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Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

RE: ***Release No. 34-62577; IA-3058; File No. 4-606***
Study Regarding Obligations of Brokers, Dealers and Investment Advisers

Dear Secretary Murphy:

This letter is submitted in response to the Securities and Exchange Commission's (SEC) request for public comments on the effectiveness of existing standards of care for the range of financial professionals who provide personalized investment advice to retail investors. We appreciate the opportunity to offer our views on the important questions raised in the release.

This issue is of keen interest to AARP for the simple fact that individuals shoulder a significant responsibility to make appropriate investment choices so that they have adequate income to fund their retirement years. According to data published by the SEC in 2008, baby boomers control roughly $13 trillion in household investable assets, or over 50 percent of total U.S. household investment assets. It also is projected that nearly one in every six Americans will be 65 or older by the year 2020. Given the increasing number of investors who will need advice and guidance, financial services firms are actively developing new products and seeking to provide financial advice and services to investors as they prepare for and reach retirement.[1] Consequently, oversight of financial advice is an integral component of assisting Americans to accumulate and effectively manage adequate retirement savings.

The request for public comments addresses a number of specific questions. AARP's comments will focus on three inter-related questions: (1) whether retail customers understand that there are different standards of care applicable to brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers in the provision of personalized investment advice about securities to retail customers (question 3); (2) whether the existence of different standards of care is a source of confusion for retail customers (question 4); and (3) whether there are legal or regulatory gaps, shortcomings, or overlaps in legal or regulatory standards in the protection of retail customers relating to the disparate standards of care for financial professionals that should be addressed by rule or statute (question 2).

<u>The roles of brokers and investment advisers are indistinguishable to many investors</u>

Investment advisers are in the business of giving advice. Brokers traditionally were in the business of selling products. Increasingly over the past decades, however, brokers have transformed themselves into advisers. They call themselves "financial advisers," offer services such as investment planning that clearly are advisory in nature, and market themselves based on the advice offered. For years, industry representatives argued that this was not a reason for concern because investors understood the differences between brokers and advisers. However, the 2008 RAND Study[2], conducted at the request of the SEC, concluded that "typical investors are confused about the nature of the services offered by their financial professionals. Many of those surveyed, as well as focus-group participants, did not understand the key distinctions between investment advisers and broker-dealers: their duties, the titles they use, the services they offer, or the fees they charge. They attributed part of their confusion to the dozens of titles used in the field, including generic titles, such as financial advisor and financial consultant, as well as advertisements that claim, 'We do it all.'"

The Rand Study verifies what investor advocates and state securities regulators long have maintained: that investors do not understand these basic differences and shouldn't be expected to in light of industry practices that promote that confusion. The research also demonstrates that investors who do not understand the differences between brokers and advisers rely heavily on the recommendations they receive, making them vulnerable to sales pitches misrepresented as objective advice.

Retail investors are routinely lured into making the mistake that a broker is acting as a trusted adviser when that broker's representative calls himself a financial adviser, offers services such as "retirement planning" or "investment planning" that appear to be advisory in nature, and markets those services based on the advice offered. Not surprisingly under these circumstances, the average investor cannot distinguish between brokers and advisers and certainly doesn't recognize that their "financial adviser" operates under a lower legal standard than an "investment adviser."[3] Lured into believing they are in a relationship of trust, investors are unlikely to be on their guard against practices that may pit their interests against the broker's.

<u>Most investors do not know that brokers and investment advisers are held to different investor protection standards when they give investment advice</u>

Brokers and their registered representatives who sell securities routinely market themselves to investors based on the "advice" they offer and use titles, such as "financial advisor," designed to encourage investors to believe they are in a relationship of trust. Under current regulations, however, brokers and their registered representatives do not have the same legal responsibilities to act in the best interests of their clients.

