

Re:

File Number S7-07-18, Regulation Best Interest
File Number S7-08-18, Form CRS Relationship Summary

Worried About Wall Street Conflicts? The SEC Isn't

A plan to limit bad sales incentives doesn't give investors the protection they need.

Senator Elizabeth Warren

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Your lawyer can't take money from your opponent to give you bad legal advice. If you're on Medicare, your doctor can't take kickbacks from drug manufacturers for prescribing their drugs. But, under current law, your broker-dealer can receive monetary rewards and other perks for recommending certain investment products, even if those products aren't in your best interest.

Each year, Americans lose billions of dollars because of brokers who are looking out for their own financial interests instead of their clients'. The Securities and Exchange Commission recently proposed a new set of rules, supposedly to address this problem — but the SEC has fallen far short of giving American families the protection they need and deserve.

The SEC's proposal claims to address the broker conflict-of-interest problem by stating that brokers must act in the "best interest" of their clients. But the proposal doesn't define what that means, creating confusion for investors and brokers and leaving the possibility that judges and corporate lawyers will chip away at the standard over time. Instead of eliminating many of the worst conflicts, the proposal only requires brokers to mitigate and disclose them. So, for example, harmful practices like quotas for the sale of in-house products or contests for hitting certain sales thresholds could continue, even though they encourage brokers to push subpar products so they can collect their rewards from the companies selling them.

The proposal has another problem: If a broker violates the best-interest rule, there is no explicit authorization for investors to sue brokers in court. If the people who get hurt can't sue, the odds of these standards being enforced drop sharply.

The SEC can fix its flawed proposal before it issues its final rule. The Commission should make four main changes:

First, the final rule should make absolutely clear that all financial professionals must act in their clients' best interest by applying a fiduciary standard to the brokerage industry. That is what the Department of Labor did with its 2016 rule requiring all financial professionals giving advice on retirement-savings plans to put client interests ahead of their own. Corporate lawyers representing the financial-services industry persuaded a federal court to strike down this rule on technical grounds earlier this year.

¹ Bloomberg Opinion, "Worried About Wall Street Conflicts? The SEC Isn't," August 3, 2018, Senator Elizabeth Warren, <https://www.bloomberg.com/view/articles/2018-08-03/worried-about-wall-street-conflicts-the-sec-isn-t>.

A fiduciary relationship is a defined legal concept. Investment advisers already owe a fiduciary duty to their clients when they provide investment advice. There's little reason not to apply the same standard to brokers who are providing similar advice. SEC Chairman Jay Clayton says the new SEC proposal "is definitely a fiduciary principle,"² but if that is the case, the SEC should say so explicitly in the final rule, rather than using a vague best-interest standard that isn't currently defined.

Second, the SEC should explicitly ban the most obvious forms of conflicted advice, like sales contests and quotas that encourage brokers and agents to make bad recommendations. The SEC must attack conflicts of interest at their source: the problematic incentives that companies use to push underperforming, money-losing or overpriced products on unsuspecting customers. By requiring brokers only to mitigate conflicts of interest, and then deferring to the brokerage firms on how they do so, the SEC's proposal would allow these conflicts to continue.

Third, the SEC shouldn't rely on disclosure alone to protect customers. A [number of studies](#) have shown that disclosure fails to reduce the harm caused by conflicted advice, and brokers have every incentive to make the disclosures as ineffective as possible. A lawyer can't represent his client's opponent just because that conflict was disclosed, and the same should be true of a broker.

Finally, the SEC should include a strong enforcement mechanism by allowing investors to sue advisers who scam them. When someone is cheated by their doctor or lawyer, they can go to court. There's no reason that families shouldn't have the same option when their life savings are at stake. Yet the SEC's proposal would force investors to rely on arbitration at the Financial Industry Regulatory Authority — a so-called self-regulatory organization funded by brokers themselves — or enforcement by the SEC, which takes only a few hundred enforcement actions each year. Regulating the worst practices in the brokerage industry will mean little if savers have no way to go after the companies that rip them off.

The SEC claims its proposal is as strong as the DOL conflict-of-interest rule issued during the Obama administration, and was set to go into effect last year. But companies that had responded to the DOL rule by transitioning to more transparent, lower-fee products — which even they described as "intended to address ... conflicts" — are quietly rolling back those changes now that the DOL rule has been tossed out and they have seen the weaker SEC proposal.³ Wall Street might be excited about a green light to cheat working families, but it's a bad sign for consumers.

With wages flatlining for many families and the cost of health care, housing, education and child care skyrocketing, it's hard enough to save money. The last thing the average American saver needs is to lose money because of conflicted advice from their brokers. If the SEC doesn't make these four concrete improvements to its proposal, it will have failed to fix this huge problem —

² Wealth Management, "SEC's Clayton: 'No Daylight' Between Advisor, Broker/Dealer Duties in Proposed Rules," David Armstrong, May 23, 2018, <https://www.wealthmanagement.com/regulation-compliance/sec-s-clayton-no-daylight-between-advisor-brokerdealer-duties-proposed-rules>.

³ AdvisorHub, "JPMorgan to Remove Some Fiduciary Rule Handcuffs, Others May Follow," Jed Horowitz, May 4, 2018, <https://advisorhub.com/jpmorgan-to-remove-some-fiduciary-rule-handcuffs-others-may-follow/>; The Wall Street Journal, "Merrill Considers Lifting Ban on Commission-Based Retirement Accounts," June 15, 2018, <https://www.wsj.com/articles/merrill-considers-lifting-ban-on-commission-based-retirement-accounts-1529074801>.

and with it, failed to substantially “increase[e] investor protections and the quality of advice,” as Chairman Clayton once promised he would do.