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April 9, 2012

Mary L. Schapiro
Chairman
Securities and Exchange Commission
100 F Street, N. E.
Washington D.C. 20549

RE: File Number 4-606, Rulemaking Re: Brokers, Dealer and Investment Advisers

Dear Chairman Schapiro:

The Institute for the Fiduciary Standard submits these comments for consideration by the SEC when engaging in rulemaking on a uniform fiduciary standard of conduct for broker-dealers and investment advisers when providing advice about personalized investment advice about securities to retail investors. These comments focus on certain issues expressed in the "Framework for Rulemaking" offered by the Securities Industry and Financial Markets Association (SIFMA) to the Commission in a July 14 letter.

The Institute for the Fiduciary Standard formed in 2011 to provide research, education and advocacy regarding the vital importance of the fiduciary standard to investors receiving investment and financial advice. Six key fiduciary duties are central to fiduciary advice that meets the requirements of the Securities and Exchange Commission's (SEC) Advisers Act of 1940. The six duties are: Serve the client's best interest, act in utmost good faith, act prudently – with the care, skill and judgment of a professional, avoid conflicts of interest, disclose all material facts and control investment expenses. For more information go to www.thefiduciaryinstitute.org.

Executive Summary

Background. SIFMA's recommendations should be viewed within the context of the rich background of fiduciary law. Among the central themes: the essential rationale for fiduciary duties; the circumstances calling for strengthened duties; the established views regarding the corrosive impact of conflicts of interest; the need for rigorous disclosure duties.

SIFMA Priorities. SIFMA's priorities are clear. Access to and choice among a wide range of products and services is paramount; the standard should be "business model neutral;" when material conflicts of interest exist, "broker-dealers and investment advisers should be able to provide disclosures to customers in a pragmatic way," and sometimes receive customer consent to these conflicts. Further, SIFMA articulates clear and unambiguous views on topics such as the scope of the obligations, defining "personalized" investment advice, disclosure and best interest.

Five Key Assumptions Derived from SIFMA's Priorities. Based on its extensive descriptions of its priorities and concerns, here are five key principles that reflect SIFMA's views:

Product recommendations that meet the suitability standard today will meet SIFMA's standard.
Conflicts need not be avoided; they need to be disclosed and can often be beneficial.
Disclosure delivery must be efficient for the firm; it need not be effective for the investor.
SIFMA's uniform standard applies only in narrowly defined circumstances – and may be further limited by contract.
There is no mention whether investment expenses and advisory fees need be controlled.

Conclusions. Four general conclusions are discussed:

SIFMA's standard fundamentally departs from the fiduciary standard under the Advisers Act; its principles are contrary to established fiduciary principles and implicitly suggest that SIFMA believes what is best for SIFMA members is best for investors.

SIFMA puts fiduciary principles on their head when, for example, SIFMA's disclosure principles for retail investors, investors who are often the least knowledgeable, are far less stringent fiduciary principles as compared to Adviser Act disclosure principles.

SIFMA's uniform standard is not an "investor best interest" standard; it should be branded what it is: a "Broker Sales" Standard

SIFMA's uniform standard does not meet the fiduciary standard under the Advisers Act of 1940; it does not comport with the requirements of The Dodd Frank Act.

Introduction

The purpose of this letter is to review key parts of this SIFMA July 14 letter proposal in the context of explicit Dodd Frank parameters.

The Dodd-Frank Act permits the SEC to adopt rules providing that the standard of conduct for broker-dealers and investment advisers, when providing personalized investment advice about securities to retail customers (and such other customers as the SEC may provide) shall be to act in the best interest of the customer "without regard to the financial or other interests of the broker, dealer or investment adviser providing the advice" such that the "the standard of conduct shall be no less stringent than the standard applicable to investment advisers." advisers under section 206(1) and (2) of [the Advisers Act]."[1]

The legislation also explicitly provides that compensation based on commissions, and the sale of proprietary or other limited range of products, "shall not, in and of itself, be considered a violation of such standard" Yet, the Dodd Frank Act also provides that SEC shall examine and where appropriate, "promulgate rules prohibiting or restricting certain sales practices or conflicts of interest and compensation schemes … that the Commission deems contrary to the public interest and the protection of investors."

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[1] SIFMA *Framework*. http://www.sifma.org/issues/item.aspx?id=8589934675

It is interesting that SIFMA acknowledges that the standard must be no less stringent than the standards imposed by Sections 206(1) and 206(2) of the Advisers Act yet "strongly opposes imposing on broker-dealers the existing Advisers Act standard together with its associated case law, guidance, and other legal precedent." The rationale for this is that (i) broker-dealers provide a different range of products and services, and operate under an operational model distinct from that of investment advisers and (ii) Section 206 precedent does not now apply to broker-dealers." No rationale is provided to explain why the first point is relevant (*i.e.*, why it matters that broker-dealers provide different services than investment advisers) and the second point seems, on its face, to be without merit (*i.e.*, the fact that the Section 206 precedent does not apply today is not a reason not to apply it in the future).