Under the Securities Exchange Act and rules of the Financial Industry Regulatory Association (FINRA), the legal obligation of brokers when selling securities is to make suitable recommendations and to know enough about their customers to determine what would be suitable. As fiduciaries, investment advisers must have a reasonable basis for believing their recommendations are in the best interests of the customer.[4] In addition, an investment adviser must disclose all material information, including information about conflicts of interest that could bias their recommendations. While a broker is not permitted to mislead the investor, brokers do not have the same obligation as advisers to provide all information that an investor might view as material to the transaction. Finally, because of the way the SEC has interpreted the broker-dealer exclusion from the Investment Advisers Act, much, if not most of the investment advice offered by brokers is not subject to regulation under the Advisers Act. As long as the advice is offered in connection with and reasonably related to a securities transaction, it is viewed as "solely incidental" to that transaction and is excluded from regulation under the Advisers Act.

The two separate laws governing brokers and investment advisers were based on the fact that, at the time they were adopted, brokers and investment advisers performed distinct functions. Investment advisers were in the business of giving investment advice about securities. Brokers were in the business of buying and selling securities on their customers' behalf. The different standards that applied – a suitability standard for brokers and a fiduciary duty for investment advisers – were designed to match these distinct functions.

Suitability requires that the broker know enough about the customer to make an appropriate recommendation and then make generally appropriate recommendations. However, this requirement can be satisfied even by recommending inferior products (based on cost, performance or appropriateness) that pay the broker more in fees and commissions or allows for revenue sharing payments to the firm so long as the product recommended is still generally suitable for the customer. Moreover, under a suitability standard you do not have to disclose the conflicts of interest that bias your recommendations.

Typically, a fiduciary duty flows from a relationship of trust or reliance. Under a fiduciary duty, an adviser is obligated to recommend the product he or she believes is best for the client from among the products available to recommend. So, for example, if both Mutual Fund A and Mutual Fund B would be suitable for a client but Mutual Fund A would be in the client's best interest, a fiduciary would have to recommend Mutual Fund A while the broker operating under suitability could recommend the inferior Mutual Fund B. A broker operating under suitability could base the recommendation on which product would compensate him more generously and would not have to disclose to the client that conflict of interest. A fiduciary with a conflict of interest would have to disclose it.

The most common problem faced by retail investors is the sale of products to benefit the broker's bottom line rather than the client's financial well-being. In a fairly typical example, a broker might recommend a particular product not because it has the lowest fees, the best management, or the best allocation of assets to match the client's investment goals, but rather because it pays the highest commission or makes revenue sharing payments to the firm.

While the different standards may have been appropriate at a point in time when there was a true distinction between the functions performed by brokers and investment advisers, today there is a great deal of overlap in the functions performed by these financial professionals.

The SEC should close the regulatory gap and impose a fiduciary duty on all financial professionals who give investment advice

Under the current regulatory system, if an investment adviser wants to sell securities, the investment adviser must be appropriately licensed and regulated to do so. On the other hand, if a broker wants to give investment advice or market their services as advisory in nature, the broker does not have to be regulated as an investment adviser. It is AARP's view that is well past time to update the regulatory system to reflect the realities of the marketplace today, rather than on what was true more than a half-century ago.

The SEC has recognized the need to update its oversight of financial planners since the advent of the financial planning profession in the 1980s, and began a more detailed exploration of the issues as part of the fee-based brokerage account rule, which was first proposed in 1999. Sensitive to the blurring of lines that already occurred between brokers and investment advisers and concerned that investors might be confused, the SEC proposed to require disclosures on brokerage advertisements and account statements designed to alert investors to the fact that the broker was not an investment adviser and did not have the same legal duty to the investor. However, when those disclosures were tested, they were found to be ineffective in terms of investor awareness.

Congress adopted the Investment Advisers Act to ensure that those who act as advisers put their clients' interests ahead of their own and disclose conflicts of interest. This intent has been undermined by a regulatory policy that allows brokers to market themselves as advisers and give extensive personalized investment advice without subjecting them to the requirements of the Investment Adviser Act. This makes it difficult for investors to make an informed choice among different types of investment service providers and exposes them to hidden conflicts of interest in what they believe to be disinterested advice.

Investors deserve a regulatory policy that both enables them to make an informed choice among different types of investment professionals and ensures that all who are engaged in providing personalized investment advice act in their clients' best interest. Anyone providing investment advice to retail investors should be required to adhere to a fiduciary duty.

