August 30, 2010

Ms. Elizabeth M. Murphy, Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: Study Regarding Obligations of Brokers, Dealers and Investment Advisers, Exch. Act Rel. No. 62,577, Investment Advisers Act Rel. No. 3058 (July 27, 2010), File No. 4-606

Ladies and Gentlemen:

This letter is submitted on behalf of the Financial Planning Coalition (the "Coalition"). The members of the Coalition are Certified Financial Planner Board of Standards, Inc. ("CFP Board"), the Financial Planning Association® ("FPA®") and the National Association of Personal Financial Advisors ("NAPFA").[1] The Coalition represents over 75,000 financial planners who, as CERTIFIED FINANCIAL PLANNER™ professionals or through their membership in FPA or NAPFA, have voluntarily embraced fiduciary accountability. The Coalition was actively involved in the legislative process that led to the adoption of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"). We thank the Commission for this opportunity to comment on the study mandated by Section 913 of the Dodd-Frank Act.

The Coalition believes that establishing a strong and uniform fiduciary standard of care, consistent with the standard currently applied to investment advisers under the Investment Advisers Act of 1940, for all financial professionals who provide personalized investment advice to retail customers, whether those financial professionals are associated with broker-dealers or investment advisers, is among the most

[1] CFP Board is a non-profit organization that acts in the public interest by fostering professional standards in personal financial planning through setting and enforcing education, examination, experience, and ethics standards for financial planner professionals who hold the CFP® certification. CFP Board's mission is to benefit the public by granting the CFP® certification and upholding it as the recognized standard of excellence for personal financial planning. CFP Board currently regulates 62,000 CFP® professionals who agree, on a voluntary basis, to comply with our competency and ethical standards and subject themselves to the disciplinary oversight of CFP Board under a fiduciary standard of care.
FPA® is the leadership and advocacy organization connecting those who provide, support, and benefit from professional financial planning. FPA demonstrates and supports a professional commitment to education and a client-centered financial planning process. Based in Denver, Colo., FPA has close to 100 chapters throughout the country representing more than 29,500 members involved in all facets of providing financial planning services. Working in alliance with academic leaders, legislative and regulatory bodies, financial services firms, and consumer interest organizations, FPA is the community that fosters the value of financial planning and advances the financial planning profession.
Since 1983, NAPFA has provided fee-only financial planners across the country with some of the strictest guidelines possible for professional competency, comprehensive financial planning, and fee-only compensation. With more than 2,200 members across the country, NAPFA has become the leading professional association in the United States dedicated to the advancement of fee-only comprehensive financial planning. For more information on NAPFA, visit www.napfa.org.

important investor protection initiatives that the Commission could undertake. The current broker-dealer standard of care under the Financial Industry Regulatory Authority's (FINRA) suitability rule is ineffective in protecting investors receiving personalized investment advice because it leaves substantial gaps in coverage when compared to the fiduciary standard applicable to investment advisers. As the study that the Securities and Exchange Commission ("Commission") commissioned the RAND Corporation to undertake found in 2008 ("RAND Institute Report"),[2] retail customers do not understand the regulatory differences between broker-dealers and investment advisers or the standards of care that apply to each, and even more importantly, customers do not believe there should be any difference in the standards of care applicable to each type of entity. The uniform, federal fiduciary standard that has applied to investment advisers ever since the passage of the Investment Advisers Act in 1940 is a well-defined and workable standard of care that has served retail customers well for seventy years. Therefore, the Commission should determine that it is necessary and appropriate in the public interest and for the protection of retail customers to initiate a rulemaking proceeding to adopt a strong and uniform standard of care for broker-dealers and investment advisers. And as the Dodd-Frank Act makes clear, that standard should be *no less stringent* than the existing fiduciary standard under the Investment Advisers Act.

The Commission Should Apply a Strong and Uniform Fiduciary Standard to Everyone Who Provides Personalized Investment Advice to Retail Customers

The Commission should apply a strong fiduciary standard to everyone who provides personalized investment advice concerning securities to retail customers. And that fiduciary standard should be uniform—the Commission should not allow certain firms to provide personalized investment advice to retail customers at a lower standard simply to accommodate those firms' business models. A fiduciary standard that is both strong and uniform is a common-sense reform that will result in substantial benefits to investors and to the markets as a whole.

As Chief Judge Cardozo famously stated:

> Many forms of conduct, permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of honor the most sensitive, is then the standard of behavior.[3]

The U.S. Supreme Court, in *SEC v. Capital Gains Research Bureau, Inc.*, held that:

> The Investment Advisers Act of 1940 thus reflects a congressional recognition "of the delicate fiduciary nature of an investment advisory relationship," as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an

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[2] RAND INSTITUTE FOR CIVIL JUSTICE, INVESTOR AND INDUSTRY PERSPECTIVES ON INVESTMENT ADVISERS AND BROKER-DEALERS (2008), *available at* http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf [hereinafter RAND INSTITUTE REPORT].
[3] Meinhard v. Salmon, 249 N.Y. 458, 464 (1928).

> investment adviser—consciously or unconsciously—to render advice which was not disinterested.[4]

The Court went on to hold that:

> Courts have imposed on a fiduciary an affirmative duty of "utmost good faith, and full and fair disclosure of all material facts," as well as an affirmative obligation "to employ reasonable care to avoid misleading" his clients.[5]

The courts have held that the fiduciary standard created by the Investment Advisers Act is a federal standard, which is not dependent on the variations of state law.[6] The fiduciary standard has longstanding roots in American law, and there is an extensive and well-understood body of law applying this standard.[7] The fiduciary standard consists of several components. The fiduciary standard includes a duty of care, which includes an affirmative duty to seek out sufficient information and expertise on which to base decisions. The fiduciary standard also includes a duty of loyalty to the client and a duty of honesty to the client. Finally, the fiduciary standard includes a duty of utmost good faith to act solely in the best interests of the client. In the investment context, the fiduciary standard has been summarized as a "prudent investor" standard: the fiduciary "shall invest and manage [client] assets as a prudent investor would . . . [and] shall exercise reasonable care, skill, and caution."[8] Because it is a principles-based standard, the fiduciary standard can be adapted to various situations that may arise in the future.

