



June 30, 2020

Vanessa Countryman  
Secretary  
Securities and Exchange Commission  
100 F Street  
Washington DC 20549

RE: S7-07-18, Regulation Best Interest: The Broker-Dealer Standard of Conduct

Dear Secretary Countryman:

We write today, as the start of the enforcement of Reg BI begins. The issue of addressing conflicts is central in the rule release. We note mentions of “conflicts” and “disclosure” is widespread. Each word is cited over 1000 times. At the same time the mentions of “eliminate”, frequently in the repeated reciting of the rule obligation to “disclose” or “eliminate” conflicts, comes to 150 mentions, while “avoidance” of conflicts is mentioned just 12 times. These word counts appear to reflect the rule release overriding emphasis on disclosing over eliminating or avoiding conflicts.

More conflicts comes with the corresponding greater burden on personalized disclosure at the point of recommendation to address them. The role of mitigation measures separate from disclosure is undefined and remains unclear at this time. This puts even more importance on plain language disclosure so that a “best Interest” standard can mean *best interest*.

The importance of effective disclosure is underscored in the recently submitted recommendations from the Investor Advisory Committee. <https://www.sec.gov/spotlight/investor-advisory-committee-2012/disclosure-effectiveness-recommendation.pdf> According to a recent Edelman’s Trust Index, the number one factor in whether or not consumers trust their financial institution is their ability to understand financial information

In this letter we discuss plain language written disclosure and criteria for making effective market disclosure and disclosure in specific customer recommendations.

*What Is Plain Language?*

Plain language is the use of proven written and design strategies that make it easy for the intended audience to find, understand, and use information – “intended audience” is where we begin. The disclosure is intended for the average consumer or investor, not for financial experts or broker/dealers or RIAs. The latter lives in the world of financial discourse; the former does not. Thus, we must use language that explains conflicts in a manner that the average investor can understand.

### *Why Is It Critical That Consumers Understand What They Are Agreeing To?*

Until recently, the SEC, emphasized the importance of avoiding conflicts, if at all possible. More recent SEC views have suggested or implied that disclosing conflicts is as permissible, or even better, than avoiding conflicts. For those conflicts that are not avoided, the back-up option is to fully disclose the conflict and also receive consent.

If we are to expect investors to understand conflicts of interest in particular and the Form ADV disclosure in general, we must address the following questions:

1. Does the Form meet the standards for plain language?
2. Do investors actually understand the disclosure?
3. What criteria will the SEC use to determine if the conflicts are written in plain language?
4. What are the minimum standards for investors to understand market disclosure such as Form ADV ?
5. We must also address: What are the minimum standards for a customer to understand a specific recommendation from a broker?

Despite the requirements for Form ADV to be written in plain language, we have run readability tests on one example from Ameriprise to see if either of their ADV meet plain language standards.

#### *1. Does the Form Meet The Standards For Plain Language?*

Let's begin with Ameriprise, which admits in their own disclosures that even their reps may not understand broker-dealer conflicts. If we run pages 19-34 (How We Get Paid) through Visible Thread's readability software, we find the following:



Long sentences are those that are outside the recommended range of 12-20; passive voice is more complex than active voice; and using the Flesch Reading Ease system, we find that the readability ease is lower than the *Harvard Business Review*. In addition, the text broke other plain language standards including dense paragraphs and too much financial jargon. In the first 1.5 pages (pp.19-20), as examples, we found the following terms consumers are not likely to understand:

- product companies
- investment platform
- cost reimbursement services
- private placements
- proprietary products
- nonproprietary investment

Of course, this list doesn't include the words in context and the difficulty of understanding the meaning of the complete sentences. Therefore, the answer to our first question: "Does the Form meet the standards for plain language?" is a resounding "no."

## *2. Do Investors Actually Understand the Disclosure?*

This is the most important question we can ask about Form ADV. The purpose of disclosures is to inform investors how these firms and brokers are being paid. As it concerns consumers, it tells them nothing. There is only one way to truly know because meeting the plain language standards does not tell you that consumers will actually read and understand the text. How do we find out? We run usability tests on the disclosures to hear the voice of the consumer.

Usability testing occurs by conducting one-on-one interviews with members of the intended audience: investors or consumers themselves. Research shows that between 5-8 people are all that is necessary to give feedback to determine the comprehension and incomprehension of any document (online or in print/pdf form). We first create a list of questions that will get to the heart of understanding: e.g. both closed ended ("What does this word mean?") and open-ended ("What is the conflict being described in this section?") to determine the issues in the text that block understanding. This method is by far the best way to determine if a consumer understands. Readability scores will tell you us if we're on the right or wrong path; the voice of the person who actually has to read the documents tells us so much more.

If firms actually want investors to know whether or not they have explained conflicts in a manner that their intended audience can understand, asking them is the best way to validate that understanding. We propose that the SEC mandate testing of this type during the drafting stage.

However, we have another issue that runs deeper than the language. In general, when concepts and actions are explained in a manner that is hopelessly complex, we look to the source. That is, the issue of conflicts and recommendations are, in themselves, the problem. If we have reason to believe that the investor cannot understand the nature of the conflict, then the advisor is supposed to not proceed. Yet we are faced not only with page after page after page of complex information that even plain language could not fully explain because the conflicts themselves are a labyrinth with no way for anyone to understand. Remember: even Ameriprise itself said their own reps might not be able to understand conflict as described. Two points:

- **Disclosure is not the same as communication.** Do firms disclose conflicts? Yes. Do they communicate those conflicts in a manner investor can understand? No. Therefore, these disclosures may meet the letter of the law, but not the spirit. Somethings even plain language cannot explain because of the nature of the disclosure itself.
- **Complexity often is a function of a poorly designed system.** If a Form ADV is long, complicated, and poorly explained, that in itself can indicate that either the disclosure is not actually disclosing or that investment firms don't actually want people to understand conflicts.