Likewise, SIFMA's arguments in footnote 14 of the SIFMA Letter that the decision by Congress not to reference Sections 206(3) (on principal transactions) and 206(4) (on rulemaking authority) of the Advisers Act in articulating the standard of care somehow means that Congress also "did not intend for Section 206 rules *or other legal precedent* to apply …. under the uniform fiduciary standard of conduct" (emphasis added) lacks any basis. The fact that Congress did not reference all of the parts of Section 206 does not logically suggest that Congress did not seek to apply the precedent applicable to those sections that it did reference (*i.e.*, Sections 206(1) and 206(2)). In addition, we fail to see how the SEC can impose a uniform standard of care without imposing the same case, law, guidance and other legal precedent under Sections 206(1) and 206(2) to investment advisers and broker-dealers. Failure to do so would ensure a lack of uniformity in the standards that are applied to broker-dealers and investment advisers. Application of the legal precedent under Sections 206(1) and 206(2) does not mean that the rules the SEC adopted under other sections of the Advisers Act (*e.g.*, under Sections 206(3) and 206(4) should apply. Rather, the SEC's guidance under Sections 206(1) and 206(2) articulating what is required of a fiduciary should apply.

Background

A rich history of law, policy and experience provides a backdrop for extending the fiduciary standard to brokers rendering personalized investment advice to retail investors.

Fiduciary law exists to restrain the conduct of experts who render socially important services or advice in relationships of trust and confidence. Fiduciary duties serve to mitigate the knowledge gap or information asymmetry that separates the two parties. The fiduciary is obligated to be loyal, render due care and act in utmost good faith. The fiduciary must adopt the client's ends or objectives[2]. Fiduciary conduct facilitates investor *trust,* the central pillar on which capital markets and the market economy depend.

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"The strictness of fiduciary law conflict-of-interest rules depends mainly on the level of entrustors' (clients) risks from the fiduciaries abuse of trust."[3] Fiduciary duties increase as the knowledge gap widens, and the gap between brokers and retail investors is widely acknowledged as large. Research reveals retail investors are sharply limited in their understanding of investing, markets and the role of advisors and brokers, suggesting a firm legal basis for applying the most stringent fiduciary duties.[4]

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[2] For a discussion of the fiduciary obligation as adopting the ends or objectives of the principal, see: Arthur Laby, *The Fiduciary Obligation as the Adoption of Ends*, 56 Buffalo Law Review, 99, 104—129.

[3] Tamar Frankel, Fiduciary Duties of Brokers-Advisers-Financial Planners and Money Managers, Boston University School of law Working Paper No. 09-36, August10, 2009, Revised February 17, 2010.

[4] Examples of this research include a 2007 AARP study http://assets.aarp.org/rgcenter/econ/401k_fees.pdf of 401(k) plan participants that revealed 83% admitted "they do not know how much they pay" in fees and expanses; 65% reported they pay no fees. The 2008 RAND study http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf is widely cited for revealing that investors are unaware of the basic legal differences between the requirements of advisers and brokers. The RAND study also revealed that 25% of respondents who reported using an advisor or broker also reported they pay $0 for these services. Also, 2009 Envestnet http://www.thefiduciaryopportunity.com/ study found that only 15% of investors said they can "very well" assess how their "advisor gets paid." These data are conventional wisdom; they are not in dispute. Seventeen years ago in a report commissioned by then-SEC Chairman Arthur Levitt produced by industry leaders led by Merrill Lynch Chairman & CEO Daniel B. Tully, the implications of this asymmetry were affirmed: Registered reps and their customers are "Separated by a wide gap of knowledge .. this knowledge gap represents a potential source of client abuse."
In the 1995 *Report of the Committee on Compensation Practices* (aka The Tully Report, for its Chairman, Daniel B. Tully), the report points out in clear terms the level and importance of investors' lack of knowledge of investment products and confusion derived from misunderstanding what's written in prospectuses. The report states that registered representatives and their clients are:
"Separated by a wide gap of knowledge – knowledge of the technical and financial aspects of investing. The pace of product innovation in the securities industry has only widened this gap. It is a rare client who truly understand the risks and market behaviors of his or her investments, and the language of prospectuses intended to communicate those understandings is impenetrable to many. It also makes communication between a registered representative and investor difficult and puts too much responsibility for decision-making on the shoulders of RRs – a responsibility that belongs with the investor."