Broker-Dealers Have Been Held to a Non-Fiduciary Standard that Is Less Effective at Protecting Retail Customers

Quite simply, under current law, broker-dealers are not subject to the same standard of care as investment advisers. Absent unusual facts such as the existence of a fully discretionary account, or a special relationship of trust and confidence between the client and the broker-dealer, the large majority of courts

[4] 375 U.S. 180, 191-92 (1963).

[5] *Id.* (citations omitted). The Court in *Capital Gains* noted that the Advisers Act was triggered by an SEC report to Congress which found that

> investment advisers could not "completely perform their basic function —furnishing to clients on a personal basis competent, unbiased, and continuous advice regarding the sound management of their investments—unless all conflicts of interest between the investment counsel and the client were removed." . . . This concern was not limited to deliberate or conscious impediments to objectivity. Both the advisers and the Commission were well aware that whenever advice to a client might result in financial benefit to the adviser—other than the fee for his advice—"that advice to a client might in some way be tinged with that pecuniary interest (whether consciously or) subconsciously motivated . . . ." The report quoted one leading investment adviser who said that he "would put the emphasis . . . on subconscious" motivation in such situations. It quoted a member of the Commission staff who suggested that a significant part of the problem was not the existence of a "deliberate intent" to obtain a financial advantage, but rather the existence "subconsciously [of] a prejudice" in favor of one's own financial interests.

Id. at 187–88 (citations omitted).

[6] Transamerica Mortgage Advisors v. Lewis, 444 U.S. 11, 17 (1979).

[7] *See generally* RESTATEMENT (SECOND) OF AGENCY (1958).

[8] *See* National Conference of Commissioners on Uniform State Laws, Uniform Prudent Investor Act at § 2 (1994), *available at* http://www.law.upenn.edu/bll/archives/ulc/fnact99/1990s/upia94.pdf.

have held that a broker-dealer is not a fiduciary to its client.[9] Even the minority of states that have recognized a fiduciary duty on the part of a broker-dealer outside of the presence of discretionary accounts or a special relationship of trust and confidence generally have held that the scope of that fiduciary duty is limited.[10] The cases are legion which hold that although a fiduciary would have been liable on the facts at issue, a broker-dealer was not liable because it was not acting as a fiduciary.[11] As a result, the current regulatory structure is ineffective because retail customers of a broker-dealer do not receive protection in situations in which an investment adviser's retail customers would be protected.

There are significant gaps between the current standards of care applicable to broker-dealers and investment advisers, and those gaps harm retail customers. A broker-dealer is subject to a duty under the rules of FINRA, a self-regulatory organization (SRO) authorized by the Commission to oversee securities firms, to make only suitable recommendations to clients on the basis of the facts, if any, disclosed by the client concerning his or her other security holdings and as to his or her financial situation and needs.[12] In a given situation, several different securities may satisfy the standard of being suitable for the client, and a broker is free (without disclosure of this fact) to recommend the one that is most highly remunerative to the broker, even if the broker believes that other choices in fact would be better for the client. By contrast, to the extent an investment adviser had such a conflict of interest, he would be required to disclose that conflict of interest fully and fairly to his customers. And an investment adviser could not recommend an investment that he believed was inferior to other alternatives available for a retail customer.

Although there is no federal private right of action for breach of fiduciary duty under the Investment Advisers Act,[13] all states recognize a cause of action for breach of fiduciary duty. By contrast, FINRA rules such as the suitability rule do not create obligations enforceable in private damages actions.[14] For an

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[9] *See, e.g.,* Lieb v. Merrill Lynch, 461 F. Supp. 951 (E.D. Mich. 1978), *aff'd*, 647 F.2d 165 (6th Cir. 1981); Paine, Webber, Jackson & Curtis, Inc. v. Adams, 718 P.2d 508, 516-17 (Colo. 1986); Dolatowski v. Lynch, 808 N.E.2d 676 (Ind. App. Ct. 2004); Pastos v. First Albany Corp., 433 Mass. 323, 330 (2001); MERF v. Allison-Williams Co., 508 N.W.2d 805, 806 (Minn. Ct. App. 1993); Fesseha v. TD Waterhouse Investor Servs., 305 A.D.2d 268, 268-69 (N.Y. App. Ct. 2003); Sterner v. Penn, 159 N.C. App. 626, 629-31 (2003) (contrasting duties of an investment adviser); In re Rea, 245 B.R. 77 (N.D. Tex. 2000); Sherry v. Dierks, 29 Wash. App. 433, 442, 628 P.2d 1336 (1981); Merrill Lynch v. Boeck, 127 Wisc.2d 127, 135-36 (1985).
[10] *See, e.g.,* Duffy v. Cavalier, 215 Cal.App.3d 1517, 1533, 264 Cal. Rptr. 740, 751 (1989); O'Malley v. Boris, 742 A.2d 845 (Del. 1999), *after remand,* No. 15735-NC (Del. Chanc. Ct. Mar. 18, 2002); State ex rel. PaineWebber v. Voorhees, 891 S.W.2d 126, 130 (Mo. 1995) (en banc).
[11] *See* De Kwiatkowski v. Bear Stearns & Co., 306 F.3d 1293 (2d Cir. 2002) (collecting cases).
[12] *See* NASD Rule 2310. As part of the consolidation of the National Association of Securities Dealers (NASD) and New York Stock Exchange (NYSE) rulebooks, FINRA has proposed a new FINRA Rule 2111 that would replace NASD Rule 2310, and the Commission is currently seeking comments on this proposed new rule. *See* Exch. Act Rel. No. 62,718 (Aug. 20, 2010), *available at* http://www.sec.gov/rules/sro/finra/2010/34-62718a.pdf.
[13] Transamerica Mortgage Advisors v. Lewis, 444 U.S. 11 (1979).
[14] *See* Hosworth v. Blinder, Robinson & Co., 903 F.2d 186, 200 (3rd Cir. 1990) (there is no legal course of action for violation of NASD rules); Thompson v. Smith Barney, Harris Upham & Co., 709 F.2d 1413, 1419 (11th Cir. 1983) (there is no private right of action for violation of the 'know your customer' or suitability rules of SROs); Jablon v. Dean Witter Co., 614 F.2d 677 (9th Cir. 1980) (there is no implied cause of action for rules violations); In re Verifone Securities Litigation, 11 F.3d 865, 870 (9th Cir. 1993) (upholding dismissal of plaintiff's claims under NASD, NYSE, and American Stock Exchange (AMEX) rules because "[i]t is well established that violations of an exchange rule will not support a private claim"). Furthermore, the NASD itself determined that there is no private right of action under SRO rules. *See* Penzer v. Advest, Inc., 1993 WL 603507, *5 (NASD Nov. 5, 1993) (granting Respondent's motion to dismiss all claims and stating "case law supports the conclusion that no private right of action exists for breach of NASD rules"); Lorenz v. Scattergood, 1991 WL 321509, *2 (NASD Mar. 4, 1991)

