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# NG INVESTMENT ADVICE FOR WORK

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## Improving Investment Advice for Workers and Retirees

**Written Testimony of Andrea Seidt Ohio Commissioner of  
Securities and  
NASAA Regulation Best Interest Implementation Committee  
Chair**

**On behalf of The North American Securities Administrators  
Association**

**September 3, 2020**

**United States Department of Labor  
Employee Benefits Security Administration  
“Improving Investment Advice for Workers and Retirees”**

### **INTRODUCTION**

Good afternoon. My name is Andrea Seidt and I am Ohio’s Securities Commissioner and Chair of the Regulation Best Interest Implementation Committee for the North American Securities Administrators Association (“NASAA”). NASAA is the oldest international investor protection organization with a



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area very closely, following the final circuit's decision against the Department's fiduciary rule in 2018,[1] and the SEC's adoption of Regulation Best Interest ("Reg BI") in 2019,[2] NASAA convened a committee to develop recommendations on implementation strategies.[3] The Committee's first order of business was to conduct a comprehensive examination of broker-dealer ("BD") and investment adviser ("IA") practices as they stood in 2018, to establish a baseline against which we could later measure the effectiveness of Reg BI.

In mid-February, the Committee launched Phase I of the examination, with 34 states participating.[4] We collected responses from more than 2,000 BD and IA firms, representing more than 360,000 investment professionals and 68 million retail investment accounts.

Today I will share highlights from the examination to shed light on what American workers experienced in the marketplace for investment advice as recently as 2018.[5] This data, along with the data that the Department and others collect prospectively regarding the quality of advice offered under Reg BI, will help the Department assess whether reliance on Reg BI is supported by the evidence. Until all of that data is in, however, that assessment cannot be done, and NASAA would therefore ask the Department to defer adoption of the proposed amendment.

**PRODUCT OFFERINGS**

In 2018, most BD and IA firms focused their customer recommendations on conventional securities, such as stocks, bonds, and mutual funds. We were curious to know how many firms offered complex, costly, and risky products like private



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...ally, the ones being recommended, BDs were three as likely as firms to recommend the purchase of leveraged and inverse ETFs, seven times as likely to recommend private placements, eight times as likely to recommend variable annuities (by a measure of 42% compared to 5%), and nine times as likely to recommend non-traded REITs. It is too soon to know if Reg BI will narrow these gaps and bring BDs closer to fiduciary practices more aligned with customer interests. If the regulation works as intended, this is exactly what should happen. To that end, NASAA will collect post-Reg BI data as part of its Phase II examination next year, and we strongly urge the Department to do the same *prior to* finalizing any amendments that rely on Reg BI.

### **DUE DILIGENCE**

Due diligence is a critical part of any securities professional's duty of care. One of the most important tools firms have to get to know their customers is the investor profile questionnaire. As such, it would be reasonable to expect all firms to use such questionnaires, and to expect those forms to thoroughly catalog all important investor facts and circumstances. That is not what the examination found. Some BD and IA firms reported that they did *not* use investor profile questionnaires (22% BD and 13% IA), while others reported using questionnaires that omitted key information like investment objective, age, risk tolerance, income, and time horizon. Surprisingly, only 20% of the firms documented their customers' education level, and less than half documented investor debt. The Reg BI adoption release says very little about the SEC's expectations in this area and it is hard to see how American workers are going to be appropriately



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compare investment opportunities. Only 30% of firms had any policies and procedures to guide agents on the proper handling IRA rollovers. Once again, there is no post-Reg BI data to indicate whether and how much progress will be made in reliance on a “best interest” standard.

### **FEE DISCLOSURE**

When it comes to fee disclosure, the examination showed that all firms relied heavily on delivering prospectuses and account statements. Less than half reported providing individualized fee disclosures at the most important point for the customer – the point of sale.<sup>[6]</sup> Many investors do not read prospectuses and do not understand the fees reflected on their account statements. They hire professionals to read and explain these documents to them and, if they have already made the decision to trust a financial professional with their entire life savings, they also trust that they will be treated fairly when it comes to fees.

What these investors do not realize is that most firms have a hard time themselves figuring out all of the fees they charge their customers, even when we regulators ask them. Investors also do not realize that they could save a lot of money by investing in lower-cost but equally suitable options because around 60% of BDs and IAs keep that information a secret. The result, as we all know, is that the average American worker who retires after 30 years with \$100,000 in her account could have walked away with twice that amount, \$200,000 or more. That is just appalling. American workers would find these unpleasant truths unacceptable, and the Department should as well.

### **COMPENSATION PRACTICES**



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accepted third-party compensation from product manufacturers compared to 2% of IAs. Fifteen percent (15%) of BD firms accepted third-party compensation from another BD, IA, or other financial institution, compared to only 3% of IAs. While these financial incentive conflicts appeared in relatively small percentages of firms (almost exclusively on the BD side), the long-term financial impact to American workers wrongfully steered into more costly products as a result of these conflicts is no small matter.

**CONFLICT MANAGEMENT**

If harmful financial incentives are not prohibited by the Department, it must find ways for firms to effectively mitigate them to avoid harm to American workers. Most American workers cannot wait to retire, and would laugh in disbelief (or kick you out of the room) if you asked them to willingly sacrifice any of their life savings so their broker could get a trip to an exotic location or a bigger bonus.

