



Consumer Federation of America

March 25, 2019

The Honorable Maxine Waters
Chairwoman
Financial Services Committee
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Patrick McHenry
Ranking Member
Financial Services Committee
U.S. House of Representatives
Washington, D.C. 20515

Re: Vote Yes on H.R. 1815, the SEC Disclosure Effectiveness Testing Act

Dear Chairwoman Waters, Ranking Member McHenry, and Members of the Committee:

We understand that H.R. 1815, the SEC Disclosure Effectiveness Testing Act, is among the bills the Financial Services Committee has scheduled to mark up this week. We urge you to vote yes on this important legislation, which would require the Securities and Exchange Commission (SEC) to conduct investor usability testing when developing disclosures that are used and relied upon primarily by retail investors.

The SEC has had evidence at least since it conducted its financial literacy study in 2012 that many of the disclosure documents we currently rely on to inform retail investors about important decisions regarding their investments and investment professionals are not well understood by those investors.¹ This includes cost disclosures that don't clearly convey costs, risk disclosures that don't clearly convey risks, and conflict disclosure that do not clearly convey the nature or impact of those conflicts. These problems occur because SEC staff, who have extensive market and legal expertise, lack the disclosure design and drafting expertise necessary to translate that knowledge into clear communications for a financially unsophisticated retail audience. As a result, retail investor disclosures often fail to provide critical information in a way that enables retail investors, and particularly the least sophisticated retail investors, to make informed investment decisions. Despite having been made aware of this significant deficiency in its existing disclosures for retail investors, the SEC has failed to act to address the problem and instead has continued to produce new retail disclosures that suffer from all the same flaws.

This legislation would address the SEC's flawed approach to developing new retail investor disclosures by requiring the SEC to conduct investor usability testing when developing disclosures that are used and relied upon primarily by retail investors. It would help to improve existing retail disclosures by requiring the SEC to test such disclosures under a schedule

¹ This well-documented in the SEC's Dodd-Frank-mandated financial literacy study. *See* SEC Staff, Study Regarding Financial Literacy Among Investors, as required by Section 917 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, August 2012, <https://bit.ly/2C9d145>. *See also* Siegel + Gale, Investor Research Report, (submitted to the SEC July 26, 2012), <https://bit.ly/1MfBbss>.

developed by the agency that prioritizes the disclosures with the greatest impact in the retail market.

Importantly, this legislation would require the SEC to undertake qualitative testing in the form of one-on-one cognitive interviews of retail investors, which is essential to determining whether proposed disclosures effectively convey the desired information and how to revise faulty disclosures to make them easier for investors to comprehend. In addition, findings of the testing would have to be made public, which would hold the SEC accountable for addressing those findings in its rulemaking proposal, though the agency would retain discretion over how to address the findings. Appropriately, disclosures that are relied on primarily by institutional investors, securities analysts, or other sophisticated third parties would not be subject to the testing mandate.

Recent experience with the SEC's development of new retail disclosures has highlighted the need for this legislation. For example:

- The SEC developed its proposed Customer Relationship Summary (CRS) without engaging in investor testing or consulting disclosure design experts, despite the central role this disclosure plays in its Regulation Best Interest regulatory package and despite past research documenting the difficulty in developing an effective disclosure regarding differences between broker-dealers and investment advisers;²
- After the CRS was released for public comment, the SEC chose to rely primarily on investor surveys and roundtables, rather than rigorous qualitative testing, to evaluate the disclosure. When the qualitative testing that we and others conducted clearly showed that the CRS is more likely to mislead than to inform investors,³ the SEC still refused to undertake a rigorous, iterative process of testing a revision to make necessary improvements to the document.
- When the SEC proposed to allow variable annuities to be sold from a summary prospectus, a proposal that we support in concept, the agency once again developed the disclosure proposal without consulting disclosure design experts or testing its proposed approach. The result, as a review of the SEC's illustrative summary prospectus mockup makes clear, is a document that is unlikely to benefit retail investors because it jumbles together information that is relevant at different stages of the investment decision, does not use plain language, and uses small type in a text-dense format, among other problems.

These are problems that could be avoided through the appropriate use of disclosure effectiveness testing, as mandated by this thoughtful and targeted bill. Anyone who supports common sense, evidence-based regulation should therefore support this legislation. It would require the SEC to fundamentally rethink its current regulatory approach to retail disclosures which, while well-intended, is based more on hope, prayer, and unrealistic expectations than

² See, e.g., Siegel and Gale, LLC, and Gelb Consulting Group, Inc., *Results of Investor Focus Group Interviews About Proposed Brokerage Account Disclosures: Report to the Securities and Exchange Commission*, March 10, 2005, <http://bit.ly/2wXS331>.


³ AARP, CFA, Financial Planning Coalition Press Release, "Independent Testing Shows SEC's Proposed Customer Relationship Summary Form May Add to Investor Confusion," September 12, 2018, <https://bit.ly/2Mv4efu>.

high-quality evidence. If the SEC were to fundamentally rethink its approach to retail investor disclosure to be more evidence-based, as required by this legislation, the long-term benefits to investors, in the form of improved investment decision-making, will be significant.

Respectfully submitted,

Handwritten signature of Barbara Roper in cursive script.

Barbara Roper
Director of Investor Protection

Handwritten signature of Micah Hauptman in cursive script.

Micah Hauptman
Financial Services Counsel