

U.S. House of Representatives Financial Services Committee
Subcommittee on Investor Protection, Entrepreneurship and Capital Markets

Hearing entitled:

“Putting Investors First? Examining the SEC’s Best Interest Rule”

Testimony of Wayne Chopus President and CEO, Insured Retirement Institute

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Chairwoman Maloney and Ranking Member Huizenga, and Members of the United States House of Representatives Financial Services Committee Subcommittee on Investor Protection, Entrepreneurship and Capital Markets, my name is Wayne Chopus, President and CEO of the Insured Retirement Institute (IRI). On behalf of our members, I want to express our appreciation for this opportunity to provide testimony to the Subcommittee with our perspective about the proposed U.S. Security and Exchange Commission's Regulation Best Interest (Reg BI) proposal as part of today's hearing.

Summary of Testimony

My testimony will address two key points:

1. IRI supports the SEC's proposed Reg BI because it establishes a new, clear, consistent and workable best interest standard of conduct for financial professionals that will serve as a platform to help consumers make informed decisions and preserve investor choice.
2. To avoid unintended consequences associated with Reg BI, the SEC should provide additional guidance and clarity regarding certain provisions.

About IRI

As you may know, for nearly three decades, the Insured Retirement Institute (IRI) has vigorously worked to promote consumer confidence in the value and viability of insured retirement strategies by bringing together members of the insurance industry, financial advisors and consumers to engage in a dialogue and advance all parties' interest. IRI is the leading association for the entire supply chain of insured retirement strategies, including life insurers, asset managers, and distributors such as Broker-Dealers, banks and insurance marketing organizations. IRI members account for more than 95 percent of annuity assets in the U.S., include the top 10 distributors of annuities ranked by assets under management, and are represented by financial professionals serving millions of Americans. IRI champions retirement security for all through leadership in advocacy, awareness, research, and the advancement of digital solutions within a collaborative industry community.

Our members support common sense, bipartisan policies to help Americans achieve their retirement goals by expanding opportunities to save for retirement by enhancing savers' access to workplace retirement plans while also seeking to improve the quality of existing workplace retirement options. To accomplish these goals, our members advocate to improve access to professional financial guidance, extend greater access to lifetime income products in workplace retirement plans, and preserve the current tax treatment of retirement savings plans. At the same time, our members understand that managing and insuring hard-working Americans' money also requires robust consumer protection efforts. For that reason, IRI has also supported consumer education and safeguards to protect Americans from financial exploitation. IRI and our members seek to constructively engage in a dialogue with federal and state policy makers to achieve these objectives which will help provide sustainable strategies to address the challenges Americans face to achieve a secure and dignified retirement.

SEC Proposed Best Interest Standard

Background

Americans face many challenges and obstacles when saving and planning for retirement. To help understand and mitigate these risks many Americans seek out financial professionals for guidance and advice. For nearly a decade, policymakers have been working to formulate appropriate enhancements to the standards of conduct for financial professionals who provide personalized advice about investments and/or insurance to retail consumers.

When Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010, Section 913 of that law empowered the SEC to impose a fiduciary standard on Broker-Dealers. Although empowered by this statute to move forward to promulgate a fiduciary standard, the section was not written as a mandate and gave the SEC discretion to formulate a standard of conduct for Broker-Dealers that would best serve the twin goals of investor protection while maintaining the robust and diverse market for financial advice.

Instead of allowing the SEC to formulate a standard to accomplish these twin aims, the Department of Labor ("DOL") decided to adopt its fiduciary rule during the administration of President Barack Obama. The Department of Labor's fiduciary rule significantly expanded the universe of "investment advice fiduciary," as the term is defined under the

Employee Retirement Income Security Act of 1974 (“ERISA”), and elevated all financial professionals who work with retirement plans or provide retirement planning advice to the level of a fiduciary.

The DOL rule proved difficult and costly to implement and was plagued by inaccurate underlying assumptions. Given these problems, the ultimate rule would have been devastating for the investment advice community, especially investors, who would have lost access to the financial advice they need to achieve a secure retirement. According to research, the proposed rule would have denied access to a financial professional for 18 million lower and middle income investors, resulting in \$240 billion lost from the system and 900,000 fewer IRA accounts.¹

The Fifth Circuit’s decision² to vacate the fiduciary rule gave the SEC an opportunity to engage in their own rulemaking and investigate how to provide proper consumer protections while preserving the market for financial advice. Subsequent to the court decision vacating the DOL rule, the SEC proposed a new rule known as Reg BI, under the Securities Exchange Act of 1934. The proposal would enhance the standard of conduct for Broker-Dealers and their registered representatives when they make a recommendation to a retail customer for any securities transaction or investment strategy. The proposed standard of conduct requires Broker-Dealers to act in the retail customers’ best interest at the time a recommendation is made and prohibits the Broker-Dealer or their registered representative from placing their own interests ahead of the interest of the retail customer.

