December 10, 2019

The Honorable Michael Crapo
Chairman, Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member, Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Crapo and Ranking Member Brown:

Better Markets[1] appreciates the opportunity to share our perspectives on the activities of the U.S. Securities and Exchange Commission (SEC) as part of the Senate Banking Committee's oversight hearing. We write to provide the Committee with our perspective on a few key issues confronting the SEC as it serves as our nation's primary regulator of the securities markets.

SEC's "Regulation Best Interest"

The SEC's primary obligation is to protect investors, not brokers' products or their lucrative business models. Unfortunately, the Commission's recently adopted "Regulation Best Interest" fails to meet that obligation. Tens of millions of American investors and retirees lose tens of billions of dollars a year to brokers and other financial advisers who have very powerful conflicts of interest. The result is that too many of them put their own economic interests ahead of those of their clients.

While a straightforward fiduciary duty rule requiring those brokers and financial advisers to put their clients' best interest first when giving investment advice would eliminate this incredibly unfair and costly behavior, the SEC unfortunately caved in the face of massive industry opposition and instead approved a so-called "Regulation Best Interest." Unfortunately, the proposal is woefully inadequate and will make things worse for hardworking Main Street investors and retirees by misleading them into thinking they're receiving protections that don't really exist. Among other problems, the SEC's proposal never defines "best interest," instead, creating a "check-three-boxes" test that brokers can use to comply with the rule and avoid accountability—even though none of the boxes actually require brokers to act in the best interest of their clients. [2]

[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street and make our financial system work for all Americans again. Better Markets works with allies – including many in finance – to promote pro-market, pro-business and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements and more.

[2] For details on the many deficiencies of Reg BI, please review our materials here: https://bettermarkets.com/newsroom/fact-sheet-secs-upcoming-vote-its-so-called-best-interest-proposed-rule

1825 K Street, NW, Suite 1080, Washington, DC 20006 TELEPHONE (1) 202.618-6464 FAX (1) 202.618.6465 WEBSITE bettermarkets.com

The economic analysis of investor harm in the proposal was so deficient that eleven former lead economists for the SEC took the unprecedented step of writing to the agency highlighting the glaring deficiencies in the analysis.[3] The SEC relies far too much on the broker's purported disclosure of conflicts of interest to protect investors and retirees. Yet, many studies – and the SEC's own expert staff – have known for years that disclosure alone cannot protect investors from conflicts of interest, any more than disclosure can protect Americans from contaminated pharmaceuticals, polluted water or spoiled food on the grocery store shelf. Only strong, clear and enforceable standards of conduct will protect Americans from the grave threats to their savings and retirements from the irresistible riches available to brokers and advisors as a result of these permitted conflicts of interest. We encourage the Committee to conduct vigorous oversight of the SEC's implementation, interpretation and enforcement of the so-called "Regulation Best Interest."

Consolidated Audit Trail

More than nine years after the trillion dollar "Flash Crash," the SEC's completion and implementation of the Consolidated Audit Trail (CAT) is an utter failure. It is important to acknowledge that Chairman Clayton inherited a suboptimal situation not of his making or desire when he took the leadership of the SEC; it is also important to note that he has admirable taken several positive actions in the face of fierce albeit baseless industry opposition. However, it remains true that the failure to get this mission-critical investor protection system up and running needlessly and irresponsibly places investors, markets and the financial system at grave risk.

An effective and functioning CAT system would revolutionize the SEC's capabilities to protect investors and promote fair and orderly capital markets. When completed, it will be the world's largest data repository for securities transactions, tracking billions of orders, executions, and quotes in all of the equities and options markets every day. That information will enable the SEC not only to reduce, manage, and better understand market disruptions and crashes, but also to identify, deter, and punish illegal manipulations and other trading abuses – all for the benefit of investors and our markets. The importance of this capability simply cannot be overstated.

But although CAT was supposed to be operating no later than November 15, 2017, it is still paralyzed by the conflicted industry-group governance structure which is unwilling to commit to critical decisions that would bring CAT online. Outsourcing this critical stability and investor protection tool to a conflicted industry which it would then police was a near-fatal flaw. Without unwavering leadership from the SEC and the full support and encouragement of the Committee, the CAT will never spring to life. The Committee simply must engage in aggressive oversight of the SEC's implementation of CAT, particularly in the next few months as the Commission is considering amendments to the SEC Rule that created the CAT. Any changes to Rule 613 must include significant improvements to the governance and control of the CAT Operating Committee, as we have detailed on numerous occasions. We further encourage the SEC to use the statutory authority it presently has to hold industry groups accountable for their delay in bringing the system online.

