Testimony Before the Maryland Consumer Financial Protection Commission

Regarding Broker-Dealer Fiduciary Duty Proposals

October 10, 2018

Good Afternoon Chairman Gensler, Vice-Chairman Rosapepe, Attorney General Frosh and Members of the Committee. My name is Melanie Lubin and I am the Securities Commissioner and Division Chief of the Securities Division in the Attorney General's Office.

Thank you for inviting me to participate in today's discussion of the Department of Labor Fiduciary Rule, the Securities and Exchange Commission's Regulation Best Interest proposal, and the broker-dealer standard of care.

The issues surrounding broker-dealer duty of care and investor confusion are not new. When Maryland passed legislation in 1989 adopting an investment adviser regulatory program, the General Assembly recognized the investor confusion issue in the investment adviser arena and adopted a "holding out" definition of investment adviser. That provision expanded on the federal and uniform state definitions of an investment adviser to include, under our statute, any person who holds out in any manner as a financial or investment planner, counselor, consultant, adviser or similar term. To this day, our statute goes further than any other to protect investors by holding to a fiduciary standard anyone who falls within that definition.

It took 25 years for the federal government to move the issue to the forefront, but now their attempts have been thwarted in some cases, and fallen short in others. The Department of Labor made substantial steps towards addressing these issues with its Fiduciary Rule, but in March that rule was vacated by the Fifth Circuit Court of Appeals.

Soon after, the Securities and Exchange Commission proposed a three part rule that was designed to address the broker-dealer duty of care. Reg BI proposes a "best interest" standard for brokers. The disclosure proposal requires customer disclosure designed to clarify the difference between a broker and an investment adviser through Form CRS, which stands for Customer Relationship Summary, while prohibiting the use of the term "adviser" -- with an "e" -- or "advisor" -- with an "o" -- by anyone who isn't an investment adviser or investment adviser representative registrant. The third part of the proposal summarizes in one place the existing standards of conduct for investment advisers.

Unfortunately, the SEC's Reg BI proposal muddies the landscape of broker-dealer duty rather than providing the clear guidance that exists under investment adviser fiduciary duty and its legal precedents. The SEC proposal provides that a broker-dealer act in the best interest of its retail customers. While that sounds like the definition of fiduciary duty, the SEC did not propose an actual fiduciary duty to act in the customer's best interest. The SEC's proposing release makes clear that the SEC does not expect that the broker will recommend the product or strategy that is best suited to achieving the client's financial goals, an approach that clearly would be required by a fiduciary standard and was required by the DoL rule. Rather the SEC interprets "best interest" to permit a broker -- as long as the situation is disclosed -- to continue to recommend investments and strategies that are high cost, complex, illiquid and risky even when there are cheaper, simpler more liquid and safer alternatives. That does not sound like best interest to me.

The SEC Commissioners were split when they voted to release the proposal for comment. In voting against its release, Commissioner Kara Stein raised the concern, which I share, that the proposed regulation would create a best interest standard that is not meaningfully better than the existing suitability standards. In many ways, the SEC's "emperor" has no clothes.

Rather than further contributing to well-documented investor confusion about what duty is owed, the SEC should have proposed a broker-dealer fiduciary standard that aligns with that owed by an investment adviser. That approach would have cut through the confusion and set a meaningful standard for a broker's duty to its clients. At the same time, the SEC should have prohibited some of the most abusive practices like sales contests, trips, prizes, and similar bonuses that are based on the volume of sales of certain securities.

If the SEC fails to amend its proposal and adopt a uniform fiduciary standard, I respectfully suggest that this commission strongly consider reproposing the fiduciary provisions that were amended out of Senate Bill 1068, incorporating the amendments that the Securities Division had recommended. The fiduciary provisions were removed from the bill before it was adopted last session in large part because of uncertainties regarding the Department of Labor fiduciary rule and the SEC proposal. There is significantly less uncertainty now.

Thank you again for asking me to participate today. I am available now or after the hearing for any questions or to assist with the review of these critical investor protection issues.