unsuitable recommendation to rise to the level of an actionable Rule 10b-5 violation, a client would have to prove that the broker-dealer acted with intent to defraud,[15] while the comparable standard in the Investment Advisers Act for violations of Section 206(1) is only negligence.[16] As discussed above, the Investment Advisers Act was designed to combat not only active, intentional fraud, but also constructive fraud (breaches of the duty of loyalty) caused by the subconscious motivations of investment advisers.[17] Because suitability cases are ordinarily resolved in an arbitration forum without any written decision and essentially no right of appeal, the law of suitability is not well-developed or consistently applied, unlike the law of fiduciary duty. The suitability standard only applies to recommendations of securities,[18] while the fiduciary standard applies to the entire relationship between the adviser and the retail customer.[19] Moreover, the "provision of investment advice" standard under the Advisers Act is much broader than the "in connection with a purchase or sale" requirement under Rule 10b-5, and covers (for example) situations in which the investment advice does not result in a transaction at all.[20]

And there are real, practical effects of this difference in standards of care between broker-dealers and investment advisers. A broker-dealer client does not receive a document like the Form ADV which provides a comprehensive disclosure of the firm's business practices and potential conflicts of interest, and a description of the background and the qualifications of the firm's principals. An investment adviser may not engage in trading practices that would be permitted for a broker-dealer.[21] An investment adviser may not enter into certain types of fee arrangements or assign its advisory contracts to others without the client's affirmative consent.[22] For all of these reasons, there are significant gaps between the current standards of care that apply to broker-dealers and investment advisers, and in each case the gap operates to the disadvantage of the retail customers of broker-dealers.

(granting Respondents' motion to dismiss claims under the NASD's Rules of Fair Practice "because there exists no private cause of action for [violation] of NASD's Rules").

[15] Aaron v. SEC, 446 U.S. 680 (1980); Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1975).

[16] SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963).

[17] *See supra* text accompanying note 4; *see also* Arleen W. Hughes, 27 S.E.C. 629, 635-36 (1948), *aff'd sub nom.* Hughes v. SEC, 174 F.2d 969 (D.C. Cir. 1949).

[18] In FINRA Notice 09-25 (May 2009), FINRA proposed expanding the suitability rule to cover non-securities transactions. However, after receiving negative comments from its member firms, FINRA withdrew this part of its proposal when it submitted its revised suitability rule to the SEC for approval. *See* Exch. Act Rel. No. 62718 (Aug. 20, 2010).

[19] As the Commission has stated:

> [T]he Commission has applied Sections 206(1) and (2) in circumstances in which the fraudulent conduct arose out of the investment advisory relationship between an investment adviser and its clients, even though the conduct does not involve a securities transaction . . . . Moreover, the staff has taken the position that an investment adviser who sells non-securities investments to clients must, under Sections 206(1) and (2), disclose to clients and prospective clients all its interests in the sale to them of such non-securities investments.

Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services, Inv. Adv. Act Rel. No. 1092 (Oct. 8, 1987); *accord* Inv. Adv. Act Rel. No. 770 (Aug. 13, 1981).

[20] *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) (no private right of action under Rule 10b-5 for fraud alleged to have caused an investor to hold a security).

[21] *See, e.g.,* Marc N. Geman, Inv. Adv. Act Rel. No. 1924 (Feb. 14, 2001), *aff'd* Geman v. SEC, 334 F.3d 1183 (10th Cir. 2003).

[22] Investment Advisers Act of 1940 § 205, 15 U.S.C. § 80b-5 (2006).

In summary, a transaction-based suitability standard is not tailored for an ongoing advice relationship, where the best advice in some situations may be a non-securities product, or not to engage in any transaction. And notably, when the Commission briefly allowed broker-dealers to offer fee-based brokerage accounts without imposing a fiduciary standard on those firms,[23] the result was a series of "reverse churning" cases in which the broker-dealers simply pocketed the fees without providing the promised investment advice or conducting any transactions for the clients, and the clients would have been better off with a commission-based account.[24] In short, the transaction-based suitability standard does not provide nearly the same level of protection as the relationship-based fiduciary standard. The Commission should determine that the existing suitability standard is insufficient to protect retail customers who receive investment advice from broker-dealers. As a result, the Commission should find that it is necessary and appropriate in the public interest and for the protection of retail customers to propose a rule to extend the fiduciary standard of care to broker-dealers who provide personalized investment advice to retail customers.

