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Invested in America

May 4, 2012

***Via E-Mail***

Mary L. Schapiro, Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: **SIFMA**[1] **supplemental response** - Framework for Rulemaking under Section 913 (Fiduciary Duty) of the Dodd-Frank Act; File No. 4-604

Dear Chairman Schapiro:

This letter provides SIFMA's responses to several points raised in a recent letter from the Consumer Federation of America (**"CFA"**), among others,[2] that discusses SIFMA's July 2011 framework for rulemaking under Section 913.[3] We describe key similarities in our views and those expressed in the CFA Letter and key differences between those views. We hope that highlighting these points will assist the Securities and Exchange Commission ("**SEC**") in developing an approach to Section 913 of the Dodd-Frank Act that best protects investors and preserves investor choice.

*Key Similarities in the CFA Letter's Approach*

SIFMA agrees with the CFA Letter that the general fiduciary duty implied under Section 206 of the Investment Advisers Act of 1940 ("**Advisers Act**") should be newly articulated through parallel fiduciary rulemaking under Section 15 of the Securities Exchange Act of

[1] The Securities Industry and Financial Markets Association (**"SIFMA"**) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

[2] Letter dated March 28, 2012 from CFA, Fund Democracy, AARP, Certified Financial Planner Board of Standards, Inc., Financial Planning Association, Investment Adviser Association, and National Association of Personal Financial Advisors, to Chairman Schapiro, re: Framework for Rulemaking under Section 913 (Fiduciary Duty) of the Dodd-Frank Act (the **"CFA Letter"**), available at http://www.sec.gov/comments/4-606/4606-2973.pdf.

[3] Letter dated July 14, 2011 from SIFMA to Chairman Schapiro re: same (the "**SIFMA Framework Letter"**), available at http://www.sec.gov/comments/4-606/4606-2952.pdf.

1934 ("**Exchange Act**"), and Section 211 of the Advisers Act.[4] The uniform fiduciary standard of conduct would apply equally to broker-dealers (through Exchange Act Section 15(k)) and investment advisers (through Advisers Act Section 211(g)) when providing personalized investment advice about securities to retail customers. The SEC should also issue rules and guidance to provide the detail, structure and guidance necessary to enable broker-dealers to apply the standard to their distinct operational model.[5]

SIFMA appreciates the CFA Letter's support of our position that adequate disclosure guidance should be in place on or before the date any new Section 913 standard of conduct becomes operative.[6] As discussed by the SIFMA Framework Letter and reiterated by the CFA Letter, broker-dealers cannot reasonably be expected to comply with, or manage liability and litigation risks associated with, the uniform fiduciary standard absent clear guidance from the SEC. This concern is particularly pressing for broker-dealers, who may face conflicts of interest that have not previously been considered or addressed in the context of a fiduciary standard of conduct. The potential for uncertainty resulting from a lack of clear guidance is perhaps the greatest concern for broker-dealers in considering how they would comply with a uniform fiduciary standard.

The CFA Letter helpfully recognizes that the application of the Advisers Act principal transaction restrictions to broker-dealers would raise serious concerns for broker-dealers.[7] As described in the SIFMA Framework Letter, we urge the SEC to affirmatively preserve broker-dealers' ability to engage in principal transactions under a uniform fiduciary standard of conduct.[8]

*Key Differences in the CFA Letter's Approach*

Notwithstanding our agreement with many of the key points made by the CFA Letter, we do not agree that broker-dealers should be subject to the existing rules, guidance, and legal

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[4] SIFMA Framework Letter at pp. 5-6; CFA Letter at p. 2.

[5] Such rules and guidance should address the full range of common scenarios that broker-dealers face in their daily operations serving clients including, for example, some of the more prevalent scenarios identified in Appendix A to this letter.

[6] SIFMA Framework Letter at p. 20; CFA Letter at p. 14.

[7] SIFMA Framework Letter at p. 23; CFA Letter at p. 6.

