Consumer Federation of America

June 18, 2013

The Honorable Jeb Hensarling
Chairman
Financial Services Committee
U.S. House of Representatives

The Honorable Maxine Waters
Ranking Member
Financial Services Committee
U.S. House of Representatives

Dear Chairman Hensarling, Ranking Member Waters and Members of the Committee:

The Financial Services Committee is scheduled to mark-up yet another set of bills this week that would weaken investor protection and undermine the transparency and integrity of our capital markets. I am writing on behalf of the Consumer Federation of America to urge you to oppose these bills. While CFA opposes each of the bills scheduled for mark-up for reasons described briefly below, our primary focus is the cynically titled "Retail Investor Protection Act," which would undermine the ability of federal agencies to ensure that Americans receive appropriate protections in their dealings with financial professionals who purport to offer investment advice.

Oppose Bill (H.R. 2374) to Undermine Protections for Vulnerable Investors

H.R. 2374 launches a two-stage attack on federal regulators' attempts to improve protections for average, unsophisticated investors in their dealings with predatory and self-dealing investment professionals. First, it would throw new roadblocks in the way of the Securities and Exchange Commission (SEC) as it attempts to close a gaping regulatory loophole that permits broker-dealers to provide investment "advice" to retail investors that is not designed to serve the best interests of those investors. Second, it would inappropriately tie the ability of the Department of Labor (DOL) to update its fiduciary definition under ERISA to the SEC's successful completion of its separate rulemaking under the securities laws.

Over the years, brokers have been permitted to call themselves financial advisers and offer extensive advisory services without having to meet the best interest standard included as part of the fiduciary duty that applies to all other investment advisers. As a result, many investors are deceived into believing they are dealing with a trusted adviser when, in fact, they are dealing with a salesperson – a salesperson, moreover, who is free to put his or her own financial interests ahead of the interests of the investor and often receives financial incentives to encourage such practices. Investors who place their trust in these salesmen in advisers' clothing can end up paying excessively high costs for higher risk or poorly performing investments that satisfy a suitability standard, but not a fiduciary duty. That is money most middle income investors can ill afford to waste.

This legislation would make it more difficult for the SEC to address this problem by requiring further study of an issue that has already been studied extensively. Indeed, the SEC has been studying the issue of the standard of conduct that should apply to brokers' investment advice for over a decade. In

the process, it has conducted focus group testing of disclosures designed (without success) to clarify the differing legal standards that apply to brokerage and advisory accounts,[1] commissioned a comprehensive independent study intended to lay the foundation for further rulemaking,[2] and conducted a staff study of the issues to be addressed by rulemaking.[3] Over the years, the SEC has collected reams of comment from all interested parties with a stake in the issue, and it has recently issued an additional Request for Information to form the basis of a thorough economic analysis to accompany any rulemaking it might decide to undertake.

Clearly, the additional cost-benefit analysis requirements in H.R. 2374 are not designed to address any shortcomings in the SEC approach to economic analysis of this issue. Instead, their primary effect would be to create additional grounds for legal challenge by fringe industry groups that oppose any rulemaking that might force them to abandon predatory practices that allow them to profit at their customers' expense. The best outcome, if this legislation were adopted, would be further delay of a rule that is already years overdue. More likely is that the legislation would inhibit SEC rulemaking altogether or result in a rule so weak as to be entirely devoid of meaningful new protections for investors. Middle income investors who need to make every dollar count would be the ultimate victims of these bureaucratic games.

But retail investors would not be the only victims of this legislation. Working Americans attempting to prepare for a secure retirement would also be denied appropriate protections, perhaps indefinitely. Loopholes in the definition of investment advice under ERISA make DOL's fiduciary standard all but unenforceable. This bill would prevent DOL from acting to address that problem until after the SEC completes an entirely separate fiduciary rulemaking under the securities laws. It would impede DOL action despite repeated assurances that the SEC and DOL are coordinating their efforts and that any rules adopted will not conflict. DOL has responded to criticism of its original approach by withdrawing that proposal in order to conduct a thorough economic analysis, redraft the proposal, and clarify how the revised definition would interact with prohibited transaction exemptions. DOL deserves to have the resulting reproposal judged on its merits, not halted based on unsubstantiated fears about the form that rulemaking *might* take. For all these reasons, we urge you to vote NO on H.R. 2374.