Yale Management Professor Daylian Cain, a leading researcher in the field, offers a sobering view of the academic research regarding how disclosed information is used when conflicts are present. Cain concludes that conflicts are far more corrosive to independent advice, and disclosure far more ineffective, than is generally acknowledged. "Conflicts of interest are a cancer on objectivity. Even well-meaning advisors often cannot overcome a conflict and give objective advice. More worrisome, perhaps, investors usually do not sufficiently heed even the briefest, bluntest and clearest disclosure warnings of conflicts of interest."[5]

SIFMA's Priorities to "Guide … the Standard"

A "Framework for Rulemaking" was offered by the Securities Industry and Financial Markets Association (SIFMA) to the Commission in a July 14 letter. The proposal leads with five priorities to "Guide the development of the standard"

SIFMA stresses the foundation of its Framework For Rulemaking is putting investor's interests first. This point is repeated throughout its July 14 letter, with recitations included on pages four, six, eight, nine, 15 and 16. The key question is what does SIFMA mean by "putting investors interests first?" The answer becomes clear as SIFMA discusses how investors should continue to have access to and choice among a wide range of products and services; the standard should be "business model neutral;" "Preservation of investor choice is at the forefront of the SIFMA position."[6]

SIFMA's concerns with (1) preserving the ability of its members to continue selling the full line of products and services that broker-dealers have historically sold to the public, (2) ensuring business model neutrality (*i.e.*, a concept that is actually never detailed at all in the SIFMA Letter but appears to mean that the rules promulgated by the SEC under Section 913 of the Dodd-Frank Act should not have an adverse business impact on broker-dealers relative to the impact on investment advisers) and (3) having rules that are tailored to broker-dealers' business practices underscore SIFMA's real concerns. The SIFMA Letter is mostly devoted to the need for the SEC to preserve broker-dealers' existing business practices and to accommodate their products, services, and compensation methods. It is interesting to note how much of the SIFMA Letter seeks to ensure that the fiduciary standards adopted by the SEC will fit broker-dealers' existing business practices and business models. Thus, the statement by SIFMA's General Counsel, Ira Hammerman, at the Institute's Fiduciary Forum 2011 that "[p]reservation of investor choice is at the forefront of the SIFMA position."

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[5] Professor Cain's remarks, and those of Rutgers law professor Arthur Laby, SIFMA General Counsel Ira Hammerman, and Financial Services Institute General Counsel, David Bellaire can be seem on the website of the Institute for the Fiduciary Standard at http://www.thefiduciaryinstitute.org/fiduciary-forum-2011

[6] See Hammerman. http://www.thefiduciaryinstitute.org/fiduciary-forum-2011/

SIFMA's Best Interest Standard:
Five Key Assumptions

SIFMA's priorities address the question of what SIFMA means by investor's "best interest." Here are five assumptions that seem to underpin SIFMA's "best interest" definition.

1. ***Investment recommendation standard.*** *"The standard of conduct should allow broker-dealers to continue to offer products and services that are available today…" (p. 8,9)*

Institute Comment. SIFMA believes that products offered as suitable recommendations today should presumptively meet SIFMA's Uniform Standard. Prioritizing "business model neutrality" and "choice" will permit broker-dealers to continue to recommend, under SIFMA's uniform standard, all the products currently recommended by broker-dealers today under the suitability standard of FINRA Rule 2111.There is no indication or suggestion that products recommended under the current suitability standard today may not be permitted under SIFMA's uniform standard.

Such a possibility is not even considered. Instead, SIFMA assumes, without any basis, argument or support, that broker-dealers can continue to recommend the same products and strategies under the uniform standard as they do today under a suitability standard. So the effect, then, from SIFMA's perspective, is that the change to a uniform standard which puts investors' interests first results in absolutely no changes in the products or services that may be recommended to customers. Nothing would change from moving to a uniform standard of care, according to SIFMA; it would be a change in standard without any corresponding change in the advice and recommendations that may be provided.

The Dodd-Frank Act provides that the sale of proprietary or other limited range of products, "shall not, in and of itself, be considered a violation of such standard." The language merely means that proprietary or a limited-range of products, as a class, do not per-se breach the fiduciary standard. This language does not, however, support the notion that moving to a fiduciary standard should have no impact whatsoever on the sale of proprietary products, on the sale of a limited range of products, or the sale of *any* product that involves a conflict of interest (whether that conflict arise because of the compensation to be earned on the sale, because the issuer or other service provider to the product is affiliated with the broker-dealer or because of any other reason), a notion that SIFMA implicitly supports in the SIFMA Letter. SIFMA's views are not supportable and would make a mockery of the fiduciary standard. As with any investment advice, whether the recommendation of proprietary products or a limited range of products depends on the facts and circumstances. The fact that a recommended product or investment strategy involves a conflict of interest because, for instance, it is a propriety product certainly is a relevant fact that should be taken into consideration.

In summary, SIFMA's position in the SIFMA Letter appears to reflect a position that suitable product recommendations suffice, and that a fiduciary "due care" screening and investment selection process to meet the "best interest" standard is not required.

