Testimony to SEC Investor Advisory Committee Hearing

December 8, 2016

I'd like to thank the Investor Advocate, the Commissioners, and members of the IAC for the opportunity to speak before you today. My name is Marcus Stanley and I am the policy director of Americans for Financial Reform. AFR is a coalition of over 200 labor, community, and public interest groups. We came together after the financial crisis of 2008 with the goal of improving and strengthening financial regulation to help the financial sector better serve the public interest.

AFR addresses a broad range of financial regulatory issues in our work, and in a moment I will list several specific priority areas for your consideration. However, I would like to begin by making a more general point. In the new political environment, it is likely that there will be a heavy emphasis on the capital formation mission of the SEC. The IAC should play a critical role in reminding the Commission that investor protection is crucial to stable and effective capital formation. Unless providers of capital are treated fairly, we cannot expect them to fully participate in capital markets. Excessive fees to capital market intermediaries also harm capital formation by directly diverting funds from the final users of capital. Finally, effective regulation to ensure the stability of financial markets must also play a role, as it is crucial to both capital formation and investor protection. Systemic events such as those we saw in 2007-2009 have a devastating impact on both investors and the investment needs of the broader economy. I hope that the IAC will advocate for the recognition of these issues in the years to come, and will also demand that they are properly recognized in SEC cost-benefit analyses and rulemaking.

I would also like to go further into several issues, specifically, fiduciary duty, materiality and corporate disclosure, disclosures for financial entities in particular, and oversight of funds.

Fiduciary duty: The Department of Labor's new fiduciary rule, which is now in the course of being implemented by industry, marks a dramatic step forward in investor rights. It is particularly important to us that the DOL rule clearly includes a best interest of the investor standard as part of its fiduciary definition, and makes that best interest standard enforceable. The DOL standard achieves this standard of genuinely mitigating conflicts while continuing to permit a range of forms of compensation, such as commissions.

In contrast, the SEC enforcement of even the fiduciary standard for investment advisors has historically emphasized disclosure and the “best interest” element of the standard has frequently been ignored, to the point of permitting advisors to recommend products that are not in the customer’s best interest so long as disclosures are deemed sufficient.

We believe a disclosure-based standard falls far short of a true fiduciary duty, and further that the DOL’s commitment to a full fiduciary duty standard means that a disclosure-based standard that is labelled “fiduciary duty” will become even more deceptive to investors. Our preferred solution is the enforcement of a true best interest fiduciary standard both for registered investment advisors and for brokers who represent themselves to customers and the public as advisors. If the SEC chooses to move forward with any form of unified fiduciary duty standard, it must avoid a disclosure-based standard that would be weaker than the DOL standard.

<u>Materiality and corporate disclosure:</u> As AFR stated in our comment on the Reg S-K concept release, we believe it is critical to maintain an investor-focused definition of materiality, where the onus is on management to provide all appropriate information that a reasonable investor could view as useful or important. We further believe that the revolution in information technology has reduced the cost to companies of providing such comprehensive disclosures, and the cost to investors of making use of information. However, recent statements by both SEC Chair White and recent FASB releases have raised doubt about whether the materiality standard will change to hinge on management’s judgement as to whether a fact is material or not. While there will always be some element of managerial discretion in disclosures, it is crucial that the needs of investors, not pure managerial judgement, be central to the determination of materiality.

<u>Disclosures for financial entities in particular:</u> The growth in the complexity of financial markets has rendered disclosures for financial entities, including banks, large insurance companies, and investment companies, ever more difficult for even sophisticated investors to understand. This complexity is particularly evident in the case of derivatives transactions.

Improving financial entity disclosures is crucial if we are to improve market discipline for large financial entities and investor discipline for funds. As market discipline can be seen as an alternative to regulation, this is and should be a bi-partisan issue. As shown by Commissioner Piwowar's recent call for improved bank disclosures through a re-examination of Industry Guide Three, there is real scope for bipartisan cooperation here. As detailed in our comment on Reg S-K, we believe the Commission should reach out to academic and market experts, to the FSOC and OFR, and to prudential regulators to convene public discussions on how to improve financial market risk disclosures and disclosure of financial entity portfolios.

<u>Oversight of funds and investment companies:</u> Recent years have brought a long overdue and welcome re-examination of the oversight of various forms of investment companies and funds. This has been triggered by several factors. These include:

1) New regulations and institutional frameworks established under the Dodd-Frank Act, ranging from the Title IX registration and reporting requirements for private funds to the establishment of the FSOC,

2) The role of various types of funds, most centrally money market funds but others as well, in the events of the 2008 financial crisis,

3) The rapid growth and increasing significance of various types of investment fund structures since the crisis, including fixed income funds and exchange traded funds.

The efforts to re-examine and strengthen fund oversight deserve IAC support to ensure that they continue in the future. One need not believe that funds are "shadow banks" in order to recognize that investors of all kinds, both institutional and individual, have a major interest in proper risk management at investment funds and in accurate and comprehensive disclosures at such funds. We are concerned that new fund regulations are in some cases too weak, that needed risk controls, particularly those not yet implemented, may come under attack in the future, and that enforcement of violations at certain types of funds, notably private equity funds, remains inadequate.

The issues above hardly exhaust the areas in which AFR is active, but provide a quick overview of some current priority areas. For more information, we would refer you to the joint letter on investor protections by AFR and other public interest organizations submitted to Chair White in March 2015 and to other AFR comment letters. I am of course happy to answer any additional questions you may have, either during this event or in the future. Thank you.