

December 7, 2018

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Investor Testing of the Proposed Relationship Summary for Investment Advisers and Broker-Dealers (File Numbers S7-07-18, S7-08-18, S7-09-18)

Dear Secretary Fields:

The undersigned organizations have a shared interest in strengthening protections for the millions of Americans who turn to financial professionals for advice about their investments. We write in response to the recently released RAND Corporation report on investor testing of the Client Relationship Summary (CRS).¹

First, we greatly appreciate that the Commission has, as we previously requested,² taken the important step of testing the proposed Form CRS disclosures for effectiveness and has made the results of that testing available for public comment before finalizing the Regulation Best Interest and Form CRS rule proposals. More broadly, we applaud the level of investor outreach that the Commission has undertaken throughout this regulatory process. We fear, however, that if the Commission focuses on the results of this outreach, which provides input on investors' opinions, rather than on actual testing of investor comprehension, it may come to some misguided conclusions.

Specifically, we are concerned that the Commission may focus on the fact that, when asked, investors respond that they like the proposed Form CRS and believe it is helpful rather than focusing on the evidence that shows that most do not understand the disclosures. While investors' opinions and preferences no doubt are important considerations when developing disclosures, they must not be the dispositive factor that informs the Commission's regulatory analysis. Instead, as we have previously explained,³ and as the Commission itself acknowledges in its rulemaking release, the critical question is whether the disclosure will enable investors to understand the differences between brokerage accounts and advisory accounts and make an informed choice among the available accounts and services. The RAND report provides compelling evidence that the Commission's proposed Form CRS disclosure fails in this fundamentally important regard.

¹ Angela A. Hung, et al., Investor Testing of Form CRS Relationship Summary, Prepared for United States Securities and Exchange Commission, RAND Corporation, November 2018, <https://bit.ly/2OxcRfj>.

² Letter to Chairman Jay Clayton, SEC, Calling on SEC to Delay Comment Deadline for "Best Interest" Regulatory Proposal, May 21, 2018, <https://bit.ly/2zMwdDR>.

³ *Id.*

First, significant percentages of investors stated in response to survey questions that important sections of the proposed Form CRS were “difficult” or “very difficult” to understand. For example, almost one quarter of respondents described the “Types of Relationships and Services” and “Our Obligations to You” sections as “difficult” or “very difficult” to understand. The responses were even higher for the “Fees and Costs” and “Conflicts of Interest” sections, with approximately 35 percent of respondents describing these sections as “difficult” or “very difficult” to understand. It is deeply troubling that huge swaths of retail investors, based on their own assessments, are likely to experience difficulty in understanding these critical components of the disclosure.

RAND’s in-depth interviews of investors show that problems with the disclosures are even more extensive than investors’ self-assessments would indicate. These interviews, which test investors’ actual understanding of the disclosures, show a widespread lack of comprehension, differing interpretations, and misunderstandings of the proposed Form CRS. For example, while participants appeared to have a general understanding that there were differences in the types of relationships and services they could choose, they did not demonstrate any meaningful understanding of the nature of those differences. It does not appear from the report, for example, that participants demonstrated a working understanding of the fundamental distinction between sales recommendations and investment advice. This would be consistent with previous research showing that investors do not distinguish between the sales recommendations they receive from broker-dealers and the advice they receive from investment advisers.

The report offers further evidence of the difficulty investors currently face in distinguishing between different types of financial service providers. When asked in the in-depth interviews about the type of financial service provider they use or used, none reported that his or her financial service provider is a broker, while seven reported that their financial service provider is an investment adviser, four reported that their financial service provider is dually registered, and four reported that they do not know. Given what we know about the distribution of account types, this is almost certainly false – reflecting investors’ tendency to believe and rely on the misleading titles and marketing used by broker-dealers to promote themselves as advisers. These findings are consistent with previous research RAND has conducted on behalf of the Commission, showing that most investors still could not identify the type of investment professional they worked with even after they were provided with fact sheets describing the differences between brokers and advisers.

