Testimony of

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On

Putting Investors First? Examining the SEC's Best Interest Rule

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Chairwoman Maloney, Ranking Member Huizenga and other members of the Subcommittee, I appreciate the opportunity to shed some light on how the lack of a strong fiduciary standard for investment advice harms retail investors.

Early in my career, some 30 year ago, I came to realize that brokers' recommendations are directly tied to compensation and incentives. At a brokerage firm I worked at, it was customary for brokers to scramble to transact business at month-end that would count towards that month's production. For some it could mean the difference between being employed or let go.

Top-selling brokers and managers were rewarded with gifts and trips to exotic locations like Monte Carlo and sales quotas were hung over brokers' heads. Product-specific pushes were also a routine occurrence, with mutual fund companies paying to be included on the firm's recommended list. The firm expected 75% of sales to come from the firm's own funds, which increased the firm's revenue. Branch managers pressured brokers to comply, regardless of the fact that many of the firm's products were inferior to available alternatives, which would have been better for investors.

With these perverse incentives, brokers routinely would make sales recommendations in order to win sales contests, hit quotas, and get to the next rung on the payout grid, regardless of whether their recommendations were in investors' best interest. Since I've left the brokerage industry, nothing has changed in this respect.

The brokerage business model, with all of these and other perverse incentives, is set up to pit broker against client. These incentives reward bad advice that harms investors. What's truly shocking is that brokers are allowed to engage in harmful conflicts of interest, all while leading investors and policymakers to believe they are "trusted financial advisors" who will do what's best for investors.

My path to becoming a fiduciary investment advisor came from a jarring personal experience after my father was diagnosed with Alzheimer's. My mother was caring for him and could not focus on finances, which he had handled. She went to a broker, who recommended a full liquidation of their holdings. No provisions were made to manage two complexities of their situation - the onerous tax implications of selling all the positions and the escalating out-of-pocket costs of my father's health care. Instead, the advice centered on product sales. I was appalled. If she had followed the broker's recommendation, there is the very real possibility that funds needed for my father's care would have been squandered on high fees and a manufactured tax bill. My husband, Tony, and I knew what was at stake and, with her urging, took over to keep fees low and make changes in a tax-efficient manner so they could afford the care he required.

This very personal experience made us worried for those who don't have experts in their family who ensure their loved ones aren't taken advantage of. It drove us to start our own investment advisory firm. We wanted to provide others the same advice that we would give our loved ones and that we would want to receive if we were in their same situation.

We began advising teachers - colleagues of my husband's – on their non-ERISA 403(b) plans.

And we joined our firm with Ritholtz Wealth Management in 2015 to begin a program specifically for teachers. We have been able to educate them on the importance of low fees and diversification. We have delivered a low-cost fiduciary option with all-in annual fees of 0.62% and no account minimum requirements.

The non-ERISA 403(b) market is a living, breathing case study as to why the lack of a strong fiduciary standard for investment advice results in harm to investors. These teachers are trying to do the right thing by saving for their retirement. They want, need, and expect that they are getting advice that puts their interests first, not sales recommendations that will enrich the financial professional at their expense. Instead, they are typically sold high-cost, low-quality investments that tie up their money for years. In fact, 76% of assets in non-ERISA 403(b) plans are in annuities – this despite the fact that both the SEC and FINRA have warned investors that these products can be extremely complex, have high costs, and may not provide meaningful value to them. What they do provide are huge commissions to the financial professionals and firms selling them.

For example, one young teacher we worked with was paying 3% a year to own the market with a guarantee that he would get his original investment at the end of 20 years, despite the fact that there has never been a 20-year period in the stock market's history when it has lost value.

Another teacher we worked with was paying $2,418 a year on an $80,000 account. To get out of that account, she needed to pay $3,000 in surrender fees. The purpose of surrender fees of course is to reimburse a firm for the commission they shell out to the salesperson. We were able to provide a solution that would cost her under $500 a year, so she paid the surrender fee.

We also worked with our son's former teacher, who barely understood what the S&P 500 is, but who was sold a complicated alternative mutual fund that had exposure to a variety of different complex derivatives and employed hedge fund strategies. Annual fund fees were just under 2% and every paycheck contribution was hit with a 3.75% sales charge, making it pretty impossible to earn a positive return after inflation.

Another teacher we worked with had more than half of his account in a single, illiquid REIT that would pay him 40 cents on the dollar if he endured an onerous liquidation process, which included applying for permission to liquidate during one of the few tender offer periods and waiting to see if see if permission is granted. Overwhelmed by the process and the potential loss, he is resigned to holding the investment for now.

And yet another teacher who inherited money from her mother and thought she had a conservative investment to generate income for her upcoming retirement, was instead invested in a portfolio of risky junk bonds that lost more in principal than it paid out in income. She ended up liquidating the portfolio and losing tens of thousands of dollars. Scarred from this experience, she is terrified to invest to recoup her losses.

I can go on and on.

I get asked: How is this legal? And I have no answers. I can feel investors' embarrassment at having been too trusting, they behave like abuse victims who then blame themselves for the abuse. When reality sinks in, they get angry and want to take action. But what can they do? It is perfectly legal to give conflicted advice. Investors' intentions to be responsible and save for their retirement with the guidance of a professional has left them feeling double-crossed, duped and set up to fail. And countless investors have no idea they are being harmed by their "trusted advisor" and that they would be so much better off if they received advice not tainted by conflicts of interest.

No one asks for complicated, expensive products that will drain their hard-earned savings and investments. No one asks to be shackled to an investment for years before surrender fees disappear. No reasonable person would consent to being given bad advice. Why are these products sold to them? It's not because financial professionals are bad people. It's because they're caught up in a web of toxic incentives.

There has never been greater access to low-cost, high-quality investment opportunities, yet the lack of fiduciary protections leaves many investors paying excessive fees and suffering poor outcomes.

Professionals referring to themselves as trusted advisors or providing what anyone would reasonably believe is investment advice must be willing to deliver on that implied promise, and put investors' needs first. Otherwise they should clearly be identified as salespeople. If that title seems too distasteful, perhaps they should reevaluate their business model.

Supporting a warmed-over suitability standard by pretending sales tactics are sound advice is damaging to investors and frankly puts them at risk for needing government assistance in retirement, when they have tried to be self-sufficient. It also casts doubt on the intentions of those in a position to change the situation, but choose not to. In this case, not being part of the solution is being a large part of the problem.

I truly hope you have the courage to act to genuinely protect investors' best interests.