Retail Customers Do Not Understand the Current Differences in Standards Applicable to Investment Advisers and Broker-Dealers

The Commission received in 2008 the RAND Institute Report. That report concluded, after an extensive survey of some 1000 investors nationwide, supplemented by multiple focus group meetings of ten to twelve investors each, that:

> most survey respondents and focus-group participants do not have a clear understanding of the boundaries between investment advisers and broker-dealers. Even those who have employed financial professionals for years are often confused about job titles, types of firms with which they are associated, and the payments they make for their services. Respondents and participants also understand relatively little about the legal distinctions between investment advisers and broker-dealers.[25]

The RAND Institute Report found that investors believed that "financial advisors" and "financial consultants" were more similar to investment advisers than to brokers in terms of the services provided, compensation methods, and duties, when in fact these titles are frequently used by broker-dealer employees.[26] The RAND Institute Report found that "many respondents are confused about the methods of payment or the type of firm with which their individual professional is associated," with many investors

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[23] See Former Rule 202a11-1, found invalid in *Financial Planning Assn. v. SEC*, 482 F.3d 481 (D.C. Cir. 2007).
[24] *See*, *e.g*., Robert W. Baird (FINRA April 2009 Disciplinary Actions) ($500,000 sanction), *available at* http://www.finra.org/web/groups/industry/@ip/@enf/@da/documents/disciplinaryactions/p118481.pdf; SunTrust Investment Services, Inc. (FINRA Dec. 2008 Disciplinary Actions) ($700,000 sanction), *available at* http://www.finra.org/web/ groups/industry/@ip/@enf/@da/documents/disciplinaryactions/p117534.pdf; UBS Financial Services, Inc. (NYAG July 2007) ($23.3 million sanction), *available at* http://www.ag.ny.gov/media_center/2007/jul/jul16a_07.html; Morgan Stanley & Co. (NASD August 2005 Disciplinary Actions ($6.1 million sanction), *available at* http://www.finra.org/web/groups/industry/ @ip/@enf/@da/documents/ disciplinaryactions/p014850.pdf); Raymond James & Co. (NASD April 2005 Disciplinary Actions ($750,000 sanction), *available at* http://www.finra.org/web/groups/industry/@ip/@enf/@da/documents/ disciplinaryactions/ p118481.pdf.
[25] RAND INSTITUTE REPORT, *supra* note 2, at 87.
[26] *Id*.

reporting that they believed their investment professionals were investment advisers, yet they were paying those investment professionals on the basis of brokerage commissions, not investment advisory fees.[27] The RAND Institute Report found that, even after receiving a fact sheet describing the differences between investment advisers and brokers, focus group participants were confused by the different job titles. Most focus group participants did not know which type of investment professional they themselves had.[28] Focus group participants had difficulty when reviewing marketing materials in telling whether a particular firm was an investment adviser, broker-dealer, or both.[29]

The RAND Institute Report reached several critical conclusions:

- Many survey respondents and focus-group participants did not understand key distinctions between investment advisers and broker-dealers—their duties, the titles they use, the firms for which they work, or the services they offer.
- The roles of broker-dealers and investment advisers were confusing to most survey respondents and focus-group participants, and the respondents could not identify the roles of professionals who use generic terms such as financial advisor and financial consultant.
- Even after explanations of fiduciary duty and suitability in plain language, focus-group participants struggled to understand the differences between the fiduciary and suitability standards of care.[30]

The data gathered by the RAND Institute Report was comprehensive and its methodology was scientific and thoughtful; we are not aware of any criticism of the validity of its findings. The RAND Institute Report data was gathered in late 2007, and it conclusions remain valid today. In short, the Commission already has powerful and persuasive evidence that investors do not understand the current differences in the standard of care between investment advisers and broker-dealers, and indeed often believe they are dealing with investment advisers when in fact they are dealing with broker-dealers. And investors do not believe there should be a difference in the applicable standard—they believe all investors should receive a uniform and high standard of care. The only way for the Commission to resolve this ongoing investor confusion is to adopt a strong and uniform standard for the delivery of personalized investment advice by both investment advisers and broker-dealers. In light of this consumer confusion and the inadequacy of the suitability standard to protect consumers, the Commission should determine it is necessary and appropriate in the public interest and for the protection of retail customers to propose a rule to extend the fiduciary standard of care to broker-dealers who provide personalized investment advice to retail customers.

[27] *Id.* at 95–95. Forty-three percent of survey respondents incorrectly believed investment advisers were paid on a commission basis. *Id.* at 109.
[28] *Id.* at 111.
[29] *Id.* at 110–12.
[30] *Id.* at 112–13.

The Clarifications in the Dodd-Frank Act Should Be Interpreted Consistently with a Strong and Uniform Fiduciary Standard

Section 913 of the Dodd-Frank Act contains several provisions that clarify the possible scope of the uniform standard of care that the Commission is authorized to adopt. All of those provisions are consistent with the adoption of a strong and uniform fiduciary standard of care for retail customers. We urge the Commission to interpret these provisions in a way consistent with strong and consistent investor protection, and not to let these provisions become loopholes that defeat the overall purpose of a uniform standard.

First, the uniform standard of care will only apply to retail customers, meaning natural persons (or their legal representatives) who use investment advice primarily for personal, family, or household purposes. Thus, a fiduciary standard will not affect the ability of large, sophisticated institutional investors to make their own assessment of investment risks and opportunities to use the services of broker-dealers as they currently may choose to do. However, we urge the Commission to clarify that there is no "accredited investor" exception to this natural person definition—accredited investors, just like any other natural persons, need and deserve the protection of the fiduciary standard. Further, investment advice to individual beneficiaries of a retirement plan should be subject to the fiduciary standard, even if (in a technical sense) the plan rather than the individual beneficiaries may be the customer of the investment adviser or broker-dealer. Individuals who are planning for retirement are among those most in need of a strong and uniform fiduciary standard.

