Consumer Federation of America

Statement of CFA Director of Investor Protection Barbara Roper

"Wall Street v The Fiduciary Duty and Core Investor Protections: Where We Are and What's Ahead?"

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I have been asked to set the stage with regard to SEC fiduciary rulemaking, which I thought I'd do by: 1) providing a little further explanation of what the problem is that we are trying to solve, 2) describing where we stand in terms of SEC efforts to solve it, and 3) explaining some of the reasons why something that should be so simple has proved to be so difficult.

1) So what exactly is the problem we are trying to solve?

The problem is that investors who are in the market for investment advice are being actively deceived and SEC regulatory policy permits that deception. That's obviously a provocative statement. So what do I mean by that? Brokers and investment advisers both call themselves advisers, both offer services such as retirement planning and investment planning that are (or should be) advisory in nature, and both market themselves to the public as if personalized investment advice is the primary service they provide to clients. As a result, they are indistinguishable to the investing public.

But brokers aren't in fact advisers, at least not legally; they are salespeople. The standard that governs their so-called advice -- the suitability standard -- is a sales standard that allows them to make recommendations that put their own financial interests ahead of those of their clients. And pervasive incentives in the broker-dealer compensation system encourage them to do just that. That is not what people expect, and have every right to expect, when they consult a "financial adviser."

So the problem is not simply that brokers and investment advisers offer the same services to clients under different standards, though that is on its face hard to justify. And it certainly isn't that investors are confused, though they unquestionably are. The problem is that a fiduciary duty -- an obligation to act in the best interest of the customer -- is in and of itself what distinguishes advice from a sales pitch. By allowing brokers to offer "advice" without requiring them to act in their customers' best interests, the SEC is permitting them to deceive investors about the nature of services they are offering.

Just to be clear, that is a problem that is created not by the statutes that govern broker-dealers and investment advisers, but by the SEC's misguided interpretation of those statutes over several decades. Long before the Dodd-Frank Act was enacted, the SEC had all the authority it needed under the Investment Advisers Act to say that brokers who want to act as advisers and market themselves as advisers would be regulated accordingly. Had the SEC done that in the late 1980s and early 1990s, we would arguably not be having this discussion today.

2) So where does the SEC stand on fixing this problem that it created?

SEC Chair Mary Jo White has said publicly that she has asked the staff to prepare a list of alternatives for addressing the issue and that she expects the Commission to decide this year on whether to move forward with rulemaking. When I've spoken to Chair White about the issue personally, she gives every impression that this is also a personal priority for her. Both Commissioner Aguilar and Commissioner Stein have expressed their support for a strong, uniform fiduciary standard for personalized investment advice. And the SEC's Investor Advisory Commission, of which I am a member, adopted a strong set of recommendations calling for rulemaking. At the same time, however, the two Republican Commissioners have made it clear in their public statements that they question the need for rulemaking in this area.

While in one sense that division within the Commission makes the Chair's job more challenging, in another sense it could be viewed as liberating. If the position of the Republican Commissioners is and remains, in essence, "just say no," the Chair can and should view herself as freed from having to negotiate to win their support by watering down the standards. She would have to have the courage to take a 3-2 vote, but she showed just last week with the 3-2 vote in support of strengthened credit rating agency rules that she was willing to do that when necessary. While we do not view this as a partisan issue, we believe that this is an area where a 3-2 vote is justified if that is what it takes to move forward with a strong, pro-investor rule.

3) So why has something so simple proven to be so difficult?

If you ask the average person on the street whether financial professionals who offer the same services should be subject to the same regulatory standards, their answer is obvious. Of course they should. And if you ask them whether their adviser should have to act in their best interests, the answer is the same. So why has it proven so difficult to adopt a regulatory policy that matches the reasonable expectations of the investing public? What are the obstacles?