Understanding of the differing legal obligations owed by investment advisers and broker-dealers was also poor. Many participants did not understand the meaning of the word “Fiduciary.” Some participants had never heard of the word, whereas others had heard it but did not know what it meant in this context. Others thought that fiduciary implies acting in the customer’s best interest, and were then confused by the second bullet point under the “Advisory Account” column, which stated that the firm’s interest and the investor’s interest can conflict. Interview discussions further revealed that participants “tended to struggle” over the language in the “Fees and Costs” section, including even with regard to terms for which further explanations or definitions were provided. Moreover, many participants expressed confusion over the

“Conflicts of Interest” section, including struggling to reconcile the information in that section with the previous “Our Obligations to You” section.

The interview discussions also revealed that there were differing interpretations of the “Our Obligations to You” section and variations in the level of understanding of the different obligations for different account types. Some participants felt that both the “Brokerage Account” and “Advisory Account” columns in the Relationship Summary were essentially conveying the same message, just using different words, while other participants interpreted the section as conveying that advisory accounts have a different standard from brokerage accounts. This pervasive lack of understanding with regard to legal obligations is of particular concern, since the Commission’s proposed regulatory approach in Regulation Best Interest is premised on the assumption that investors can make an informed choice between different types of financial professionals operating under differing standards of conduct.

In reality, the unavoidable conclusion from RAND’s in-depth interviews is that, even after carefully reviewing Form CRS, investors do not sufficiently understand differences in the types of accounts and service providers to be able to determine which would be the best option for them. For example, while some participants understood discrete sections of the Relationship Summary when they first reviewed it, when questioned at the end of the interviews, “they did not appear to have synthesized the information and be able to apply it,” according to the report. Others “seemed to misunderstand the differences between account types and financial professionals from the beginning, never fully grasping it.”

The RAND report’s findings also show the risk of relying on surveys and other informal input to determine whether proposed disclosures would be effective at achieving their regulatory purpose. Despite the fact that investors say they like the disclosure and believe that it is helpful, the RAND report provides compelling evidence that the proposed summary relationship disclosure fails to achieve its intended purpose. This is particularly true for the least financially sophisticated who are most in need of protections and most likely to place their trust in the financial professionals they turn to for assistance with their investments.

The RAND report’s findings reinforce our view that the Commission should fundamentally rethink its regulatory approach. Given the evidence that, after being provided a summary relationship disclosure, investors still cannot fully understand, and in some cases misunderstand, fundamental differences in the nature of the brokerage and advisory relationships and the respective duties they are owed, the different fees they would pay, or how various conflicts of interest can influence the recommendations they receive, a regulatory regime that relies on disclosure for investors to make an informed decision about what type of financial professional to work with and what type of account to use is certain to fail.

If the Commission chooses to maintain different standards for brokers and advisers, it must clearly delineate what the differences are in a way that investors can readily understand and apply to their own situation. This would require rethinking the Form CRS and re-testing it to ensure that it achieves these goals. We’re frankly skeptical that clear and readily understandable disclosures of such complex and technical issues can be achieved, which is why we continue to maintain that the correct approach is the adoption of a strong, uniform fiduciary standard, backed

by strong conflict mitigation requirements to ensure that misaligned incentives aren't allowed to taint the advice. This approach would minimize the potential harm to investors should the disclosures prove ineffective.

Thank you for your consideration of our concerns.

Respectfully submitted,

AFL-CIO
American Federation of State, County and Municipal Employees (AFSCME)
Alliance for Retired Americans
Americans for Financial Reform Education Fund
Allied Progress
Better Markets
Center for Economic Justice
Committee for the Fiduciary Standard
Consumer Action
Financial Planning Association
Fund Democracy
National Association of Personal Financial Advisors
National Employment Law Project
Public Citizen
U.S. PIRG