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STATEMENT AT OPEN MEETING ON FORM CRS, PROPOSED REGULATION BEST INTEREST AND NOTICE OF PROPOSED COMMISSION INTERPRETATION REGARDING STANDARD OF CONDUCT FOR INVESTMENT ADVISERS (PROPOSED RULE)

Commissioner Michael S. Piwowar

April 18, 2018

I would like to start by thanking the Directors of the Divisions of Investment Management and Trading and Markets for their joint leadership in devising the package of recommendations before us this afternoon. Each of these recommendations, in its own way, seeks to address confusion among retail investors about the disparate regulatory regimes governing investment advisers and broker-dealers.

Of course, resolving this confusion is no easy task, as I am sure Dalia [Blass] and Brett [Redfearn] will each attest. From their earliest days on the job, it was clear that they were each committed to working together to seek potential solutions in an area that has vexed both the Commission and other regulators for years.

While Dalia and Brett charted the course for this project, it could not have been accomplished without the hard work of their respective staffs. These teams spent countless hours analyzing comment letters, meeting with industry participants, and drafting these weighty documents. And I do mean weighty — it took two giant four-inch binders to hold the copy of this package they delivered to my office. Further thanks go to the staff in the Division of Economic and Risk Analysis and the Office of General Counsel, who provided critical input along the way.

Finally, and most importantly, thank you to Chairman Jay Clayton for pledging the SEC to act in this area, where our leadership has been sorely needed. Chairman Clayton has constantly reminded us that today's recommendations are not really about investment advisers and broker-dealers; they are about the retail customers they serve. Last week, I joined SEC staff in talking to a group of 200 U.S. Marines at Camp Pendleton — some of them straight from boot camp — about saving and investing for the future. It is not lost on me that those Marines are dedicating their lives so that we can be secure in our liberties. The least we can give them is the tools they need to secure their financial future. These are the investors we must have in mind as we design rules to clarify and improve the standards of conduct across the investment adviser and broker-dealer industries.

We cannot discuss standards of conduct without acknowledging the proverbial elephant in the room: the Department of Labor ("DOL") Fiduciary Rule. In 2015, the DOL acted unilaterally to pass what I have described as a "terrible, horrible, no good, very

bad" rule,[1] ignoring input from the SEC staff (including that from our knowledgeable economists), FINRA, state securities regulators, and state insurance regulators. DOL's hasty approach drew immediate backlash. The only thing clear about that rule was that it would drive up compliance costs for broker-dealers and insurance providers to the point where many investors would be left without access to the affordable financial advice that these business models can offer. Thankfully, for the sake of retail investors — or as Chairman Clayton likes to say "Mr. and Mrs. 401(k)" — the Fifth Circuit called out the DOL's highly questionable use of authority and vacated its rule.[2] Now, all eyes are on the SEC as we seek to provide a workable, non-political path forward.

That is why I am happy to support all three of today's recommendations. Nevertheless, I cannot hide my misgivings about certain aspects of the nearly 1,000 page tome before us today. The size of this package alone gives me pause. If it takes us that many pages to explain what we are trying to do, dare I say that our solution might necessarily lack the clarity that is needed to address retail investors' confusion? With that overarching concern off my chest, I will now discuss my views on each of the three proposals in turn.

I. FORM CRS

Form CRS would require financial professionals to deliver to their retail customers a short and simple disclosure form to clarify the scope of these customers' relationships with those people and companies who offer them financial services.

This type of disclosure-based regulation is premised on standard economic theory supporting the notion that disclosure can solve information asymmetries. Indeed, one of the primary failings of the DOL rule was that it dismissed the efficacy of conflict of interest disclosure, in stark contrast to decades of Commission experience.[3]

While I support the spirit of today's Form CRS proposal, it is evident that our relationship summary templates — as proposed — are in need of substantial public input. These summaries are meant be clear and concise, and to read like 'plain English.' Yet the

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[1] Commissioner Michael S. Piwowar, "Comment Letter in Response to the Department of Labor's "Request for Information Regarding the Fiduciary Rule and Prohibited Transaction Exemptions" (July 25, 2017) ("DOL Comment Letter"), https://www.sec.gov/news/public-statement/piwowar-comment-dol-fiduciary-rule-prohibited-transaction-exemptions.

