FACT SHEET ON SEC'S PROPOSED "REGULATION BEST INTEREST"

WILL THE SEC FINALLY REQUIRE BROKERS TO PUT THEIR CLIENTS' BEST INTEREST FIRST?

Tens of millions of America's investors and retirees are losing tens of billions of dollars a year to brokers and other financial advisers who have conflicts of interest and put their economic interests ahead of their clients' best interest. A straightforward fiduciary duty rule requiring those brokers and financial advisers to put their clients' best interest first when giving investment advice would eliminate this incredibly unfair and costly behavior. However, in the face of massive industry opposition, the SEC rejected that strong, clear, and simple standard and decided to propose a so-called "Regulation Best Interest." Unfortunately, the proposal is woefully inadequate. It will actually make things worse for hardworking investors and retirees by misleading them into thinking they're receiving protections that don't really exist.

The Wall Street Journal reported last Thursday, May 23rd, that the SEC is about to vote on the proposal, which its advocates—including SEC Chairman Jay Clayton—claim would protect Americans savers and investors from investment advice corrupted by broker conflicts of interest. The SEC subsequently noticed a meeting for Wednesday, June 5th.

If what the article says is accurate—that the final rule will be "similar" to the April 2018 proposal—then investors in this country should be very alarmed. Their brokers will be able to ***claim*** that, under the new rule, they must make recommendations solely in the client's "best interest." However, that will be meaningless because, remarkably, the proposal never defined "best interest." Instead, it essentially created a "check-three-boxes" test that brokers can use to comply with the rule and avoid accountability—even though none of the boxes actually require brokers to act in the best interest of their clients. If finalized as proposed, the new rule will merely declare "business as usual," if not worse, for investors, which is why the financial industry is almost universally applauding the SEC's expected move.

The proposal issued last year was riddled with other problems as well.

First, it relied far too much on requiring disclosures about conflicts of interest instead of setting an enforceable standard of conduct that requires putting the client's best interest first. However, we've known for years that disclosure alone cannot protect investors from conflicts of interest, any more than disclosure can protect Americans from contaminated pharmaceuticals, spoiled food on the grocery store shelf, or toxic industrial waste poured into our local water ways. Only strong, enforceable standards of conduct will protect Americans from these threats.

Second, the proposal allowed the most basic disclosures to be made "at the time" of the investment recommendation, when they will come too late to do investors much good. And the more detailed disclosure requirements accompanying the proposal in "Form CRS" proved to be so confusing that many investors who were surveyed came away still deeply confused about the standards of conduct they should expect from their advisers, how they pay for advice, and the alternative sources of advice they can find among registered investment advisers. Unfortunately, the SEC never tested those draft disclosures ahead of time, and it's obvious on the eve of the final rule they have no intention of doing so.

Third, the proposal didn't actually require brokers to eliminate any conflicts of interest, just to disclose them and in some cases to "mitigate" them. Moreover, the proposal left it entirely up to advisers to decide what “mitigation” means and how to go about achieving it. Letting the financial industry police itself is doomed to failure, with investors inevitably paying the price.

Fourth, the SEC utterly failed to acknowledge the enormous costs imposed by adviser conflicts of interest and the terrible toll that such a weak rule will continue to take on tens of millions of Americans. The economic analysis of investor harm in the proposal was so deficient that eleven former lead economists for the SEC actually took the unprecedented step of writing a letter to the agency highlighting the glaring deficiencies in the economic analysis.

The industry’s leading talking point in support of the proposal is that a strong investor protection rule would deprive investors of product choices and access to affordable investment advice. But do investors really want the “choice” to be sold poor performing, over-priced products that enrich brokers at investors’ expense? No one would knowingly choose to pay bloated fees, suffer inferior returns, or assume excessive risk. Moreover, even under a genuine “best interest” standard, investors would have plenty of choices about where to obtain investment advice and how to pay for it, and they would be receiving much better advice, not advice that benefits the brokers at investors’ expense.

The SEC’s primary obligation is to protect investors, not brokers’ products or their lucrative business models. If the rule is finalized as proposed as has been reported, it will be a dark day for the agency and a sad day for investors.

We will comment in more detail when the proposal is finalized, but, for now, you can find more information in Better Markets’ detailed letters on the proposal here and here.