The SEC’s proposed rule was open for public comment for several months and more than 3800 comments were filed regarding the rule proposal. IRI filed a comment letter³ in which we urged the SEC to advance a proposed regulation to require financial professionals to act in their clients’ best interests. IRI’s comments emphasized that the proposed SEC rule will help investors make informed decisions about the type of financial professional that would best meet their needs while preserving investors’ choice and access to the products and services they need to achieve their financial

¹ Cathy Weatherford, *Department of Labor Fiduciary Rule: Major unintended consequences*, The Hill, August 8, 2011, <https://thehill.com/blogs/congress-blog/economy-a-budget/176473-department-of-labor-fiduciary-rule-major-unintended-consequences>.

² *Chamber of Commerce of United States of Am. v. United States Dep't of Labor*, 885 F.3d 360, 365 (5th Cir. 2018).

³ Insured Retirement Institute, Comment Letter on Proposed Regulation Best Interest, Form CRS, and the Proposed Commission Interpretation Regarding Standard of Conduct of Investor Advisors (Aug. 7, 2018), <https://www.sec.gov/comments/s7-07-18/s70718-4185630-172656.pdf>.

goals. In addition, IRI's comments also offered several recommendations to enhance the effectiveness of the SEC's proposed regulation by providing additional clarity or guidance to help IRI members understand and meet the obligations imposed under the proposal.

The SEC is still in the process of reviewing and digesting the comments it has received. As such, the rule remains a proposal now when this hearing is being conducted. The rule has not been made final, and no one knows what, if any, changes, edits or additions may be made by the SEC before the rule is published as final. It is therefore critical that all interested parties continue to engage with the SEC to ensure the final rule accomplishes all of its goals.

Why does IRI support Reg BI?

IRI and its members have long supported the principle that financial professionals should be required to act in their clients' best interest. IRI has been among the leaders of the financial services industry's efforts to advocate for adoption of a clear, consistent and workable best interest standard that will provide meaningful and effective consumer protections without depriving Americans of access to valuable financial products and services.

IRI supports the SEC proposed rule because it will:

- Provide a solid foundation for an enhanced standard of conduct for financial professional providing investment advice while appropriately preserving investor choice and access to the products and services they need to achieve their financial goals;
- Preserve the important and valuable distinctions between Broker-Dealers (BDs) and investment advisers (IAs), focusing instead on helping investors understand the differences between BDs and IAs so they can make informed decisions about the type of financial professional that would best meet their needs;
- Formulate a best interest standard that provides a clear and straight-forward compliance roadmap for firms and financial professionals; and
- Encourage the development of innovative disclosure techniques to improve the investor experience.

How Can Reg BI be Improved?

IRI's comments filed with the SEC offered several recommendations to enhance the effectiveness of the SEC's proposed regulation. The recommendations made by IRI would provide additional clarity and guidance to help financial professionals understand and meet the obligations imposed under the proposal.

IRI's comments request for the final rule to include:

- Guidance to help firms identify and evaluate the factors that should be considered when deciding how to manage material conflicts of interest, including the extent to which a conflict would directly impact a financial professional's behavior;
- Greater clarity as to the disclosure requirements (including the use of incorporation by reference for information that is already disclosed under other rules) without mandating the use of specific verbiage; and
- An opportunity for the SEC to send a strong signal to advisors – including the many new advisors joining the industry every day – that longevity risk and retirement income needs are important factors that must be part of any discussion with clients about retirement saving and planning.

What Concerns Have Been Raised About Reg BI?

Although the SEC Reg BI proposal has not been finalized into a rule yet, critics are voicing concerns about the effectiveness of the proposed rule. To respond to some of the concerns, we are highlighting those concerns below and providing a response to address them.

Concern: Reg BI does not define "Best Interest".

Reg BI does define "Best Interest." The core function of the proposed rule requires Broker-Dealers and their registered representatives to act in the best interest of their retail customers and forbids these financial professionals from placing their own interests ahead of the customers' interest. To ensure that Broker-Dealers and their registered representatives are meeting this standard, the proposal lays out three affirmative duties for these financial professionals to comply with:

the disclosure⁴, care⁵, and managing conflicts of interest⁶ obligations. In formulating the rule in this way, the SEC has brought some clarity to financial professionals in how they will meet the best interest standard while also providing consumers expectations about how their Broker-Dealer should act.

Concern: A “fiduciary standard” for Broker-Dealers would be stronger than “Best Interest.”

A fiduciary standard imposes duties at specific points in time (duty of care) and on an ongoing basis (duty of loyalty). The imposition of a fiduciary standard would severely limit the services Broker-Dealers can effectively offer and, in turn, limit the ability of millions on Americans to access financial professionals who can offer advice commensurate with an individual’s investment goals and risk tolerance. Ongoing duties are incompatible with the transactional nature of brokerage relationships since Broker-Dealers generally provide investment advice and assistance on a transactional basis. These services are commonly more affordable and are heavily utilized by low and middle-income Americans who use these services to obtain tailored investment advice.