The problem starts with the SEC staff itself. For whatever reason, there seems to be reluctance within the staff … and particularly within the Division of Trading and Markets … to acknowledge any problem with a regulatory policy that allowed brokers to remake themselves as advisers while still regulating them as salespeople. We have been meeting with SEC staff on this issue for many years, and at some point in those meetings someone from the SEC staff inevitably asks, "is fiduciary duty really a higher standard than suitability?" Or they make the point that brokers are subject to more rigorous regulatory oversight than investment advisers, as if that was relevant to the legal standard that should be applied when they provide advisory services. Ironically, the main broker-dealer trade association, SIFMA, appears to have a more evolved position on fiduciary duty than do some of the very SEC staffers we rely on the craft those rules. And that presumably is how you end up with a document, like the Request for Information that the SEC put out on this issue in 2013, that managed to define fiduciary duty without ever once mentioning the best interest obligation that should be its central component. To overcome this obstacle, the SEC will need to put oversight of the project in the hands of individuals within the agency who believe in the project and are committed to ensuring no watering down of the existing standard.

Another obstacle to rulemaking is that the problem rulemaking is intended to solve often gets mischaracterized. In particular, people (including people of good intent) focus on investor confusion as the problem in need of a solution. Those who resist regulation inevitably respond that, if investor confusion is the problem, then the solution is simply to adopt better disclosures and to educate investors. But this completely misses the point of why investor confusion is important. Investor confusion is relevant precisely because it limits the available regulatory solutions. If investors can't distinguish brokers from advisers -- and they typically can't, even after the differences are explained to them -- then disclosure will never be adequate to solve the problems associated with inconsistent regulatory standards, and the notion of informed investor choice between two equally valid business models is an illusion.

Perhaps the most significant obstacles we face, however, is that we operate in an era where economic analysis has become a tool, not to promote good, thoughtful regulation, but to gum up the regulatory process. And that has certainly been a problem here, where even today, the question continues to be asked, where is the evidence of harm that justifies rulemaking? That's one of the reasons I stated the problem so starkly at the outset of these remarks. When you conduct economic analysis, you have to start with the right question if you want to arrive at a logical regulatory solution. So to the question, where's the harm, the first answer is that investors who go out into the market seeking advice -- which by definition means recommendations designed to promote their best interests -- are being deceived into purchasing services that do not meet those reasonable expectations. It shouldn't take a genius to understand that SEC policy should not promote deception or misrepresentation and that action is needed to correct that problem. This is particularly true when the evidence also overwhelmingly suggests that investors suffer real financial harm -- albeit unquantifiable harm -- as a result of biased "advice" to invest in products that have unnecessarily high costs, that expose them to unnecessary risks, or that simply offer mediocre performance relative to other options available in the market.

In short, if the SEC frames the issue correctly, then rulemaking becomes easy to justify on economic grounds. The real question is not -- or should not be -- where is the economic data to support the regulation. The question is -- or should be -- where is the data that justifies maintaining the status quo.

I'd like to make one quick final point about obstacles to progress, and that is that the language in the Dodd-Frank Act is itself something of an obstacle. The legislation is obviously well intended, and we greatly appreciate the herculean efforts that were made to win its inclusion in the final bill. But the reality is that some of the concessions that were made in the process make it difficult -- difficult but not impossible -- to draft a good rule based on that language. For the SEC to develop a strong, pro-investor fiduciary standard based on that Dodd-Frank authorization, it will need to interpret key provisions -- provisions on on-going duty of care, for example, and limited menu of products -- very carefully to ensure that they do not create loopholes that render the effort meaningless.

In closing, this should not be a partisan issue. Rooting out misrepresentations, promoting fair competition, harnessing market forces to benefit rather than harm investors is a policy that should be able to win bipartisan support. But if Chair White must take a 3-2 vote to bring it about, so be it. This is an issue of sufficient importance to the basic financial well-being of millions of investors that the Chair must be willing to take that vote.

Thank you.