Second, the uniform standard of care will only apply in connection with personalized investment advice. Any personalized advice about securities, from specific advice about investing in a particular security to advice about whether investment in securities would be appropriate, would be considered personalized investment advice. Personalized investment advice includes when a financial professional provides a client with any form of guidance or recommendation regarding specific securities, classes of securities, the advisability or inadvisability of investing in securities, and advice about the selection or retention of an investment adviser. The principal limits on what constitute personalized investment advice is that the information must include an opinion or analysis rather than simply relaying facts, and the advice must concern securities (e.g., as opposed to commodities or real estate). Advice is personalized if it reflects the personal circumstances of the customer. If the transaction involves a security and the financial professional gives an opinion on whether or not that security is appropriate for a particular investor, then the response is personalized investment advice and should be subject to a fiduciary duty. For example, a fiduciary standard will not affect the ability of broker-dealers and investment advisers to prepare generalized research reports, target asset allocations, or electronic investment analysis tools, without fear that those activities will give rise to fiduciary liability to everyone who reads those reports or uses those tools.[31] However, to the extent that a firm or an investment professional presents one of those reports or

[31] Of course, as is true under existing law, the firm would be required to have a reasonable basis for believing that the report or tool makes recommendations that are appropriate for at least some investors, would be required to have a reasonable basis for all statements in the report or algorithms used in the tool, and would be required to be fair and balanced and not omit any material facts relevant to the report or tool. Where the research is provided in the context of a client relationship, for example in association with a personalized recommendation, it becomes personalized investment advice and should be subject to a fiduciary duty.

tools to a retail customer in support of personalized advice to that client, the firm or investment professional would have a fiduciary obligation to assure that the advice was fully appropriate for and in the best interests of that customer. Similarly, if a retail customer chooses to conduct only unsolicited trading at a firm, then the firm would not assume a fiduciary duty to advise the customer concerning that trading.[32] However, if the firm or investment professional gives a retail customer personalized investment advice, then it becomes a fiduciary and must remain so throughout the relationship. Once the firm or investment professional is a fiduciary, then it must advise the customer solely in the customer's best interest, even if the customer chooses not always to take the firm's or the investment professional's advice.

Third, charging a retail customer on a commission basis, without more, is not inconsistent with a strong and uniform fiduciary standard of care. Some customers, especially those who do not expect to conduct frequent transactions, may be better off in an account with transaction-based pricing rather than asset-based pricing. However, to the extent a firm or investment professional chooses to use a commission-based pricing model, it must recognize that this model creates inherent conflicts of interest that are not present in an asset-based pricing model.[33] The firm or investment professional must disclose that potential conflict of interest to the customer before the beginning of the relationship and at regular intervals thereafter, and obtain fully informed consent to that model from the client. Moreover, the burden must remain on the firm and the investment professional, not the customer, to justify each and every transaction (and the sum total of the transactions) as consistent with the client's best interest. And, if the firm offers both commission-based and asset-based pricing models, the firm and the investment professional have the obligation to recommend to the retail customer the pricing model that is in the customer's best interest, and to monitor regularly to assure that the customer remains in the account structure that is in the customer's best interest.[34] The Commission must not allow the fact that the Dodd-Frank Act permits commission-based pricing to become an excuse for churning or unsuitable recommendations that would be forbidden even under existing law.

Fourth, the clarification that the provision of individualized investment advice does not necessarily create an ongoing duty of care to the retail customer should be interpreted by the Commission in a manner consistent with a strong and uniform fiduciary standard. A customer may obtain a one-time "snap-shot" financial plan from a financial planner, without necessarily creating an obligation on the part of the financial planner to monitor the ongoing activity of the customer. However, if the customer and the investment professional agree to create an ongoing relationship involving investment advice, then the fiduciary standard must continue throughout the course of that relationship. As the Commission has long held, an investment adviser cannot provide personalized advice to a customer, and then take off the investment adviser "hat" and act as merely a broker when executing transactions for that client.[35] If an

[32] Of course, even in the unsolicited trading situation, the firm will continue to have a fiduciary obligation to the client to execute the all of client's orders on the best terms reasonably available. *See* Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 135 F.3d 266, 270 (3d Cir. 1998) (en banc).
[33] *See* SECURITIES AND EXCHANGE COMMISSION, REPORT OF THE COMMITTEE ON COMPENSATION PRACTICES (1995), *available at* http://www.sec.gov/news/studies/bkrcomp.txt [hereinafter TULLY REPORT].
[34] *See* NASD Notice to Members 03-68 (Nov. 2003) (requiring broker-dealers to assess appropriateness of accounts for retail clients).
[35] *See* Marc N. Geman, Inv. Adv. Act Rel. No. 1924 (Feb. 14, 2001) (rejecting argument that investment adviser can use "dual hat" approach and act simply as a broker-dealer when executing client's transactions), *aff'd sub nom.* Geman v. SEC, 334 F.3d

investment professional promises to provide ongoing services to a customer, then the investment professional must live up to that ongoing obligation, and all of those services must be subject to the strong and uniform fiduciary standard of care. If the firm gives a customer advice with respect to an account at the firm, and then sees that the customer's account has fallen out of balance over time or the customer has erred in implementing that advice, the firm cannot simply "look the other way"—that would not be consistent with basic notions of fiduciary duty.

Fifth, the provision of a limited range of products, or of proprietary products, is not, standing by itself, necessarily inconsistent with a fiduciary standard of care. Fiduciary duty does not create an obligation to create "open architecture"; indeed, a thorough and prudent due diligence process before offering each new product necessarily means that a firm likely will choose not to offer some products or services. However, the decision to offer only a limited range of products, and particularly the decision to offer a proprietary product, does create a potential conflict of interest with the customer. As a result, the firm and the investment professional must have a duty to make full and fair disclosure of this conflict of interest to the customer, and obtain the customer's fully informed consent, before offering the product in these circumstances.