[3] https://www.sec.gov/comments/s7-07-18/s70718-4895197-177769.pdf

Transaction Fee Pilot Project

Today's securities markets are too often rigged by insiders to enrich themselves at the expense of the hardworking Main Street investors. To test that proposition, to collect data to determine the extent of anti-investor conduct in the markets, and to have data-informed remedies, in 2018, the SEC released for comment a long-considered, thoughtful, and balanced Proposal to conduct a pilot program by lowering some access fee caps and prohibiting rebates or other economic inducements offered by the exchanges. Better Markets strongly supported this effort, because payments by the exchanges that incentivize and induce routing decisions by broker-dealers at the expense of best execution and market quality is one of those most entrenched and insidious market practices today.[4]

Unfortunately, the large exchanges that take advantage of the current broken system that is harmful to investors and the integrity of the markets, have sued the SEC to stop the Pilot.[5] The Committee should support the Pilot and help the SEC to promptly finalize and implement it. Tens of millions of investors are harmed by current market practices that rely heavily on access fees and rebates and the Committee would be well-served by oversight of these practices and the remedies for them.

Clawbacks and Incentive-Based Compensation

Compensation policies that encouraged high-risk behavior were major contributors to the financial crisis of 2008. The report of the House Financial Services Committee on the "Corporate and Financial Institution Compensation Fairness Act of 2009," which was a precursor to the executive compensation provisions in the Dodd-Frank Act, observed that as the financial crisis has unfolded, "a broad consensus has developed that executive and financial institution compensation structures relate directly to both the safety and soundness of individual financial institutions and the health of the broader financial system."[6]

And yet, regulators have failed to act with speed and seriousness of purpose in addressing the flawed incentive-based compensation policies that can pose a threat not only to the long term health of individual financial institutions, but also to the long-term health of the U.S. economy. For example, in the Dodd-Frank Act, Congress enacted a number of measures aimed at correcting the structural flaws in the traditional approach to executive compensation. Those measures include shareholder votes on executive compensation, new listing standards to ensure that compensation committees and their consultants at public companies are independent from management, mandatory disclosure of executive compensation in relation to corporate performance, recovery of erroneously awarded compensation, and limitations on incentive-based compensation arrangements that could encourage inappropriate risks or that could lead to a material financial loss.[7]

Consider the SEC's delay in implementing rules regarding recovering erroneously awarded compensation. As required by the Dodd-Frank Act, the SEC must adopt a rule directing the securities exchanges to establish issuer listing standards providing for the recovery of incentive-based compensation paid to executives in excess of what those executives should have received, as shown by

[4] https://bettermarkets.com/rulemaking/better-markets-comment-letter-transaction-fee-pilot-nms-stocks
[5] https://bettermarkets.com/resources/court-filing-sec-attempts-protect-investors-and-market-integrity-exposing-exchange-pricing
[6] H.R. REP. NO. 111-236, 111th Cong., 1st Sess., at 6 (2009)
[7] Dodd-Frank Act §§ 951-957.

an accounting restatement. This is intended to address the tendency of some corporate executives to engage in accounting fraud or manipulation to justify inflated compensation awards. And while the SEC has implemented many of the Dodd-Frank reforms, progress on the so-called clawback provisions has remained stalled.

It should not take nearly a decade for the SEC to write rules to recovery money from executives who were paid bonuses to which they were never entitled. We encourage Congress to make 2019 the year that the SEC is held to account for its delay in implementing this common-sense rulemaking. These compensation rules have to meaningfully deter and punish those who obtain compensation in violation of the law, and not be riddled with loopholes that render the rules ineffective, as reports suggest industry has been seeking.[8]

High Risk Broker Firms

The Financial Industry Regulatory Authority (FINRA) is the self-regulatory organization that oversees the broker-dealer industry. The SEC oversees FINRA and approves its rules, and SEC rules require broker-dealer firms to be members of FINRA. FINRA has the responsibility of writing and enforcing the rules that broker-dealers and registered brokers have to follow in the United States.

FINRA recently proposed a new rule that, after a convoluted and lengthy process, may require firms with a long-history of misconduct to set aside some funds that can be used to reimburse future harmed investors who win arbitration settlements. The rule would apply to firms that have a history of misconduct and specialize in hiring of recidivist brokers — those with 3, 4, 5 or more disciplinary infractions on their record for ripping off their customers or deceiving investors. Many FINRA members have several of these recidivist brokers on their payroll, and both the firms and the rule-breaking brokers they employ have a de facto business model that appears based on maximizing profits by targeting and ripping off unsuspecting, vulnerable and often elderly investors, breaking rules set up by FINRA, the SEC, and other regulators. What FINRA is proposing will not meet the enormous challenges today's investors face and the protections they need.

Investors deserve concrete, effective, and swift action from FINRA against brokers that repeatedly violate FINRA's rules, and the firms that employ them, not convoluted and weak attempts at regulation. Instead, FINRA chooses to do the bare minimum by proposing to make it marginally more expensive for the worst-of-the-worst broker-dealer firms, that have already proven that they will brazenly disregard FINRA rules, to continue hiring and rewarding brokers that give self-serving advice and sell unsuitable products that are harmful for investors' and their families' financial health.

We appreciate the leadership shown by many members of the Committee on this matter and we urge the Committee to conduct oversight of FINRA's lack of sufficient and effective efforts in expelling and barring recidivist broker firms. We also call upon the Committee to ensure that the SEC will only approve FINRA rules that effectively deal with the enormous problem of recidivist broker firms.