This blanket product approval also appears to suggest that a fiduciary "due care" screening and investment selection to meet the "best interest" standard is not required. Ironically, while SIFMA

appears to advocate against applying a more stringent "due care" standard to brokers, FINRA CEO, Rick Ketchum, has expressed concerns about the suitability standard that would appear to lead to the opposite conclusion. "In recent years, business practices have evolved to a point where for some firms products and services were being offered not on the basis of whether they were in the best interest of the customer, but whether they met a minimum standard of acceptability." Ketchum continues and then concludes:

"The larger point is that there needs to be a shift in the way some firms approach their development of new products and the way they market these products to the public. Your integrity and commitment to good business practices should be the first line of defense in investor protection, and I urge you to view your responsibilities in a true fiduciary spirit."[7]

2. ***Conflicts of interest.*** *"If such guidance (avoiding conflicts rather than appropriately managing them) were applied to broker-dealers under the uniform fiduciary standard … it would create legal and compliance uncertainty (described in greater detail below) that would in the worst case prevent, and in the best case disincentivise, broker-dealers from offering many of the beneficial products and services that they currently provide and that retail customers have come to value and rely on." (p. 13)*

   Over the years the SEC staff has issued guidance regarding (Section 206)… These statements speak far more in terms of entirely avoiding conflicts, rather than appropriately managing them. Accordingly, these statements could be interpreted and applied in a manner more prescriptive than the "eliminate or disclose conflicts" approach recommended in the Study." (p. 12)

Institute Comment. SIFMA's views regarding why conflicted brokers' product recommendations can benefit investors, and why SIFMA prefers that brokers disclose conflicts as opposed to avoiding conflicts are clear. At its core, SIFMA, it appears, unabashedly champions the benefits of conflicted advice.

SIFMA's stance on conflicts is hard to reconcile with investors' best interests. Its statements on conflicts in the SIFMA Letter are written from the perspective of the broker-dealer and focus only on the impact of conflicts on broker-dealers' business practices and operations. There is no discussion of how broker-dealers can and should operate under a fiduciary standard to act in the best interests of clients. SIFMA's *absolute and unconditional* support of broker-dealers' ability to continue to have conflicts with customers' interests makes it hard not to conclude that SIFMA's (1) position is based more on the economic and business concerns associated with a fiduciary standard than on customers' best interests and (2) argument that customers interests would be harmed if broker-dealers decided not to provide certain products or services that involve conflicts of interest is based on the economic and business repercussions of imposing a true fiduciary standard on broker-dealers.

The extent to which SIFMA's support of conflicted recommendations sharply departs from established SEC views is apparent. While there is no question that advisors are permitted to choose to either eliminate or to disclose conflicts, there is also no ambiguity which option the SEC strongly urges advisors follow. The SEC urges that advisors avoid conflicts. The SEC or its

1. [7] SIFMA Annual Meeting, October 27, 2009.

senior staff repeatedly advocate avoidance; I. e.: Advisors "As a fiduciary, you also must seek to avoid conflicts of interest with your clients, and, at a minimum, make full disclosure of all material conflicts…"[8]; or "You should not engage in any activity in conflict with the interest of any conflict… You must eliminate or at least disclose all conflicts of interest…"[9]

A veteran SEC staff member (whose view does not necessarily reflect the SEC' views) expresses this view even more succinctly: "An adviser must act solely for the benefit of its client and must not place itself in a position of conflict with its client. *An exception is made*, (emphasis added) however, when the adviser makes full disclosure to its client and obtains the client's informed consent."[10]

These views appear to reflect the general view of conflicts in the landmark Supreme Court Capital Gains decision that recognized a fiduciary duty in the Investment Advisers Act. The opinion noted, "... 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."[11]

SIFMA's support for conflicted recommendations sharply departs from established regulatory and legal views. While the SEC seems to seek to have conflicts be "an exception," it appears that SIFMA seeks to have conflicts be the rule. While the SEC seems to seek to nurture a culture that instinctively views conflicts negatively, and encourages avoiding conflicts, SIFMA seems to seek a benign acceptance of conflicts.

3. ***Disclosure. "****Where products and services involve material conflicts of interest broker-dealers and investment advisers should be able to provide disclosures to customers in a pragmatic way to clearly and effectively communicate, and receive the customers consent to, these conflicts of interest. Similarly, the SEC should provide guidance to clarify whether a customer's affirmative consent is required or not, and if so, at what point it should be made." (p. 9)*

   "In general the consent regime should focus particular attention on ensuring that it can be practically implemented and readily integrated into the current broker-dealer operational model." (p.22)

   "Guidance should be given that would allow customers with accounts established prior to the effective date …. to consent to disclosure of conflicts by continuing to accept or use account services after receiving written disclosures." (p.23)

<u>Institute Comment.</u> SIFMA believes disclosure is the answer to conflicts and appears to view the disclosure duty very narrowly. SIFMA explains a firms' disclosure regime should be pragmatic and efficient for the firm. "Pragmatic" means that the act of delivering a disclosure generally

