

**Statement for the Record by the
Public Investors Arbitration Bar Association
Hearing before the House Financial Services Committee; Subcommittee on
Investor Protection, Entrepreneurship, and Capital Markets:
Putting Investors First? Examining the SEC’s Best Interest Rule**

March 14, 2019

Chairwoman Maloney
Ranking Member Huizenga
U.S. House Committee on Financial Services
Subcommittee on Investor Protection, Entrepreneurship,
and Capital Markets
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairwoman Maloney and Ranking Member Huizenga:

The Public Investors Arbitration Bar Association (PIABA)¹ appreciates the opportunity to submit this statement for the record in connection with the March 14, 2019 hearing, “Putting Investors First? Examining the SEC’s Best Interest Rule.”

PIABA has long advocated for a true fiduciary standard for brokers who provide investment advice to their clients. Consistent with numerous studies, including the Securities and Exchange Commission’s (“SEC”) findings in 2011, we believe that a uniform fiduciary duty applicable to all financial intermediaries who provide investment advice would best protect customers.² We therefore believe that the fiduciary duty should apply to all forms of financial advice, and should last throughout the duration of

¹ PIABA is an international bar association comprised of attorneys who represent investors in securities arbitrations. Since its formation in 1990, PIABA has promoted the interests of the public investor in all securities and commodities arbitration forums, while also advocating for public education regarding investment fraud and industry misconduct. Our members and their clients have a strong interest in rules which govern the conduct of those who provide advice to investors.

² SEC, *Study on Investment Advisers and Broker-Dealers* (“SEC Study”) (Jan. 2011), available at <http://www.sec.gov/news/studies/2011/913studyfinal.pdf>. The SEC reviewed two studies which it sponsored (the “Seigel & Gale Study” and the “RAND Report”), and a study conducted by Consumer Federation of America. The SEC Study found that, based on the comments, studies and surveys it had reviewed, investors did not understand the differences between investment advisers and broker-dealers. The SEC determined that this misunderstanding is compounded by the fact that many retail investors may not have the “sophistication, information, or access needed to represent themselves effectively in today’s market and to pursue their financial goals.” *Id.* at 101.

the advisor-customer relationship. We also believe that disclosure should be used to inform investors, and not to absolve firms of responsibility.

Brokers and Investment Advisers should be held to a true fiduciary standard

Most retail investors think their financial advisor – regardless of whether that advisor is a broker or an investment adviser – is a fiduciary.³ The industry is well aware of this misimpression. In a survey open to all brokers, investment advisers, and insurance consultants and producers, 97 percent of them said: “investors don’t understand the differences between brokers and investment advisers.”⁴

Many firms and their personnel are also “dually-registered,” meaning that they operate simultaneously as broker-dealers and as registered investment advisers. Investors working with such firms often open both “brokerage” accounts and “investment advisory” accounts with the same person at the same time. The investors are typically given a sheaf of paperwork, much of it in small print, in which the firm attempts to disclaim any duties related to the brokerage accounts. Investors rarely read these materials; rather they rely on the representations made by their financial advisor about the scope of the relationship. They do not understand that their financial advisor may claim to have one duty with respect to their brokerage account, and a separate and different duty with respect to their advisory account.

Investors are further misled about the scope of brokers’ duties by firm advertising. In a study conducted by PIABA in 2015, PIABA examined the websites of nine different brokerage firms (the “PIABA Report”).⁵ PIABA examined Allstate, UBS, Morgan Stanley, Berthel Fisher, Ameriprise, Merrill Lynch, Fidelity, Wells Fargo, and Charles Schwab and found that the firms’ advertising presents the image that firms are acting in a fiduciary capacity.⁶ Those firms have continued to promote themselves as offering all-encompassing financial advice with no differentiation between the firms’ investment adviser services and brokerage services.

³ See Spectrum Group, *Fiduciary – Do Investors Know What it Means* (2015), available at <http://spectrum.com/Content/Whitepaper/fiduciary.aspx>.

⁴ See fi360-ThinkAdvisor, *Trustworthy Advice and Individual Investors: Will Regulators Act in Investors’ Best Interest?* (Aug. 2013), available at http://www.fi360.com/uploads/media/fiduciarysurvey_resultsreport_2013.pdf; see also fi360-ThinkAdvisor, *Seeking Trustworthy Advice for Institutional Investors – Financial Intermediaries Indicate Strong Support for Fiduciary Standard* (Feb. 2015), available at <http://www.fi360.com/uploads/media/2015fiduciarysurvey.pdf>.

