and harm. The only way the SEC can be sure that these critical disclosures will serve their intended purpose is to develop disclosures based on strong, enforceable best interest standard and to test the disclosures for effectiveness before finalizing the proposal.

Respectfully submitted,



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