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[8] Form ADV, Part 2, General Instructions, page 1.
[9] *Information for Newly-Registered Investment Advisers*, "Investment Advisers Are Fiduciaries"
[10] *The Regulation of Investment Advisers*, Robert E. Plaze, Updated to November 22, 2006.
[11] Securities and Exchange Comm v. Capital Gains Research Bureau , 375 U.S. 180 (1963)

fulfills the duty, that disclosing the conflicts is managing the conflict. "Pragmatic" means that the "consent regime" should be designed to easily fit BD operations. This means for existing clients that clients are deemed to have "consented" to a conflict – not by receiving a disclosure and providing informed, intelligent and independent consent – but by receiving a disclosure and continuing "to use" the service or product.

The SIFMA Letter focuses on disclosure process and the importance of broker-dealer efficiency. The SIFMA Letter emphasizes the importance of obtaining guidance "for broker-dealers on how to manage, disclose, or obtain consents to these conflicts" and mechanisms best suited (for the broker-dealer) for disclosure delivery (*e.g.,* web disclosure) and a "consent regime" that can be "pragmatically implemented." For instance, the SIFMA Letter states that:

> Where products and services involve material conflicts of interest, broker-dealers and investment advisers should be able to provide disclosures to customers in a pragmatic way to clearly and effectively communicate, and receive the customer's consent to, these conflicts of interest. Similarly, the SEC should provide guidance to clarify whether a customer's affirmative consent is required …[12]

SIFMA does not offer any suggestions as to when a conflict is so serious that a consent should be required and assumes that every conflict can be managed through disclosure. There is no discussion of the possibility that a conflict of interest is so great that disclosure is insufficient to cure the conflict.

SIFMA describes the disclosure and consent process in a manner that seemingly presumes investor consent. It notes firms must be permitted to disclose in "a pragmatic way to clearly and effectively communicate, and receive the customer's consent to, these conflicts of interest." We find it interesting that the SIFMA Letter addresses the impact of an important aspect of the fiduciary regulatory framework from the perspective of the impact on broker-dealers.

In this respect, certain of SIFMA's suggestions seem to ensure that disclosure would not be effective. For instance, SIFMA writes at the bottom of page 20 of the SIFMA Letter that firms "could provide printed materials applicable to all retail customers at the time of account opening, with more detailed disclosures that are relevant to particular transactions available on the internet." On page 22 of the SIFMA Letter, SIFMA writes that "[t]he regime should be sufficiently flexible to allow for verbal disclosures with further details made available via confirmation or online information." SIFMA also writes on this page [w]hen it is required, the rules should facilitate obtaining customer consent, including, in appropriate circumstances, through global consents granted at account opening. In general, the consent regime should focus particular attention on ensuring that it can be practically implemented and readily integrated into

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[12] Page 7 of the SIFMA Letter likewise lists as a key component of SIFMA's Framework the provision of "clear guidance regarding disclosure that would satisfy the uniform fiduciary standard of care." Page 18 of the SIFMA Letter states that "The SEC should provide the necessary rule-based guidance regarding when the fiduciary duty begins and ends and what disclosures and consents, if any, are necessary to satisfy the duty …." Page 20 of the SIFMA Letter asks for "guidance regarding disclosure that would satisfy the uniform fiduciary standard of conduct." These statements clearly indicate that SIFMA believes that *all* conflicts can be cured simply by disclosure.

the current broker-dealer operational model." SIFMA therefore argues for: generic disclosure at account opening with more detailed disclosure relevant to particular transactions on the internet; verbal disclosure with details provided via confirmation after the transaction has been executed and global consent at account opening. Global disclosures, global consent and disclosure after the fact is not effective disclosure. For disclosure to have a chance of being effective it must be timely provided, it must clearly and precisely alert the client to the nature of the conflict and all of the implications there from and give the client an ability to act on the information provided. SIFMA's suggestions for global disclosures, global consent and disclosure after the fact does not meet these standards and will ensure that disclosure will be ineffective.

Finally, we note that it is necessary, but not sufficient, under a fiduciary standard for a customer to provide informed consent to a conflict of interest. Even where informed consent of a customer is obtained, such consent does not obviate the need for the fiduciary to also determine that the proposed transaction is in the best interests of the customer. Thus, even where customer consent is provided, a transaction may not be engaged in, under a fiduciary standard, if the proposed transaction is not in the customer's best interests. We urge the SEC to clarify that customer consent may not operate to override the need for the transaction to be in investors' best interests. Customer consent can obviate the need for the transaction to be in the customer's best interest.