### *3. What Criteria Will The SEC Use To Determine If The Conflicts Are Written In Plain Language?*

Finally, a requirement that Form ADV explains conflicts in plain language will only be met if we understand the criteria for the SEC determining if such a requirement has been met. It is not enough to simply use an algorithm to determine the grade level necessary for a consumer to understand. Such scores are only a starting point. For example, if we were to score the readability of a sentence that contained several of the jargon words listed above, we would get a score of 17<sup>th</sup> grade (rounded up). That would indicate that a consumer who has one year of graduate school could understand the text.

However, readability scores primarily calculate the average number of words per sentence and the number of syllables per word implying that longer words are more difficult to understand. Therefore “private placement” would score at a low-grade level (only two syllables for each word) and yet testing would likely show that consumers do not understand that term. In addition, plain language experts also could help both the SEC and financial institutions create Form ADV to meet the standard. That, coupled with testing, would give companies the confidence that they could meet SEC standards.

### *4. What Are The Minimum Standards For Investors To Understand Market Disclosure such as Form ADV ?*

If “understandability” is truly a goal, then using even the minimum standards for plain language at least gives investors a chance at being able to understand market disclosure of conflicts as in Form ADV. Using the best practices of Plain Language, including the SEC’s own standards discussed in *A Plain English Handbook: How to create clear disclosure documents* created by the Office of Investor Education and Assistance in 1998, we can see that at a minimum a readable Form ADV must, *at a minimum*, have the following characteristics:

**Systemic Complexity:** The nature of the complexity of the conflicts may prevent investors from understanding disclosure that is well written plain language. This is systemic complexity.

*At a Minimum: The complexity of the magnitude, number and opacity of the incentives and conflicts are also either summarized in one or two pages or vastly simplified – or both.*

**Sentence and Paragraph Length:** Long sentences are difficult for readers to process and overloads our short-term memory making it often impossible to understand the content. Dense paragraphs also are difficult to read and the appearance of dense paragraphs immediately affects a person’s decision to read (or not read) any content.

*At a Minimum: Sentences that are meant to be understood should be between 12-20 words and paragraphs should have no more than five sentences.*

**Document Length:** The length of existing Form ADVs are far longer than people are likely or willing to read. Ameriprise’s Form ADV Part 2A is 64 pages and the sections Fees and Compensation and How We Get Paid total 20 pages. Commonwealth’s Form ADV Part 2A is 131 pages and the sections on Fees and Compensation and Performance-Based Fees totals 13 pages.

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*At a Minimum: Form ADV Part 2A should be as brief as possible, no more than ten pages, which is summarized to one or two pages. The SEC recognizes the inability of people to read, understand, and remember dozens of pages by requiring that the new CRS be only two (or four depending) pages.*

**Jargon:** The inability of investors to understand Form ADV Part 2A is a function of the overwhelming amount of financial jargon in these documents. Looking at the Table of Contents for Ameriprise and Commonwealth, we see words and phrases that the average person is unlikely to understand.

*At a Minimum: Use common words whenever possible or, at a minimum, define financial terms at the point of use. Even people with higher degrees do not understand financial jargon.*

**Type Size:** *At a Minimum: Use at least a 10 point typeface and 12 point if possible. Smaller type sizes repels readers and, particularly considering the age of many of today's investors, smaller type size discourages readers.*

Of course, again, the best way to determine if investors understand financial content comes with testing the document with members of the intended audience. But using even these minimum standards will at least increase the possibility that investors will understand.

#### *5. What Are the Minimum Standards For a Customer To Understand Specific Recommendations?*

Disclosures of a specific recommendation to a customer should meet a higher standard than do general market disclosures. Reg BI calls for a “best interest” standard that includes a higher standard for disclosures. The Sentence / Paragraph Length, Jargon Criteria, Type Size remain the same as noted above. A higher standard for specific recommendations should add these criteria:

**Testing:** Common product recommendations should be pre-tested and be affirmed to be understood, by firms for investor comprehension, as noted above. Any recommendation should seek to follow the format of pre-tested recommendations shown to be understood, as much as is feasible.

**Length and Form:** The recommendation and the “full and fair disclosure” of the associated conflicts(s) should be written. The recommendation should be no more than two pages or shorter if conflict(s) are fewer, smaller, simpler and transparent.

**Delivery:** The recommendation should be delivered to allow the customer ample time to review, understand, and raise any questions about the recommendation before the transaction is executed.

**Acceptance:** To proceed with the recommendation, a retail customer must agree to the recommendation.

## *6. Conclusion*

Reg BI is an historically important rule. It affirms a fundamental change in investment advice standards. It implicitly transforms the meaning of conflicts from being inherently harmful to being generally acceptable. The rule release, in its silence, discourages conflict elimination or avoidance. Conflicts are, instead, implicitly encouraged and deemed acceptable, merely needing disclosure. This new encouragement comes despite significant evidence, discussed in the release, that disclosures have routinely been shown to fail to achieve their investor protection purpose.

The result is the need for a new generation of thinking on disclosure. New thinking should reflect the increased burden placed on disclosure in 2020; it should demonstrate the importance of plain language and the challenge of systemic complexity. It should also stress testing for consumer comprehension in real settings, and whether new technologies may offer greater assurance of disclosure effectiveness.

2020 brings new challenges for delivering competent and ethical planning and investment advice. Disclosure has clearly moved to center stage. We will continue to offer guidance on this critical issue.

Sincerely,

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