Concern: Reg BI has no teeth to prosecute bad actors.

Unlike the DOL fiduciary rule, which would have deferred to the plaintiffs’ bar for enforcement, Reg BI relies on rigorous SEC and FINRA enforcement mechanisms to protect consumers and resolve conflicts in a timely and efficient manner. The SEC has statutory authority to protect investors and to enforce the provisions of the rule through its Division of Enforcement as well as through FINRA. They are authorized to conduct investigations into possible violations of the federal securities laws and prosecute the Commission’s civil suits in the federal courts as well as its administrative proceedings. The Division has the authority in civil suits to seek injunctions to prohibit future violation and if violated is subject to fines or imprisonment for contempt. In addition, the Commission often seeks civil money penalties and the disgorgement of ill-gotten gains. In certain circumstances, the Commission also may seek, among other things, a court order barring or suspending individuals from acting as corporate officers or directors.

⁴ Regulation Best Interest, 83 Fed. Reg. 21574, 21599-21608 (May 9, 2018) (“Reg BI”).

⁵ Reg BI, 83 Fed. Reg. 21574, 21608-17 (May 9, 2018).

⁶ Reg BI, 83 Fed. Reg. 21574, 21617-28 (May 9, 2018).

The Division also has the authority to bring a variety of administrative proceedings including cease and desist order against any person who violates the federal securities laws. With respect to regulated entities (e.g., brokers, dealers and investment advisers) and their employees, the Division may institute administrative proceedings to, among other things, revoke or suspend registration, or to impose bars or suspensions from employment. In both cease-and-desist proceedings and administrative proceedings against regulated persons as well as order the payment of civil penalties and disgorgement of ill-gotten gains. Certain industry, associational, and conduct-related bars may also be available.

Concern: Reg BI preserves the status quo.

The SEC's proposal would significantly strengthen consumer protections by establishing a best interest standard for those providing personalized advice. While the current standard only requires Broker-Dealers to establish that a financial product is suitable for the client. The SEC's proposed rule enhances that standard and forbids Broker-Dealers from considering their own interest over their clients' interest. In addition, Reg BI requires several new requirements for Broker-Dealers including:

- Disclosure: The Broker-Dealer must reasonably disclose to the retail customer the material facts relating to the scope and terms of the relationship, including material conflicts of interest associated with the recommendation;
- Care: The Broker-Dealer must exercise reasonable diligence, care, skill and prudence to (A) understand the potential risks and rewards associated with the recommendation and have a reasonable basis to believe that the recommendation could be in the best interest of at least some retail customers; (B) have a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile and the potential risks and rewards associated with the recommendation; and (C) have a reasonable basis to believe that a series of recommended transactions is not excessive and is in the retail customer's best interest;

- Conflicts of Interest: The Broker-Dealer must establish, maintain, and enforce written policies and procedures reasonably designed to identify and then to (A) at a minimum disclose, or eliminate, material conflicts of interest associated with the recommendation; and (B) disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with the recommendation.⁷

Conclusion

The Subcommittee has posed a question about the SEC Reg BI proposal which is the subject of the hearing for which we are submitting testimony, asking whether it puts the investor first? IRI's response to that question is yes, it does put the investor's interest first.

The SEC's proposed Reg BI presents a platform to enact a national standard of conduct for Broker-Dealers. With Reg BI, consumers will be able to make informed decisions about the types of financial professionals which will best meet their needs and allow investors greater choice and access to the products and services they require.

The SEC proposed rule reflects the realities of the long—standing relationships between financial advisors and their clients. Although IRI and our members believe that the vast majority of Broker-Dealers already act in their clients' best interest and are intensely committed to helping their clients reach their retirement income objectives, we also understand that many consumers are dubious about seeking out assistance from financial professionals. Therefore, we believe the SEC rule effectively establishes a baseline for all Broker-Dealers to adhere to and provides consumers confidence that their financial professional is working first and foremost on their behalf.

With its proposed Reg BI, the SEC is properly taking the lead on this critically important initiative. IRI and our members generally support the proposal, and we have offered feedback focused on avoiding unintended consequences and helping firms and advisors understand and meet the obligations that would be imposed under the proposal. The SEC

⁷ Chairman Jay Clayton, "Overview of the Standards of Conduct for Investment Professionals Rulemaking Package," April 18, 2018, <https://www.sec.gov/news/public-statement/clayton-overview-standards-conduct-investment-professionals-rulemaking>.

should move expeditiously to finalize the proposal in collaboration with its fellow regulators to ensure consistency across jurisdictions.

Thank you for the opportunity to present this testimony. It is our hope you will find it useful, and IRI welcomes the opportunity to work with the Subcommittee in the future.