Moreover, an investment professional offering only a limited range of products, or only proprietary products, has the "prudent investor" obligation to inform himself fully about the comparable products available in the marketplace, even if those products are not available through his firm. To the extent there are comparable products available in the marketplace on better terms to the retail customer, the investment professional has the obligation to inform his customer about those products, even if the firm does not offer them. If the customer then chooses to buy the firm's proprietary product (because, for example, the customer does not want to have to monitor positions at multiple firms) after this full disclosure, then this would be consistent with notions of fiduciary duty. But the burden must be on the investment professional, not the customer, to justify the transaction in these circumstances. An investment professional cannot simply be blind to products or services available on better terms elsewhere in the marketplace. He can only offer a proprietary product after full and fair disclosure, which necessarily includes disclosure of the availability of products on better terms elsewhere. Otherwise, the investment professional is not acting in the customer's best interest; he is preferring his own interest to that of the customer.

In sum, the Coalition believes the provisions of Section 913 are all fully consistent with adoption of a strong and uniform fiduciary standard for both investment advisers and broker-dealers. The Commission should interpret all the provisions of Section 913 consistent with the broad remedial purposes of the Dodd-Frank Act. There are many potential conflicts of interest that are not per se breaches of a fiduciary standard on their face. However, in each instance, the burden must be on the investment professional to demonstrate that he has fully satisfied his fiduciary duty, for example by making full and fair disclosure even where that full and fair disclosure is not in the interest of the investment professional. None of these potential conflicts of interest excuse an investment professional from the basic obligation to act solely in the best interests of his clients at all times. The fact that some potential conflicts of interest, in some circumstances, may be permissible, should not become a set of loopholes that undercuts the fundamental strength of a strong and uniform fiduciary standard.

1183 (10th Cir. 2003); *see also* Arleen W. Hughes, 27 S.E.C. 629 (1948), *aff'd sub nom.* Hughes v. SEC, 174 F.2d 969 (D.C. Cir. 1949).

The Fiduciary Standard Requires More than Just Disclosure and Consent

It has been argued by some that compliance with a fiduciary standard is solely a matter of disclosure and consent concerning a firm's potential conflicts of interest. The Coalition disagrees, and fortunately, the Commission staff long has disagreed as well:

> We do not agree that "an investment adviser may have interests in a transaction and that his fiduciary obligation toward his client is discharged so long as the adviser makes complete disclosure of the nature and extent of his interest." While section 206(3) of the Investment Advisers Act of 1940 ("Act") requires disclosure of such interest and the client's consent to enter into the transaction with knowledge of such interest, the adviser's fiduciary duties are not discharged merely by such disclosure and consent. The adviser must have a reasonable belief that the entry of the client into the transaction is in the client's interest. The facts concerning the adviser's interest, including its level, may bear upon the reasonableness of any belief that he may have that a transaction is in a client's interest or his capacity to make such a judgment.[36]

The structure of the Investment Advisers Act itself argues against the "disclosure and consent" position: for example, the provisions of Section 205 forbidding profit-sharing apply whether or not the client gives consent. The Commission staff has long found that hedge clauses in investment advisory agreements may be impermissible even if the client agrees and even if, read literally, nothing in the hedge clause was affirmatively misleading.[37] And, of course, Section 215 of the Investment Advisers Act forbids investment advisers from seeking waivers from clients of the protections of the Act, no matter how fully informed the client is when the waiver is requested.

Consent is only informed if the client has the ability fully to understand and evaluate the information. Many complex products (such as collateralized mortgage obligations ("CMOs"), structured products, options, security futures, margin trading strategies, alternative investments, and the like) are appropriate only for sophisticated and experienced investors. It is not sufficient for a firm or an investment professional to make full disclosure of potential conflicts of interest with respect to such products. The firm and the investment professional must make a reasonable judgment that the client is fully able to understand and evaluate the product and the potential conflicts of interest that it presents.

The fiduciary standard is not just a "disclosure and consent" process standard—it is a substantive standard that requires an investment professional to act consistently with the long-standing and well-established duty to act as a "prudent investor." It is well-established that an element of fiduciary duty under the Investment Advisers Act is (as part of the duty of due care) a duty of due diligence to assure that the investment professional fully understand and have fairly evaluated an investment recommendation. Even with full and fair disclosure and consent, if an investment professional gives investment advice that is

[36] Rocky Mountain Financial Planning, Inc. (pub. avail. Feb. 28, 1983).
[37] *See* Heitman Capital Management, LLC (pub. avail. Feb. 12, 2007) (discussing previous no-action requests concerning hedge clauses and announcing staff would not entertain future requests on the subject). Public policy supports the principle that investment professionals should not be free to seek to have clients negate the fiduciary duties to which they are subject. *See* Erlich v. First National Bank of Princeton, 208 N.J. Super. 264, 505 A.2d 220 (N.J. Super. Ct. Law Div. 1984).

inconsistent with what a prudent investor would do in similar circumstances, then the investment professional has violated the fiduciary duty to the client to engage in fair dealing and provide disinterested advice. It is vitally important that the Commission include these substantive elements of the Investment Advisers Act fiduciary standard as part of the fiduciary standard applied to broker-dealers who provide personalized investment advice.

