

The SEC Isn't Giving Us Straight Talk

by [Knut Rostad](#), 10/3/18



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If passed, the SEC's 125,993-word proposed Reg Best Interest ("Reg BI") will harm investors and greatly change the competitive landscape for brokers and advisors. The SEC's four-page proposed disclosure (Form CRS) for advisors and brokers reveals much of what ails Reg BI. It also illuminates how the comments of Commissioners Peirce and Stein could be the basis for a bipartisan fix.

The SEC disclosure has been on a five-month tour gathering feedback from investors through a series of roundtable discussions. The tour has not gone well. Investors everywhere have booed it off the stage. Why?

The disclosure is incomprehensible.

This result was not preordained. The SEC is in a hole today 35 years in the making. Getting out won't be easy, but the route is clear. Commissioners Hester Peirce, a Republican appointee, and Kara Stein, a Democratic appointee, have set a tone and offer bipartisan guidance.

"We're going to keep working on it until we get it right," SEC Chair Jay Clayton said about his proposals after the seventh SEC roundtable in Baltimore. *Investment News* reported the chairman's chief takeaway from investors was, "Try to give us some straight talk."

Straight talk would help. In fact, securities regulations were conceived by President Roosevelt as a code of *ethics* in 1933 that was, as he said, "simple enough for the public to understand."

Broker and advisor roles were well understood for years, until the *conflation* of the two began. Law professor Arthur Laby recounts how broker-dealers (BDs) began shedding their stockbroker title in the early 1980s for various "trusted advisor" titles. Examples abound. One firm advertised, "total financial planning."

A Consumer Federation of America paper last year showed how BDs tell investors they're trusted advisors, and then tell the courts they're just sales people. Brokers lead a double life.

While advertised as trusted advisors and presumed to have been recruited, obliged, trained and compensated to advise, the fact is brokers do none of this. They distribute products and represent manufacturers.

This matters. Laby notes, "Advertising works [by creating] a positive emotional reaction" such as *warmth* that is stimulated by words or pictures of "friendship, caring, or tenderness."

So there's no surprise, in Washington anyway, when we hear again and again that the public misunderstands what brokers and advisors do. After 35 years of advertising brokers' trust and confidence and "caring," it's obvious most investors don't know BDs' main function is to distribute products. This disclosure must be an "amber alert." Anything less is not serious.

The SEC's proposed conduct standard rules don't help. A unique "authority" in Washington suggests so. This authority is not based on ideology or partisanship – a unique occurrence in Washington. It's based on common sense.

Common sense demands that calling the SEC disclosure *confusing* understates the problem. Driving in rush-hour traffic in a foreign city is *confusing*. Understanding legally cleansed language that makes brokers and advisors seem the same – or brokers better – is a challenge *for even attorneys*. For others, it is wishful thinking. The disclosure is *incomprehensible*.

Republican SEC Commissioner Hester Peirce makes good points outlining why the proposals fall way short. The commissioner noted that the text of Reg BI is unclear as to what "best interest" means.

Democratic SEC Commissioner Kara Stein also makes good points outlining why the proposals are unacceptable. The Commissioner complained that, "this rule will not only confuse retail investors, but also broker-dealers."

Investors agree. Media reports from SEC roundtables of investors revealed their incomprehension, as do the results of AARP research and my organization's analysis of the transcripts of the first six roundtables.

Reg BI fails to use plain language to clearly explain core differences that divide advisors and brokers, such as basic legal, contractual and business differences. Brokers give incidental advice in relationships of three (investors, brokers and product manufacturers) while advisors give fiduciary advice in intimate relationships of two (investors and advisors). Instead, the language in Reg BI says brokers and advisers are basically identical.

Language expert, Deborah Bosley, PhD., found Reg BI is written at the "14th grade" reading level. But the average American reads at an eighth grade level. Chairman Clayton's emphasis on straight talk underscores this point. Indeed, she has proposed an alternative disclosure.

The Fiduciary Institute and Dr. Bosley's alternative disclosure stresses language that is clear, concise and accurate. In reference to brokers, it says, "We represent issuers or underwriters who sell financial products. We do not represent you." It requires that advisors disclose, "We must give you fiduciary advice in your best interest at all times. We only represent you."

Chairman Clayton says, "We're going to keep working on it until we get it right." Chances of getting it right will improve by testing proposed disclosures and taking a *bi-partisan approach*. Commissioners Peirce and Stein and investors offer bi-partisan guidance, starting with *common sense*.

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