⁵ 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* (Mar. 25, 2015) (the “PIABA Study”), available at <https://piaba.org/system/files/pdfs/PIABA%20Conflicted%20Advice%20Report.pdf>.

⁶ *Id.* at 1.

Investors have been misled to believe that financial advisors, whether brokers or investment advisers, are acting as fiduciaries when providing investment advice. Firms should be required to meet the expectations they have set with investors. Both brokers and investment advisers should be held to a fiduciary duty that encompasses both a *duty of care* and a *duty of loyalty*.

Duty of Care: The duty of care should require brokers to act with the care, skill, prudence and diligence, that a reasonably prudent person acting in a like capacity would use in connection with providing investment advice, based on the investment objectives, risk tolerance, financial circumstances, and needs of the investor, without regard to the financial or other interests of the broker. This duty would require the investment advice to not only be suitable, but to also be the best possible advice given the circumstances. Investment costs must be a factor in determining what investment is best for a client, as well as investment objectives, risk and liquidity.

Duty of Loyalty: The duty of loyalty should require the mitigation or elimination of conflicts of interest, not just the disclosure of such conflicts – which the industry knows very well are almost never read. Incentives which encourage brokers to engage in conduct that they would not otherwise engage in should be prohibited. Brokers should not be paid differential compensation that is dependent on the product recommended. Commissions should be leveled so that the incentive to recommend one product over another is eliminated.⁷ This will ensure that a broker considers the needs of his or her clients, rather than his or her own pecuniary interest. In addition, sales contests should be eliminated because they encourage financial advisors to put their own interests ahead of their clients’.

A true fiduciary standard should apply to all forms of investment advice and should last throughout the duration of the broker-investor relationship

Brokerage firms create the impression that they provide comprehensive advice on a continuous basis. First, brokerage firms give their “registered representatives” titles that sound trustworthy, like “Financial Advisor,” “Retirement Consultant,” and “Wealth

⁷ This is not to say that commission based accounts need to be eliminated to comply with a fiduciary standard, as the industry often attempts to suggest. There are times when a commission based account is the account in the best interests of an investor (as opposed to a fee based account). However, commissions cannot be used to incentivize brokers to sell one financial product over another as that creates a conflict of interest that will encourage fiduciary violations.

Manager.”⁸ Next, as shown in PIABA’s research of brokerage firm marketing, financial services firms tell prospective clients that they can assist investors in planning and managing their wealth and investment goals over the course of their relationship. Brokers encourage investors to *trust* them, saying they will provide *advice* and *guidance*. For example, UBS describes its services as follows, “Advice that’s all about you and what you need is what UBS does best. It starts with a plan that we develop together—as part of a strategy for managing your wealth and pursuing your personal goals for every part of your life, at every stage of your life. It’s what we call: Advice. Beyond investing.”⁹ Wells Fargo advertises that “Our Financial Advisors are committed to providing you with top-notch service and attention that you expect and deserve.”¹⁰ Merrill Lynch says, “Your advisor will help guide you, making adjustments as your needs change.”¹¹

Because of the impressions created by the brokerage industry, investors rightly expect that brokers will advise them when a change in strategy is appropriate. Investors often maintain their accounts with a broker for years and, at times, decades. During that time, an investor’s investment profile will change, sometimes dramatically. Investors may retire, or marry and have children. Investors look to their broker to advise them as to how these life changes impact their investment strategies. Similarly, the characteristics of investments change over time. While an investment in a particular security may be suitable at a time when it has certain characteristics, it may become unsuitable over time as those characteristics change, e.g., an investment in a bond that is investment grade when sold to the investor, but, over time, becomes a “junk bond” because of a change in financial circumstances of the company. While arguably suitable when sold, over time, that same investment is likely unsuitable and the investor may not realize the difference unless the changes in characteristics are properly explained to the investors. Investors will not always recognize that they should seek out this advice.

Additionally, brokers are often compensated for investment transactions and investment advice after the sale has occurred. For example, variable annuities and mutual funds continue to pay commission trails to brokers and their firms for years after the investments are sold. The broker’s fiduciary duties to a customer should

⁸ See Consumer Federation of America and Americans for Financial Reform, *Financial Advisor or Investment Salesperson? Brokers and Insurers Want to Have it Both Ways* (January 18, 2017), available at https://consumerfed.org/wp-content/uploads/2017/01/1-18-17-Advisor-or-Salesperson_Report.pdf.

