When Words Get in the Way
New SEC Trove of “Plain English” Disclosures by Money Managers Reveals Much, Leaves Much to Be Desired

Gadi Dechter  October 2011
Introduction and summary

People paid to manage others’ money have a legal duty to put client interests above their own. And yet your trusted adviser at AXA Equitable Life Insurance Company won’t get health benefits unless he convinces you to buy the insurance giant’s wares over third-party products. Bank of America Corp.’s “wealth managers” at its Merrill Lynch subsidiary have a policy of firing clients who refuse to engage in a type of transaction identified by Congress as potentially abusive. And traders at Goldman Sachs Group Inc.’s proprietary trading desks sometimes bet against the very people whose money they manage.

These are among the many revealing disclosures released publicly with little fanfare earlier this year by the Securities and Exchange Commission, the Washington regulator that keeps tabs on more than 11,000 investment advisers. Now, under new rules more than a decade in the making, all money managers registered with the SEC must publicly release annual disclosures of their fees, conflicts of interest, and disciplinary history—and do so in “plain English.”

For the first time since the SEC began registering money managers in 1940, these brochures are now available to the general public and in one searchable database. They represent “one of the most important investor protection initiatives in decades,” according to SEC Commissioner Elisse B. Walter. Indeed, they are a major step forward by the federal government in helping investors make informed choices about perhaps the single-most important financial decision they make: Whom to entrust with their money.

Unfortunately, the new “Form ADV Part 2” disclosures (the bureaucratic name for these documents) are also an object lesson in missed opportunity. They’re still too hard to understand, cumbersome to navigate, and will likely continue to be ignored by the very people they’re intended to help—unless the SEC releases the data in a more user-friendly way, or encourages the private sector to do it.
“They’re a vast improvement over what we had before, which sets a pretty low bar,” says Barbara Roper, director of investor protection with the Consumer Federation of America. “There’s better disclosure about conflicts of interests. There’s a clearer description of the services they’re offering.”

William Lutz, a retired English professor who led a yearlong SEC disclosure initiative during the Bush administration, is less charitable. “The random sample that I looked at were pretty terrible,” he says.

For the SEC to make good on its regulatory goal of ensuring that investors get “clearly written, meaningful, current disclosure of the business practices, conflicts of interests and background of the investment adviser,” the agency should take the following three steps:

• The commission should bulk-release all adviser registration information on data.gov, in a format that most readily allows the data to be sliced and diced in meaningful ways by private companies and consumer advocates.

• The SEC should use its newfound authority under the Dodd-Frank financial reform law to conduct “investor testing” to determine whether the new disclosures are comprehensible, useful—and improve them accordingly.

• The SEC should vigorously enforce its “plain English” requirement, penalizing money managers that fail to explain their business practices and conflicts of interests in a way that the average investor can understand.

In general, the commission and other government agencies should move toward an outcome-focused way of measuring whether regulated industries are fairly, effectively, and efficiently disclosing information.

What do we mean by that? Today, laws that require companies to share information with investors or consumers tend to measure compliance by whether mandatory disclosures are made. But any casual reader of a Federal Register notice or credit card agreement knows that ineffective disclosures can undermine the civic and protective aims of a responsible government. Too much information is overwhelming. Poorly presented information creates confusion. Gratuitous complexity sows distrust.
We need a better standard for determining whether the government and the industries it regulates are fulfilling their obligations to communicate openly and honestly with the public. That’s why in addition to measuring whether companies are complying with disclosure requirements by outputs—whether a required disclosure form was filled out—the SEC should measure transparency by outcomes—whether the information was comprehensible to its intended audience. This paper details how this can and must happen.
The Center for American Progress is a nonpartisan research and educational institute dedicated to promoting a strong, just and free America that ensures opportunity for all. We believe that Americans are bound together by a common commitment to these values and we aspire to ensure that our national policies reflect these values. We work to find progressive and pragmatic solutions to significant domestic and international problems and develop policy proposals that foster a government that is “of the people, by the people, and for the people.”