AARP members may not be able to tell you the precise legal definition of "fiduciary," but they do have clear views on what they expect from financial professionals. In six state-specific opinion polls[5] conducted by AARP during consideration of the Dodd-Frank Wall Street Reform bill, AARP asked residents at least 50 years old questions related to the various investor and consumer reforms under consideration. Overwhelmingly, respondents favored requiring financial professionals to put the client's interest ahead of their own when making recommendations, as well as disclosing upfront any fees or commissions they earn and any conflicts of interest that potentially could bias that advice. The level of support for this reform ranged from a low of 88 percent (Arkansas) to a high of 95 percent (Indiana). To view the state-specific surveys, go to http://www.aarp.org/money/scams-fraud/info-04-2010/finprotect_states.html.

Requiring all financial professionals who offer investment advice to adhere to a fiduciary duty should not be overly burdensome for brokers or any other financial professional. Many financial planners operate as investment advisers as well as sell insurance and securities. They have operated successfully under a fiduciary duty for their investment advice and a suitability standard when they sell products. There is no fundamental conflict here. Instead, providing a fiduciary duty for investment advisers simply closes a gap in existing investor protections.

As you consider this issue, AARP urges you to resist weakening the current fiduciary duty standard with a less rigorous standard. Far from being a one-size fits all standard, the Advisers Act fiduciary is precisely the sort of flexible, principles-based regulation that many industry participants claim to favor, imposing obligations based on the particular facts and circumstances of the relationship and the services offered. AARP strongly supported inclusion of legislative language in the financial regulatory reform bill imposing a fiduciary duty on brokers when they give investment advice. The final compromise reached in the Dodd-Frank Wall Street Reform and Consumer Protection Act authorizes but does not require the Commission to adopt rules imposing the Investment Advisers Act fiduciary duty on brokers when they give personalized investment advice to retail investors. While we supported the mandate, we believe that this provision has the potential to transform the agency's approach to regulating investment professionals.

Retail investors across the country trust their savings and retirements to the advice of brokers. Yet, under current rules brokers are free to sell products that are less advantageous to investors in order to make more money for themselves, without the clients ever knowing. Investment advice should be transparent and if there are conflicts of interest or higher fees, investors should know it.

In the best of times, the middle income Americans who are most vulnerable to deceptive sales tactics can ill afford the high costs they pay as a result of these practices. As investors seek to recover from the devastating losses they suffered in the recent financial crisis, the need for action is even more urgent. AARP urges the SEC to close the regulatory gap that currently exists and to adopt a fiduciary duty for any financial professional providing investment advice to retail investors.

We appreciate your consideration of our views. If you need more information or have questions, please contact Cristina Martin Firvida on our Government Relations staff at (202) 434-3760.

Sincerely,

David Certner

David Certner
Legislative Counsel & Legislative Policy Director
Government Relations & Advocacy

[1] PROTECTING SENIOR INVESTORS: COMPLIANCE, SUPERVISORY AND OTHER PRACTICES USED BY FINANCIAL SERVICES FIRMS IN SERVING SENIOR INVESTORS, Securities and Exchange Commission's Office of Compliance Inspections and Examinations,*North American Securities Administrators Association, and Financial Industry Regulatory Authority, September 22, 2008. http://www.sec.gov/spotlight/seniors/seniorspracticesreport092208.pdf

[2] Angela A. Hung, Noreen Clancy, Jeff Dominitz, Eric Talley, Claude Berrebi, and Farrukh Suvankulov, RAND Institute for Civil Justice, *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers,* commissioned by the Securities and Exchange Commission, 2008

[3] RAND Institute for Civil Justice.

[4] While the fiduciary duty is not explicit in the Investment Advisers Act, the Act has been interpreted by the Supreme Court to impose a fiduciary duty.

[5] The state-specific surveys were conducted in Arkansas, Indiana, Maine, Montana South Dakota, Wisconsin. The surveys are available at http://www.aarp.org/money/scams-fraud/info-04-2010/finprotect_states.html