[8] https://www.wsj.com/articles/limits-on-wall-street-pay-are-back-on-regulators-agenda-11551839333

Fraudulent Comment Letters

On November 15, 2018, the SEC held a roundtable in Washington, D.C. focusing on "the current proxy voting mechanics and technology, the shareholder proposal process, and the role of proxy advisory firms."[9] The SEC solicited public comments on those topics and received over 18,000 submissions following announcement of the roundtable.[10] In August of this year, the SEC issued two forms of guidance relating to the proxy process.[11] And on November 5, 2019, the SEC released the two Proposals.

The Proxy Access Proposal would impose new burdens on shareholders seeking to submit proxy proposals, including higher ownership thresholds, more onerous resubmission standards, and additional procedural requirements. The Proxy Adviser Proposal would increase the burdens on proxy advisers by treating them as engaged in proxy ***solicitation*** and by conditioning certain exemptions currently available to those advisers upon compliance with additional disclosure and procedural requirements. These important and increasingly high-profile issues have generated intense debate, along with heavy lobbying by corporate interests who seek to limit the influence of minority shareholders in the governance of their public companies.

At the open meeting on November 5, 2019, Chairman Clayton issued a statement in support of the Proposals.[12] In that statement, he singled out as particularly influential seven specific comment letters, purportedly filed by everyday citizens after the roundtable. Those letters all expressed strong support for new measures that would limit the influence of proxy adviser firms. In Chairman Clayton's words,

> "Some of the letters that struck me the most came from long-term Main Street investors, including an army veteran and a Marine veteran, a police officer, a retired teacher, a public servant, a single mom, a couple of retirees who saved for retirement, all of whom expressed concern about the current proxy process."

The clear intent of those comment letters and of Chairman Clayton's public reference to them was to convey the impression that the Proposals were strongly supported by everyday investors, not only by large corporate interests, their boards, and their trade association allies.

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9 Securities and Exchange Commission, Spotlight on the Proxy Process (Nov. 15, 2018), *available at* https://www.sec.gov/proxy-roundtable-2018; *see also* Securities and Exchange Commission, Statement Announcing SEC Staff Roundtable on the Proxy Process (July 30, 2018), *available at* https://www.sec.gov/news/public-statement/statement-announcing-sec-staff-roundtable-proxy-process

10 Securities and Exchange Commission, Comments on Statement Announcing SEC Staff Roundtable on the Proxy Process, *available at* https://www.sec.gov/comments/4-725/4-725.htm

11 Securities and Exchange Commission, Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice, Release No. 34-86721 (Aug. 21, 2019), *available at* https://www.sec.gov/rules/interp/2019/34-86721.pdf; Securities and Exchange Commission, Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, Release Nos. IA-5325; IC-33605 (Aug. 21, 2019), *available at* https://www.sec.gov/rules/interp/2019/ia-5325.pdf.

12 Statement of Chairman Jay Clayton on Proposals to Enhance the Accuracy, Transparency and Effectiveness of Our Proxy Voting System (Nov. 5, 2019), *available at* https://www.sec.gov/news/public-statement/statement-clayton-2019-11-05-open-meeting.

However, on November 19, 2019, just two weeks following Chairman Clayton's statements and the Commission's vote to release the Proposals, a Bloomberg article appeared that cast grave doubts on the authenticity of dozens of comment letters submitted to the SEC, including the seven comment letters highlighted by Chairman Clayton.[13] The article included the appalling revelation that those seven letters, along with at least 19 additional letters in the comment file, were either fraudulent or materially misleading with respect to the identities of the signers. According to the article, several people denied ever signing the letters that bore their names; several people were prevailed upon to sign their letters without any understanding of the issues they were supposedly addressing; and numerous signers were people with close connections to an advocacy group known as "60 Plus Association" ("60 Plus"), which is funded by corporate supporters of the Proposals. As further reported in the article, those signers included former employees of 60-Plus; a contractor for the group; and friends and relatives of the President of the organization—none of whom disclosed their connection to 60-Plus in their letters.

If the allegations prove to be true, then the notice and comment process for these two SEC Proposals has been corrupted, the administrative record on which they rest is defective, and any final rules predicated on that record would be subject to challenge under the Administrative Procedure Act. Accordingly, we have called upon the SEC to investigate these matters, take remedial measures, hold the wrongdoers accountable, and identify long-term measures that could effectively detect and address such alleged abuses in the future. And because the problem is not confined to the SEC or any one agency, have also urged other financial regulatory agencies as well as the Department of Justice to determine whether similar abuses have occurred in connection with other rulemakings. We urge the Committee to consider appropriate action on this matter as well.

Conclusion

Thank you for the opportunity to share our perspective on these important matters, and thank you for the Committee's leadership in conducting effective oversight of the SEC's operations and policymaking.

Sincerely,

Jeremy Bratt
Director of External Affairs

Lev Bagramian
Senior Securities Policy Advisor
Better Markets
1825 K Street NW, Suite 1080
Washington, DC 20006

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13 Zachary Mider and Ben Elgin, *SEC Chairman Cites Fishy Letters in Support of Policy Change*, BLOOMBERG, *available at* https://www.bloomberg.com/news/articles/2019-11-19/sec-chairman-cites-fishy-letters-in-support-of-policy-change.