Firms have a lot of work to do to effectively manage their conflicts, based on what we see in the 2018 data. Only about half of the firms had policies and procedures pertaining to conflicts. Less than half had conflict registers, and less than a third had conflict committees or officers. Again, it is too soon to know if Reg BI will fix these problems and, consequently, it is premature for the Department to rely upon Reg BI as an effective solution.

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trust and confidence vis-à-vis their customers.[8] The Department properly accounted for these distinctions in its current proposal, recognizing a carveout for firms that engage in isolated, arms-length transactions but including firms that have a special relationship with their customers based on agreement or mutual understanding.

Let's be clear; BDs want their customers to think of them as trusted advisors as evidenced by their marketing campaigns and staunch opposition to regulatory efforts that would curtail their usage of the "advisor" title. Forty percent (40%) of the BDs we surveyed allowed their agents to use the title while acting specifically in a BD capacity, but so did 26% of the IAs. Firms also allowed brokers to use titles like "wealth manager" and "financial consultant." None of them, as far as I know, hold themselves out as a "salesperson." These are not terribly surprising facts, but we know, based on the extensive factual record in the Department and SEC rulemakings, that American workers are very confused by these blurred lines, and about the services and standard of care they can expect to receive from people who exploit titles of trust.[9]

As for the data, the examination showed that only about half (51%) of the BDs surveyed were even engaged in the sales-centric practice of *customer-directed* brokerage in 2018, the kind of service that the Fifth Circuit focused on in its decision. There were more BDs (52%) engaged in *recommended* brokerage, and a significant number of BDs engaged in core advisory services, such as *managed* brokerage (23%), *financial planning* (19%), and *account monitoring* (16%). BDs who hold themselves out as



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has a factual record regarding the effectiveness of the SEC's approach. There is no such data at this time. Should the Department proceed in the absence of that record, NASAA would ask that it follow the recommendations outlined in NASAA's comment letter<sup>[10]</sup> and stand resolute on the helpful guidance noted in its adoption preamble so that American workers are given a fighting chance to have a secure retirement future.

### NOTES

[1] See *Chamber of Commerce of the U.S. v. U.S. Dep't. of Labor*, 885 F.3d 360 (5th Cir. 2018) (holding that the Department acted in an arbitrary and capricious manner when, among other things, it expanded the class of advisors regulated as "investment advice fiduciaries," and created a new broad-based ERISA prohibited transaction class exemption known and referred to as the "Best Interest Contract Exemption").

[2] Regulation Best Interest, SEC Rel. No. 34-86031, File No. S7-07-18 (Jun. 5, 2019), *available at* <https://www.sec.gov/rules/final/2019/34-86031.pdf>.

[3] NASAA's Regulation Best Interest Implementation Committee was established by the NASAA Board of Directors in October 2019. During the first quarter of 2020, the Committee launched an examination initiative to identify a baseline of broker-dealer and investment adviser firm policies, procedures, and practices involving sales to retail investors, as those policies, procedures, and practices existed in 2018, prior to adoption and release of Reg. BI. The Committee plans a second phase of the initiative, scheduled for 2021, to evaluate key



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[5] The above-referenced conclusion, and many other findings discussed in my testimony, are based on data collected and analyzed during the course of the NASAA Regulation Best Interest Implementation Committee’s Phase 1 Examination Initiative. NASAA expects to release a report summarizing this data in the coming weeks.

[6] See also “Point Of Sale Disclosure In The Insurance, Banking And Securities Sectors.” The Joint Forum: Basel Committee On Banking Supervision, International Organization Of Securities Commissions, and International Association Of Insurance Supervisors (Apr. 2014), *available at* <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD439.pdf>.

[7] The term “third party compensation” refers to compensation for the sale of specific products and services arrangements and other types of compensation from third parties (such as payments for order flow, cash sweep payments, mutual fund revenue sharing or marketing support payments, or cash referral fees from investment advisers) that are not tied directly to securities transactions. Third party compensation structures are often associated with conflicts of interest.

[8] See *Chamber of Commerce*, 885 F.3d at 31 n.13 (stating that “[t]o the extent . . . that some brokers and agents hold themselves out as advisors to induce a fiduciary-like trust





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consisted of a literature review, focus group interviews, and a quantitative survey that examined consumer perceptions of financial professionals. Overall, the study found that focus group participants had a low understanding of financial services and the various types of financial professionals, and that there was some degree of confusion, or ambiguity, in the marketplace for investment advice and, consequently, potentially significant matching and search frictions for investors. See Rick Fleming, *Investor Testing Regarding Standards of Conduct for Investment Professionals* (Oct. 12, 2018), available at <https://www.sec.gov/comments/s7-07-18/s70718-4513005-176009.pdf>.

[10] See Letter from Christopher Gerold, NASAA President, to Office of Exemption Determinations, Employee Benefits Security Administration, United States Department of Labor, *Docket ID Number EBSA-2020-0003: Improving Investment Advice for Workers & Retirees* (Aug. 6, 2020), available at <https://www.nasaa.org/wp-content/uploads/2020/08/NASAA-DOL-Comment-Letter-8-6-2020.pdf>.



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202-737-0900

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