SIFMA's emphasis on disclosure "process" and disclosure "efficiency," contrasts sharply with the SEC which stresses disclosure *effectiveness with the investor*. In its landmark case, "In the Matter of Arleen Hughes," the SEC makes clear the "registrant" has the fiduciary obligation to ensure the client understand the nature of the conflict and provides informed consent. The SEC further stated that the SEC itself could not provide any "hard and fast rule" for disclosure as the nature of the disclosure depended on the particular client.[13]

4. ***Scope of obligations; defining "personalized investment advice."*** *"A broker-dealer's obligation … should be specified in the customer agreement…. (and) apply on an account by account basis… (p.17) personalized investment advice should include … communications to a specific customer recommending that the customer …. Communications about securities to one or more targeted customers encouraging the particular customers … (or) technology that …. sends specific investment suggestions that the customer… purchase or sell a (one or more) security… (or) discretionary decisions regarding securities bought, sold … (p. 18, 19)"*

<u>Institute Comment</u>. SIFMA believes the standard should generally only apply as specified by contract for certain topics on an account by account basis. Further, personalized investment advice should be explicitly limited to communications or discretionary decisions, or technology that makes recommendations, regarding the sale or purchase of securities, and allowing brokers to apply the uniform standard on an account by account basis is consistent with current BD contractual processes and record keeping requirements.

SIFMA's strict limitations contrasts sharply with the robust application of duties embedded in the Investment Advisers Act. Today, fiduciary status implies a relationship of trust and

[13] Release No. 4048/February 18, 1948, In the Matter of: Arleen W. Hughes.

confidence where the clients can rely on the SEC registered investment adviser to be loyal, to render due care and to act with utmost good faith essentially *at all times.*

That would not be the case under SIFMA's proposed uniform standard. SIFMA envisions a fundamentally different adviser – client relationship, where the standard of care may switch back and forth between the uniform fiduciary standard and the fair dealing standard in conversation with clients with a turn of a phrase or the mention of selected key words. SIFMA's proposal raises a host of questions. For instance, must a registered representative of a broker-dealer who wishes to switch from one standard to the other during a conversation disclose to the client in writing *as the switch is being made* of the switch, the implication of the switch and why the switch is material to the client?

We note that SIFMA believes that a broker-dealer's obligations to retail customers *"may be crafted to reflect the specific agreement and objectives of the parties*. For example, the customer agreement might specify that the broker-dealer's obligations do not extend beyond the particular sale, or might address the broker-dealer's obligations in the case of 'hybrid' accounts; or the obligations may appropriately be limited to assets over which the broker-dealer has been given discretionary authority specific recommendations about securities that are available through the broker-dealer, *or such other limitations and disclosures to which the customer agrees*" (emphasis added). The SIFMA Letter indicates that broker-dealers' fiduciary obligations can be "crafted to reflect the specific agreement and objectives of the parties" and that "the obligations may appropriately be limited to … such other limitations and disclosures to which the customer agrees."

We strongly disagree. The fiduciary duty may not be negotiated and contracted away or otherwise limited by contract. In this respect, SIFMA believes it is perfectly fine to subject the fiduciary duty to the contractual agreement of the parties; in SIFMA's view, customers should be free to negotiate and contract the contours of their broker-dealers' fiduciary duty and broker-dealers should be able to impose *any* limitations on their fiduciary obligations that are agreed to by customers. The SEC should remember the premise for imposing the fiduciary duty on broker-dealers in the first place: the information asymmetry and bargaining position of the parties. SIFMA seeks to impose a uniform standard of care solely on the most vulnerable part of the investment community: the retail investor. Such investors do not have any ability to negotiate the terms of their agreements with broker-dealers. Virtually every broker-dealer contract with retail investors is a "take it or leave it proposition" – there is no ability for retail investors to negotiate their contracts even if they had the knowledge and information necessary to do so. And in the vast majority of cases, of course, retail investors do not have the knowledge and information needed to negotiate with broker-dealers. To think that retail investors can adequately protect their interests in negotiating with broker-dealers is to ignore decades of experience in the brokerage industry.

If broker-dealers were able to craft and limit their fiduciary obligations via contract with investors, then the result would be that retail investors are not protected by a fiduciary standard. If SIFMA's suggestions were followed, then broker-dealers would effectively eliminate any fiduciary protections via their customer agreements just as they currently limit their customers' ability to bring suit in courts. SIFMA knows this. It knows retail brokerage customers are not subject to negotiation. It knows that the ability to contract away fiduciary protection is tantamount to a lack of protection. For it to suggest that broker-dealers should be able to eliminate fiduciary protections in their customer agreement demonstrates SIFMA's real

intentions: it wants the illusion of a fiduciary duty but does not want one implemented in practice. Allowing firms to contract away their fiduciary obligations will guarantee that investors have the appearance of substantive protection but nothing more.

Finally it should be noted that SIFMA's described limitations and exclusions are fundamentally different from the notion in the Dodd Frank Act that the scope of the fiduciary duty need not include ongoing monitoring of an investment after advice is furnished.