[2] *Chamber of Commerce of the United States v. United States DOL*, 2018 U.S. App. LEXIS 6472 (5th Cir. 2018).

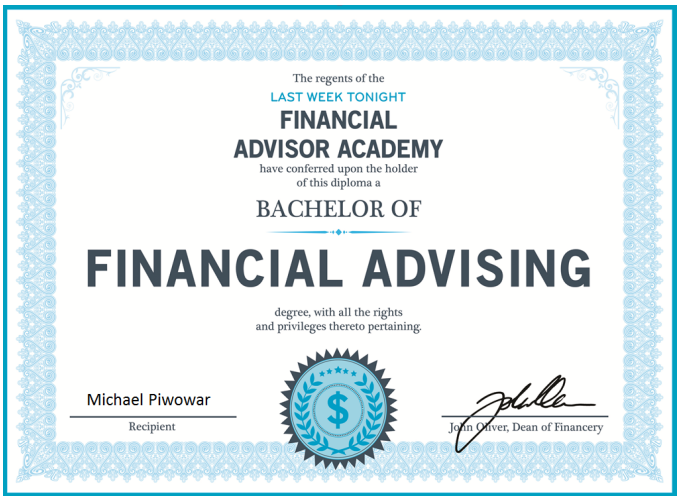
[3] DOL Comment Letter.

Flesch-Kincaid readability calculator shows that they are about as comprehensible to the average reader as Herman Melville's *Moby Dick*. This makes sense, considering that the SEC staff who drafted them are securities lawyers and Ph.D. economists. However, it does not make sense if our true goal with these forms is to help retail customers break through the confusion that can cloud their interactions with broker-dealers and investment advisers. That is why I hope to hear from a wide range of commenters — including consumer behavior researchers in fields such as economics, marketing, and advertising — who can each help us make these disclosure forms more effective at conveying information in a way that retail investors can understand. I also look forward to the results of investor testing, which our Office of Investor Advocate will conduct, related to this topic.

Lastly, on this proposal, I am thrilled that we are finally addressing the specific confusion and resultant potential harm to retail investors from the use of misleading titles by financial professionals. As the proposal on Form CRS notes, retail investors must be able to distinguish between the types of financial service providers they can choose to deal with, including those who sell products and those who offer full-service advice as a fiduciary. But currently, the titles used by many of these financial services providers offer investors little to no help. For example, under current regulations anyone can call him- or herself a financial "adviser" (or "advisor"), regardless of whether they are a registered investment adviser complying with all of the investor protections such registration entails.

So it is hard to argue with the comedian and television host John Oliver who, while dedicating an entire episode of his show "Last Week Tonight" to this issue, pointed out that the "term [financial adviser] doesn't necessarily mean much."[4] In fact, you may not have known, but in addition to being a Ph.D. economist and SEC Commissioner, I recently earned a "Bachelor of Financial Advising" from the "Financial Advisor Academy." In fact, "Dean of Financery" John Oliver himself (well, at least his website) bestowed me that title, and I have a certificate with his signature to prove it.

[4] *See* Last Week Tonight with John Oliver (HBO), "Retirement Plans" (June 13, 2016).



While today's proposal would ultimately limit my "financial advising" activities, I am willing to make that personal sacrifice in order to ensure greater clarity for retail investors.

II. REGULATION BEST INTEREST ("REG BI")

As I mentioned previously, I have been eager for the SEC to take the lead in offering a regulatory alternative to the DOL Fiduciary Rule. While I have kept an open mind as to what that alternative should be, I strongly believe that whatever the Commission ultimately adopts must (1) be *clear* about the new obligations we are imposing, and (2) not be so restrictive or difficult to comply with that firms stop offering retail investors services they can pay for through commissions or other transaction-based fees. Today's proposal of Reg BI is a solid building block towards those ultimate goals.

This proposal imposes on broker-dealers a new "best interest" standard. This sounds simple enough — it's not merely a "good" interest or a "better" interest standard, it is a "best" interest standard — and that term has attracted many advocates within the industry. However, as everyone who has worked on this rulemaking knows, the devil is truly in the details. According to the proposing release, this "best interest" standard is wholly different from the well-established Investment Adviser's Act fiduciary standard and FINRA's suitability standard. Unfortunately, after 45 days of reviewing and commenting on this release, I am not convinced that we have clearly and adequately explained the exact differences.