Oppose Anti-Investor Bills to Undermine Market Transparency and Integrity

The Committee is also scheduled to mark up three other bills, each of which would in its own way undermine market transparency and integrity.

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[1] Siegel & Gale, LLC and Gelb Consulting Group, Inc., *Results of Investor Focus Group Interviews About Proposed Brokerage Account Disclosures*, Report to the Securities and Exchange Commission, March 10, 2005. Based in part on evidence from this study, the SEC concluded that it was not possible to develop a disclosure that would clearly convey the different legal standards that apply to adviser and broker accounts.

[2] RAND Institute for Civil Justice (Angela A. Hung, Noreen Clancy, Jeff Dominitz, Eric Talley, Claude Berrebi, Farrukh Suvankulov), *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers*, Sponsored by the United States Securities and Exchange Commission, 2008. Among other things, this study demonstrated conclusively that the lines between brokers and advisers had become blurred, that investors did not distinguish between brokers and advisers, and could not tell whether their own financial professional was a broker or adviser even after the differences were explained to them, and that they expected any advice their received to be designed to serve their best interests.

[3] SEC Staff, *Study on Investment Advisers and Broker-Dealers as Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, January 2011. Building on the findings of earlier research, the staff study concluded that the Commission should move forward with rulemaking to ensure that all those who provide investment advice to retail investors are required to act in their best interests and otherwise meet a fiduciary standard appropriate to the advisory relationship.

- **H.R. 1564, the "Audit Integrity and Job Protection Act,"** would prevent the Public Company Accounting Oversight Board (PCAOB) from adopting a rule to require rotation of auditors at public companies even if it determines, based on a thorough review of the evidence, that doing so is necessary to address the persistent lack of independence and professional skepticism in the audits of public companies. The PCAOB has not yet decided on a regulatory approach and is instead engaged in carefully weighing the evidence. In contrast to the PCAOB's balanced and thoughtful approach, this legislation would decide the issue without any consideration of the evidence on audit failures tied to lack of auditor independence, a problem that has been highlighted by regulators both here and abroad. We urge you to protect the independence of the PCAOB and the audit process by voting NO on H.R. 1564.

- **H.R. 1105, the Small Business Capital Access and Job Preservation Act,** would exempt a large swath of "private equity" funds from registration with the SEC without showing any reason why such an exemption is necessary or appropriate. The bill would leave it to the agency to define the scope of funds that might qualify for the exemption, setting up an inevitable regulatory race to the bottom as funds pressure the agency to write as expansive an exemption as possible. As such, the bill would limit the ability of the agency to provide effective oversight of a portion of the securities business with a proven capacity to spread risk through the financial system. We urge you to vote NO on H.R. 1105, which would undermine efforts to protect the financial system from systemic threats.

- H**.R. 1135, the "Burdensome Data Collection Relief Act**," would undermine market transparency by denying investors information about the relationship between CEO and worker pay at the companies in which they invest. Not only would this bill hide material information from the owners of public companies, but it would also undermine efforts to rein in out-of-control CEO pay. Opposition to this disclosure is clearly based not on any excessive costs or insurmountable burdens associated with making the disclosure, but on the fact that the information is likely to be embarrassing to many companies and could provide the impetus for reform. We urge you to stand up for market transparency and economic equality by voting NO on H.R. 1135.

Taken together, these bills would reduce oversight of potentially risky market segments (H.R. 1105), tie the hands of regulators seeking to address a persistent market failure (H.R. 1564), deprive investors of information that could provide a check on excessive CEO pay (H.R. 1135), and impede the ability of federal regulators to act to protect unsophisticated investors from predatory industry practices (H.R. 2374). We urge you to vote NO on each of these bills. Thank you for your attention to our concerns. You may contact me (719-543-9468, bnroper@comcast.net) if you have any questions about our position on the issues.

Respectfully submitted,

Barbara Roper

Director of Investor Protection

cc: Members of the Committee