5. ***Investment expenses – do they need to be controlled****?*

While SIFMA explicitly states that all types of current brokerage sales or compensation arrangements should be permitted, it is silent on whether there should be any limitations on the amount of investment expenses and advisory fees charged an investor. The SEC has spoken of the need to determine that advisory fees are "reasonable in relation to the services provided."[14]

Implications of SIFMA's Best Interest Standard

SIFMA's view of the investor's best interests can be summarized as follows: The uniform standard is strictly limited to discretionary decisions or communications regarding personalized investment advice to retail clients involving the sale or purchase of securities. The standard is applied on the basis of contractual specifications and designated accounts, not on the basis of a trusted relationship. Minimally acceptable product recommendations permitted by the suitability standard today are permitted by the SIFMA uniform standard of conduct. Conflicts are not to be discouraged and need not be avoided. Sometimes they can be beneficial to investors. They must be disclosed and sometimes consented to. Disclosure may be made in a "pragmatic" way that is efficient for the firm; yet disclosure need not be effective and understood by the investor. There are no expressed views whether there are any constraints on the amount of permissible investment expenses.

Conclusions

<u>SIFMA's standard of conduct priorities are contrary to established fiduciary principles and SIFMA requirements depart in fundamental ways from the fiduciary standard requirements under the Advisers Act of 1940. On its face, SIFMA seems to suggest that the best interests of investors and its members are generally aligned.</u>

Fiduciary principles – principles reflected in the thinking of our Founding Fathers – are based in the duties of loyalty, due care and utmost good faith. Fiduciary law has *existed* for centuries to significantly restrain the conduct of experts who render advice in order to infuse beneficiaries and clients with trust and confidence in the investment professional.

In contrast, SIFMA's proposed uniform standard priorities serve to either eliminate or to minimize restraints and limitations that are imposed on broker-dealers. This approach is evident throughout SIFMA's discussion, from its implicit acceptance of the current suitability standard to its acceptance of all conflicts of interest regardless of their nature and scope and from its

[14] See Shareholder Services Corporation, Feb. 3, 1989

emphasis on the ability of disclosure to manage all conflicts of interest and to its statement that the fiduciary obligations can be dictated by contract.

SIFMA seeks to turn centuries of fiduciary law on its head. The contours and requirements of the standard SIFMA substantially contradict the duties required under the Advisers Act. Instead, SIFMA essentially argues that investors' "best interests" are aligned with or the same as the interests of its Wall Street members, such as when both Wall Street and Main Street benefit, for example, when brokers-dealers sell products involving material conflicts.

SIFMA's uniform standard principles of disclosure puts fiduciary law on it head when it leaves retail investors, investors who are often the least sophisticated and knowledgeable investors, with protected with far less stringent fiduciary duties. This contradicts established fiduciary precepts that suggest the wider knowledge gaps mean greater investor risk which require more stringent fiduciary duties.

Disclosure is often the last line of investor protection against conflicts. The rigorous Advisers Act disclosure requirements which generally apply to all clients (and not just retail clients), as noted above, hold the investment adviser accountable for ensuring the disclosure is effective– that the client understand the ramifications of a conflict. In sharp contrast, SIFMA's disclosure regime for retail investors is explicitly narrower in its scope and purpose, based on what is pragmatic and efficient for the firm. This means that an explicit consent should not be required when doing so is inefficient or not practical. SIFMA only requires that a disclosure be delivered to the investor and only sometimes requires a consent.

SIFMA's standard should not be branded an "investor best interest" standard;
it should be branded how SIFMA describes it: a "broker sales" standard

In providing guidance in interpreting the "best interest" standard, it is not unimportant to note how the investor may interpret "best interest." The meaning of *best* is pertinent. Dictionary.com suggests: "Of the highest quality, excellence or standing." Webster's dictionary: "*superlative of* good **:** excelling all others. American Heritage offers, "Surpassing all others in excellence, achievement, or quality; most excellent: the best performer."[15]

SIFMA's priorities summarized in the five assumptions, implicit in its own description, do not, constitute a standard that is a "best interest" standard. SIFMA's suggestion that all current products deemed to meet the current sales brokerage standard be deemed to meet the "best interest" standard is just one plain example that there is no pretense about being a "best interest" standard. In fact, a fair reading of the five assumptions discussed above suggest that SIFMA's primary goal is to ensure that broker-dealers' business practices can continue unabated and without any material change. In short, SIFMA seeks to change very little in broker-dealers' practices and at the same time to rebrand its practices as being fiduciary in nature. One cannot fairly read the goals underlying the Framework in the SIFMA Letter and conclude that SIFMA

[15] The importance of the "best interest: label is noted by the Staff Study. It is "important" to retail investors that "advice be given in their best interest, without regard to the financial or other interest of the financial professional," for a plain (and perhaps, obvious) reason: that "retail investors can be made more confident in the integrity of the advice they receive." [page 101]

has investors' best interests at heart. Instead, the SIFMA Letter reveals that SIFMA's goal is to ensure that the uniform standard of care is in the best interests of the brokerage industry. Thus, to brand this uniform standard as such could be construed as misleading and also contribute to greater investor distrust of the markets and market participants. As such, it should be branded the "Broker Sales" Standard.