Adopting a Strong and Uniform Fiduciary Standard Will Not Limit Retail Customers' Access to Investment Advice

Among the issues that Section 913 directs the Commission to address is the impact of a fiduciary standard on investors' access to investment advice, and any additional costs and expenses associated with that advice. We agree that, because the differences between a fiduciary standard and a suitability standard are real and substantial, if broker-dealers do not adapt their business models, then they will incur additional liabilities under a fiduciary standard. However, the Coalition does not believe that it therefore follows that a fiduciary standard will deprive retail customers of access to financial services. In fact, even with the differences in the standard of care between investment advisers and broker-dealers, there has been a large and steady increase in the number of investment advisers in recent years, while the number of broker-dealers has been steadily decreasing. According to the Commission's most recent Annual Performance Report, between 2003 and 2009, the number of Commission-registered investment advisers has risen by 47%, and the assets under management by those investment advisers has increased by 105%.[38] By contrast, FINRA, which all broker-dealers who do business with members of the public must join,[39] currently reports under 4700 member firms, down from over 6500 at its predecessor SROs in the middle of the decade.[40] Similarly, the U.S. Bureau of Labor Statistics estimated that there were fewer people employed by broker-dealers in late 2009 than at the beginning of the decade.[41] In short, despite the higher standard of care for investment advisers than for broker-dealers, there has been a substantial migration towards investment advisers and away from broker-dealers. The higher standard of care simply has not proven to be a barrier to retail customres obtaining investment advice from investment advisers, in rapidly increasing numbers. Nor do we believe there is any evidence that a fiduciary standard of care would have a disproportionate impact on smaller investors—even under the existing suitability standard of care, those investors at broker-dealers already are relegated to online or call-center channels in which they receive limited, if any, personalized investment advice.

Some commentators have argued that the standard of care for firms providing personalized investment advice to retail customers should be modified to accommodate different business models. The Coalition believes this is a dangerous notion that the Commission should firmly reject. As discussed above, the fiduciary standard already provides flexibility. A client and an investment adviser already may negotiate the scope of the firm's obligations, so long as the final investment advisory agreement is consistent with

[38] SECURITIES AND EXCHANGE COMMISSION, PUTTING INVESTORS FIRST: 2009 PERFORMANCE AND ACCOUNTABILITY REPORT, at 18, chart 1.9 (2009), *available at* http://www.sec.gov/about/secpar/secpar2009.pdf#2009review.
[39] *See* Securities Exchange Act of 1934 § 15(b)(8), 15 U.S.C. § 78o (2006); Exemption for Certain Exchange Members, Rule 15b9-1, 17 C.F.R. § 240.15b9-1 (2010). As a practical matter, the only non-FINRA member broker-dealers are a very small number of exchange specialists, floor-brokers, and proprietary trading firms.
[40] *See* FINRA Home Page, http://www.finra.org/.
[41] SIFMA, SECURITIES INDUSTRY EMPLOYMENT UPDATE 2 (Nov. 2009), *available at* http://www.sifma.org/research/statistics/other/employment-NY-quarterly.pdf.

the anti-waiver provisions of Section 215 of the Investment Advisers Act—and whatever obligations the firm undertakes are subject to a fiduciary standard. For example, a financial planner may negotiate to provide a one-time "snap-shot" financial plan subject to the fiduciary standard without undertaking an ongoing obligation to monitor the client's implementation of that plan.

Modifying or watering down the fiduciary standard to accommodate different business models is not necessary. CFP Board and FPA are business model neutral. CERTIFIED FINANCIAL PLANNER™ professionals and FPA members operate in a variety of different business models, including brokerage, insurance, and advisory models, with a variety of fee structures, including commission-based, fee-only, and assets under management fee structures. [42] At the same time, CERTIFIED FINANCIAL PLANNER™ professionals and FPA members voluntary embrace, by virtue of their CFP® certification or membership in FPA, a commitment to provide financial planning services (which include investment advice) at a fiduciary standard of care. The successful application of the ficuciary standard by financial planners across a variety of different business models and fee structures is strong evidence that it is a practical, flexible, and workable standard.

Moreover, permitting a modified or watered down version of the "fiduciary" standard to accommodate different business models would completely frustrate the interests of eliminating client confusion, closing regulatory gaps, and developing a strong and uniform standard of care for the delivery of personalized investment advice—regardless of the legal registration of the investment professional. Commentators have also argued that imposition of the fiduciary standard of care will increase costs to clients, which will in turn reduce consumers' access to investment advisory services. It is certainly true that, in some business models with numerous imbedded potential conflicts of interest, such as the Wall Street "all things to all people" wirehouse business model, a strong and uniform fiduciary standard is likely to impose more costs and expenses than in a more typical agency-only investment advisory firm, which has much more limited potential conflicts of interest.[43] At firms with more limited potential conflicts of interest, the costs of monitoring and controlling those conflicts of interest are lower (as should be the cost for those firms of obtaining errors and omissions insurance). As a result, the corresponding costs for clients to receive investment advice from those firms should be lower as well.

The Commission should not mold the fiduciary standard to accommodate business models with substantial embedded conflicts of interest. Rather, it should impose a strong and uniform fiduciary standard of care, and then allow clients and the market to determine which business models will succeed under that standard. The Coalition believes the result will be, as it has been over the past decade, that clients will gravitate towards business models with reduced potential conflicts of interest.

Even if, in the aggregate, adopting a strong and uniform fiduciary standard of care does increase costs to clients somewhat at some firms, the benefits to clients will far outweigh those costs. Clients will benefit from a lack of confusion about the duties and obligations of their financial services providers and from a

[42] In contrast, NAPFA members operate only under a fee-only compensation model. The organization has required its members to sign the NAPFA Fiduciary Oath since the 1980s.
[43] That being said, in 2007 the Wall Street wirehouses converted their fee-based brokerage accounts (which had not been subject to a fiduciary standard) to non-discretionary advisory accounts fully subject to the fiduciary standard under the Investment Advisers Act.

better ability to compare among investment advice providers, and likely choose a provider with fewer potential conflicts of interest. There are currently investment advice business models that have succeeded and have attracted increasing numbers of clients and assets even under the current unlevel playing field. Those business models will be even more successful if all investment advice providers have a strong and uniform fiduciary standard of care. There is no reason to believe that a strong and uniform fiduciary standard of care will result in overall higher costs or decreased access to investment advice on the part of retail customers.