This lack of clarity is worrisome and could undermine our goal of preserving retail investors' ability to access different types of financial services. On a basic level, ambiguity in this rule would make it difficult for broker-dealers to know how to comply with its

requirements, which could then lead to disparate treatment of retail investors or a decision to stop offering transaction-based services.

At the same time, uncertainty about our requirements would also make the rule more costly to implement. As Chairman Clayton accurately stated in his speech setting out his guiding principles: "the costs of a rule now often include the cost of demonstrating compliance."[5] I fear that despite the laudable goals of proposed Reg BI, ambiguity in its requirements could make demonstrating compliance particularly challenging.

We must remember that any implementation challenges and compliance costs created by these new Reg BI obligations add to those that broker-dealers already bear when complying with other regulators' requirements — namely those from FINRA, the DOL, state securities regulators, and state insurance regulators. So we must ask ourselves, and I encourage commenters to respond to the same question: Will Reg BI raise compliance costs to such a level that it becomes economically disadvantageous for broker-dealers to offer retail investors transaction-based advice?

Despite these concerns, I am supporting this proposal because I believe it is a very positive step towards furthering the Commission's goal of better aligning broker-dealers' obligations to the expectations of their retail customers by: (1) requiring broker-dealers and registered representatives to subordinate their interests to those of their retail customers; (2) protecting retail customers from investment strategies that drive up broker-dealers' fees; and (3) requiring broker-dealers to provide their customers with enhanced disclosures of conflicts of interest.

We must now rely on commenters to let us know how well we have articulated the new best interest standard, and how we might be able to modify or clarify it to better accomplish these stated goals. Particularly, should we have more explicitly adopted FINRA's suitability standard, which has been interpreted as having a "best interest" requirement, into the Commission rulebook? With regard to disclosures, should we have sought to consolidate Reg BI's disclosure requirements with those mandated by Form CRS? Responses to these and other questions in the release will help us tailor our final rules to prevent unnecessary ambiguity and unintended consequences.

I trust that this proposal will launch a vigorous discussion, and I look forward to the feedback we will undoubtedly receive.

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[5] Chairman Jay Clayton, "Remarks at the Economic Club of New York" (July 12, 2017), https://www.sec.gov/news/speech/remarks-economic-club-new-york.

III. NOTICE OF PROPOSED INTERPRETATION REGARDING STANDARD OF CONDUCT FOR INVESTMENT ADVISERS

Finally, we are proposing an interpretation of the standard of conduct for investment advisers. This issue has not received nearly the same scrutiny as the broker-dealer standard of conduct in recent years, but it is no less important. Most people in this room would immediately be able to identify the "fiduciary duty" as the standard of conduct for investment advisers. What may not be as readily identifiable are its parameters. Put another way, what specifically does the fiduciary duty entail?

Such a question should not surprise us, as the Advisers Act prescribes few particular obligations related to this standard. As a result, the proposed interpretation infers certain requirements from common law principles and generally cites to treatises and law review articles for support. However, the relative lack of case law underpinning this proposed interpretation raises questions about our legal authority to issue this guidance. I recognize that many of these proposed requirements have become industry standard practices in response to Commission orders in settled enforcement actions. But, settlements are not legal precedent. While I am pleased that we did not seek to rely on settled orders as support for this guidance, I am eager to know what legal authority exists to support the interpretation of advisers' fiduciary duty that we are proposing today.

While I am not opposed to proposing this guidance for comment, I hope that commenters will fill in any gaps in our analysis to bolster the common law support for the propositions in this document. Where we find that such support is not available, yet still believe that certain obligations merit the imprimatur of the Commission, we should consider engaging in rulemaking rather than attempting to impose requirements through guidance.

IV. CONCLUSION

In summary, while I have some misgivings about certain aspects of all three recommendations, I overwhelmingly support putting them out for public comment. No longer can anyone say "The SEC really needs to do something about this."

Thank you. I have no questions.