In May 2009 Chairman Schapiro spoke at the Investment Company Institute and made a vital point about what is required to restore investor trust. This same point should be applied to why the SIFMA Uniform Standard should not be branded be a fiduciary standard.

Any new regulatory system must promote and preserve public trust in our financial markets. Markets do not work well unless investors believe they do. And investors will not believe that markets work well unless they do, in fact. That means, above all, that investors must know that the information upon which they base their investment decisions is the truth, the whole truth, and nothing but the truth…. Without that essential confidence that they have truthful and complete information upon which to base their decisions, investors will avoid our financial markets for ones that are more transparent, or they will demand risk premiums for their continued participation

<u>SIFMA's uniform standard does not meet the fiduciary standard under the Advisers Act of 1940; and does not comport with the requirements of Dodd Frank</u>

The clearly expressed priorities central to SIFMA's vision are set out in its July 14 Framework letter and at the Fiduciary Forum 2011, and they are characterized in these five assumptions.

Product recommendations that meet the suitability standard today will meet SIFMA's standard.
Conflicts need not be avoided; they need to be disclosed and can often be beneficial.
Disclosure delivery must be efficient for the firm; it need not be effective for the investor.
SIFMA's uniform standard applies only in narrowly defined circumstances – and may be further limited by contract.
There is no mention whether investment expenses and advisory fees need be controlled.

These findings would appear to suggest SIFMA's uniform standard is at odds with the Advisers Act and at least two requirements of Dodd Frank. Dodd Frank requires the uniform standard be established "*without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice,"* (and) *… such standard of conduct shall be no less stringent than the standard applicable to investment advisers under section 206(1) and (2) of this Act…*

Closing Comment

At a recent conference,[16] flanked by three former SEC chairmen on the panel, Tim Ryan, head of Securities Industry Financial Markets Association (SIFMA) CEO, delivered a candid account of how SIFMA changed its position from opposing the need for a fiduciary standard for brokers – as permitted by Dodd Frank – to expressing support for a new uniform standard that it claims is "investor protections focused."

[16] The John C. Bogle Legacy Forum, http://www.thefiduciaryinstitute.org/. The three former SEC Chairman were: Arthur Levitt Jr., Harvey Pitt and David Ruder.

Ryan shared a "behind closed doors" account of SIFMA's deliberations on the fiduciary issue. He said, it was "a long discussion ... (over) about a three-year period. It was not an easy discussion." The crux of the question was whether SIFMA, whose mission is to "brings together the shared interests of securities firms, banks and asset managers" should support the fiduciary standard. According to Ryan, the discussion concluded when the group finally "embraced ... a reality:" The reality, it seems, was that retail investors expect their broker or advisor to put the investor's interest first, and as such, SIFMA could not plausibly continue to oppose the fiduciary standard. Ryan then noted that SIFMA's key concerns were "to retain investor choice" and ensure the fiduciary standard applied to brokers was "business model neutral,"

SIFMA's comments on the fiduciary standard have been punctuated with blunt candor and exuberance. Disclosing its difficult internal discussions about the fiduciary standard is candor that is to be applauded. Similarly, in a October 7, 2009 webinar, SIFMA staffer Kevin Carroll acknowledged that SIFMA's rebranded its uniform standard a federal fiduciary standard because it made people feel more comfortable. SIFMA's arguments also display a certain exuberance. SIFMA's testimony before Congress in October 2009 included the assertion that SIFMA's fiduciary standard is "Stronger and more pro-investor than any other alternative than we have heard advanced."

Today, SIFMA's exuberance is evident in its pledge that the principle that underpins this uniform standard is "to act in the best interest of the customer," all the while unambiguously describing its uniform standard of conduct as the same standard of conduct broker-dealers meet today. Seventeen years ago, the SEC's Tully Report, headed by Merrill Lynch Chairman, Daniel Tully, stated that brokers and retail investors are: *"Separated by a wide gap of knowledge – knowledge of the technical and financial aspects of investing... This knowledge gap represents a potential source of client abuse, since uninformed investors have no basis for evaluating the merits of the advice they are given."* The record suggests that (at minimum) the same knowledge gap and potential (and evidence of) for abuse exists today as did in 1995 when Dan Tully penned these candid words.

We urge the SEC to use this historic rulemaking opportunity to heed the warning of Chairman Tully and develop a uniform standard, which ensures equal protection under the law and is "no less stringent than the standard applicable to investment advisers."

Respectfully,

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