The Commission Should Allocate Appropriate Examination and Enforcement Resources for Oversight of All Firms and Investment Professionals Who Provide Personalized Investment Advice to Retail Customers

Section 913 directs the Commission to consider the regulatory, examination, and enforcement resources at the Commission, the states, and the SROs to enforce a strong and uniform standard of care. Section 914 directs the Commission to conduct a parallel study on enhancing the examinations of investment advisers. The Coalition strongly urges the Commission to allocate all of the resources it needs to examine and enforce a strong and uniform fiduciary standard of care. While a robust and effective examination and enforcement program for this standard of care is likely to require additional resources, this consideration should not prevent or delay the Commission from adopting a strong and uniform fiduciary standard of care.

As it addresses the appropriate allocation of examination and enforcement resources for broker-dealers and investment advisers, we encourage the Commission to keep in mind the significant differences in the scope of their respective regulated activities. Some commentators point to more frequent examinations and investigations of broker-dealers by FINRA as evidence of the inadequacy of oversight of investment advisers by the Commission on an annual basis. The Coalition does not believe that a comparison of the frequency of examinations or investigations of investment advisers and broker-dealers is an "apples to apples" comparison. While large broker-dealers are examined more frequently than investment advisers, many of those examination resources are devoted to issues that are far removed from the provision of personalized investment advice to retail customers, such as financial responsibility, market-making and exchange floor activities, underwriting and institutional sales, books and records, and operational issues. The level of appropriate oversight and the resources necessary to provide that oversight should be considered separately for broker-dealers and investment advisers and should be tailored to match the scope of the respective regulated activities of each group.

The Coalition believes that additional resources must be allocated to the oversight of both investment advisers and broker-dealers. On the adviser side, public statements by Commission staff members have suggested that in recent years the Commission has examined less than 10% of investment advisers registered with the Commission on an annual basis. The Coalition believes this is insufficient and we urge the Commission to devote additional resources to this task. The increase in the threshold for state investment adviser jurisdiction from $25 million to $100 million in assets under management in the Dodd-Frank Act will decrease the number of Commission-registered advisers, and should significantly reduce the Commission's oversight burden. We understand that NASAA has assured the Commission that its member states, many of which have "self-funding" mechanisms, will be able adequately to examine investment advisers in this $25–$100 million range. Further, the President's budget proposal for 2010 increases the Commission's budget by 12% (on top of a significant budget increase in 2009), which should provide the Commission with substantial additional staff resources for increasing investment adviser examinations.[44] And the Commission has requested 800 additional staff members to carry out its responsibilities under the Dodd-Frank Act.[45]

As for broker-dealers, we expect that, between the Commission, the states, and FINRA, the adoption of a strong and uniform fiduciary standard will require additional resources. This is especially true because (unlike investment advisers) broker-dealers generally are not used to operating under a fiduciary standard. Nor does FINRA have any experience in examining or enforcing a fiduciary standard. For this reason, the Coalition believes the Commission should not give FINRA any new role in the oversight of investment advisers. FINRA will have a formidable challenge in applying a fiduciary standard of care even to its existing population of broker-dealers. It would be much more effective and efficient to expand the Commission's investment adviser examination and enforcement program—which already has a core of people who are very familiar with the application of a fiduciary standard.

The additional Commision appropriations should be more than adequate to examine and enforce a strong and uniform fiduciary standard of care for both broker-dealers and investment advisers. Moreover, Section 991 of the Dodd-Frank Act allows the Commission to submit budget requests directly to Congress if it believes it needs additional resources. In short, the Commission is getting substantial additional resources, and can request more if it believes them necessary. Insufficient resources is not an excuse that should prevent or delay the Commission from adopting a strong and uniform fiduciary standard.

Section 913 directs the Commission to review the substantive difference in the regulation of broker-dealers and investment advisers when providing personalized investment advice to retail customers. The application of a fiduciary standard would require broker-dealers to provide their clients with better disclosure concerning conflicts of interest. Improved disclosure would facilitate customers' ability to make comparisons among different broker-dealers, and between investment advisers and broker-dealers. Beyond this initiative, the Commission's Divisions of Trading and Markets and Investment Management have long discussed a more comprehensive harmonization of broker-dealer and investment adviser regulation (e.g., in the areas of books and records, advertising, and disclosure), and the Coalition urges the Commission to make this project a priority. However, again, the desirability of harmonizing regulation is not an excuse that should prevent or delay the Commission from adopting a strong and uniform fiduciary standard.

While there are certainly differences in the substantive regulation of broker-dealers and investment advisers, the vast majority of substantive regulation of broker-dealers has to with activities discussed above—financial responsibility, market-making and exchange floor activities, underwriting and institutional sales, books and records, and operational issues—that have nothing to do with personalized investment advice. Other than the suitability rule, there are few, if any, broker-dealer regulations directly addressing the delivery of personalized investment advice about securities to retail customers. The

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[44] *See* Mark Schoeff Jr., *Schapiro: SEC Needs to Hire 800 More Workers*, INVESTMENT NEWS, July 20, 2010, *available at* http://www.investmentnews.com/article/20100720/FREE/100729987.
[45] *Id.*

Commission need not wait to harmonize regulation in areas unrelated to personalized investment advice before adopting a strong and uniform fiduciary standard of care.

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In sum, for all of the reasons stated above, the Commission should determine that it is necessary and appropriate in the public interest and for the protection of retail customers to initiate a rulemaking proceeding to adopt a strong and uniform fiduciary standard of care for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers. And as the Dodd-Frank Act makes clear, that standard should be *no less stringent* than the existing fiduciary standard under the Investment Advisers Act. Given the short comment period, the Coalition recommends that the Commission allow for additional comments, research, and data from interested parties to supplement the record. Members of the Financial Planning Coalition are available to meet and discuss these matters with the Commission and its staff and to respond to any questions.

Respectfully Submitted,

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CERTIFIED FINANCIAL PLANNER BOARD OF STANDARDS, INC.

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cc: The Honorable Mary L. Schapiro, Chairman
The Honorable Kathleen L. Casey, Commissioner
The Honorable Elisse B. Walter, Commissioner
The Honorable Luis A. Aguilar, Commissioner
The Honorable Troy A. Paredes, Commissioner