⁹ UBS, *Wealth Planning*, available at <https://www.ubs.com/us/en/wealth/planning.html> (last visited Mar. 13, 2019).

¹⁰ Wells Fargo Advisors, *Why Choose Wells Fargo Advisors*, available at https://info.wellsfargoadvisors.com/form.aspx?type=wellsfargoadvisorspacket&cid=WFA140043903&in_cid=WFA140043903 (last visited Mar. 13, 2019).

¹¹ Merrill Lynch, *Working with Us*, available at <https://www.ml.com/working-with-merrill-lynch-financial-advisor.html> (last visited Mar. 13, 2019).

continue for as long as the broker or the firm is continuing to be compensated for that recommendation.

Brokers use the language of fiduciaries to gain the trust and confidence of investors.¹² As a result of decades of the above type of advertising, investors rightfully believe they are doing business with individuals who will work with them along their financial journey. Investors do not believe that their financial advisor is there to make a recommendation, and then disappear. Representations like the ones above are clearly meant to tell potential clients that investment advice beyond the “transactional advice” that brokerage firms want the SEC and other regulatory bodies to judge them by is what will be provided if an investor entrusts their savings to the firm. These firms have purposely create an impression that they will be providing a fiduciary service, but then ask not to have to live up to that standard when the advice they give does not meet the standard.¹³

Disclosure should inform the investor, not absolve the financial services firm of any obligations

While disclosure is always an important part of any fiduciary relationship, it is vitally important that such disclosure be used to benefit and inform the customer, not as a shield against misconduct, as it is often used and could be used under the current Regulation Best Interest standard.

As part of Regulation Best Interest, the SEC has proposed the use of a Client Relationship Summary (“CRS”) form.¹⁴ PIABA has concerns about whether the CRS form can or will provide effective disclosure to investors, whether such a form will be lost in the voluminous written materials which investors typically receive when making a securities transaction, and whether investors will be able to reasonably understand and synthesize the information on the form.

Recent studies show that disclosures do not lead to greater understanding, even when read. For example, a Rand Corporation study commissioned by the SEC revealed that,

¹² See *supra* n. 5.

¹³ This is an example of the type of situation that mere disclosure cannot resolve. Brokerage firms have spent decades and billions of dollars to create an impression of trustworthy financial professionals providing unbiased and continual advice to their clients. A boilerplate disclosure in a document handed to new clients, along with many other documents when opening an account, will not undue this perception that the brokerage industry has been instilling in the minds of the public for so long. Rather, the only real solution is to make brokerage firms live up to the standard they have been advertising towards for decades.

¹⁴ The proposed Rule provides that a broker’s required disclosure relating to the scope and circumstances of its relationship with the customer would be made through the CRS form, provided to customers at the opening of a new account. 17 CFR Part 240, 249, 275 and 279, Release No. 34-83063 (April 18, 2018).

after reviewing disclosures regarding the differing duties of investment advisers and brokers, many individuals still remained confused about when firms owed them fiduciary duties and when they did not.¹⁵ This finding was confirmed by another study of the effect of such disclosures which was conducted by the American Association of Retired Persons, the Consumer Federation of America, and the Financial Planning Coalition.¹⁶ In short, disclosure of differing duties does not adequately put investors on notice that they should not trust their broker, or that a “buyer beware” standard applies.

Providing greater disclosure also does not appropriately mitigate the conflicts of interest inherent in the relationship between brokers and investors. Instead, it places the burden on the investors to fully understand the impact of those conflicts on the future of their retirement savings. However, the brokers have held themselves out to be professionals who are there to offer guidance to investors on important life decisions. They should accept the responsibility that comes with the profession and with the trust they have sought to earn by managing the life savings of an individual.

Thank you for your attention to this issue. We appreciate the opportunity to provide a statement. Please do not hesitate to contact us if you have any questions or would like any additional information.

Respectfully submitted,

Christine Lazaro
President

cc: Chairwoman Waters; Ranking Member McHenry

¹⁵ SEC, *Investor Testing of Form CRS Relationship Summary*, 46 (Nov. 2018), available at <https://www.sec.gov/about/offices/investorad/investor-testing-form-crs-relationshipsummary.pdf>.

¹⁶ AARP, Consumer Federation of America, and Financial Planning Coalition, *Final Report on Testing of Proposed Customer Relationship Summary Disclosures*, 12 (Sept. 10, 2018), available at <https://consumerfed.org/reports/report-on-testing-of-proposed-customer-relationship-summary-disclosures/>.