[8] SIFMA Framework Letter at p. 23. In addition, we note that Rule 206(3)-3T (temporary rule regarding principal trading with certain advisory clients) is set to expire on December 31, 2012. *See* http://www.sec.gov/rules/final/2010/ia-3128.pdf. We also urge the SEC to now consider the further extension of the temporary rule in order to provide the time necessary for the SEC to figure out how to best incorporate principal trading relief into the uniform fiduciary standard of conduct.

precedent under Section 206 of the Advisers Act.[9] The SEC should articulate a new, rule-based uniform fiduciary standard that would apply equally to broker-dealers and investment advisers when they provide personalized investment advice about securities to retail investors. We believe that this approach would serve retail investors better than the application of rules and guidance developed under Section 206(1) and (2) of the Advisers Act, which were not drafted for, or designed to apply to, brokerage or dealing activities.[10]

The difference between a newly articulated standard and the direct application of the Advisers Act standard is not merely technical or semantic. Rather, it has important implications that derive from differences in how Section 206 of the Advisers Act and existing standards of care for broker-dealers under the Exchange Act and FINRA rules are enforced. As you know, an investment adviser's customer does not now have the right to sue his adviser for breach of Advisers Act Section 206, as no private right of action has been recognized under that provision. In contrast, a broker-dealer's customer has private rights of action under the Exchange Act and FINRA rules for violations of the broker-dealer's standard of care. Consequently, merely importing the existing Advisers Act standard and applying it to broker-dealers would not harmonize the standard for broker-dealers and investment advisers. Instead, doing so would cause a mismatch between how investment advisers and broker-dealers are governed by the standard, inconsistent with the purposes of Section 913.

SIFMA firmly believes that, to meet the fundamental purpose of Section 913, a uniform fiduciary standard ought to apply equally to broker-dealers and investment advisers and ought to be enforceable on the same terms. To achieve this result, SIFMA urges the SEC to implement a new, rule-based standard – derived directly from, and no less stringent than, the Section 206 standard – but nevertheless, separately and distinctly articulated under Section 15 of the Exchange Act and Section 211 of the Advisers Act.

With respect to disclosure guidance, we also disagree with the CFA Letter that such guidance could appropriately be provided by SEC staff through interpretive guidance, letters to industry, and FAQs.[11] We agree that SEC staff guidance plays an important role in addressing issues that may arise or become clear after a new rule has become effective. But we believe that the SEC itself should consider and articulate disclosure guidance as part of the formal rulemaking process to facilitate the setting of clear standards before any

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[9] SIFMA Framework Letter at p. 11; CFA Letter at p. 3.

[10] *See* Letter from Congressman Barney Frank to Chairman Mary Schapiro (May 31, 2011) (Dodd-Frank Section 913 "was not intended to encourage the SEC to impose the … Advisers Act… standard on broker-dealers…").

[11] CFA Letter at p. 9.

rules become effective and to avoid unnecessary uncertainty or delay in such guidance becoming available.

Finally, SIFMA disagrees with the CFA Letter that a recommendation regarding the type of account the customer should enter into – such as a fee-based versus a commission-based account – should be subject to the new uniform fiduciary standard.[12] Imposing such a requirement is in inconsistent with the plain language of Dodd-Frank Act Section 913, which covers investment advice about securities, and not advice about account types. Moreover, such a requirement goes beyond the obligations applicable to investment advisers under Section 206 when negotiating advisory arrangements with prospective clients. We believe such an obligation is inappropriate for broker-dealers and investment advisers and is outside the scope of Section 913.

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This letter highlights our "big picture" assessment of the key areas in which we agree with the CFA Letter and those where the CFA Letter advocates a different approach that could be detrimental to retail investors and financial services firms. Although beyond the scope of this letter, the CFA Letter raises a number of additional, more detailed concerns for the broker-dealer community that we would also like to see addressed through the rulemaking process. We are happy to discuss these more detailed concerns at your convenience.

We continue to believe that SIFMA's proposed framework is the optimal approach for a uniform fiduciary standard that ensures that investors are well-protected, yet still able to access the financial products and services they desire to achieve their investing goals. Thus, we urge the SEC to newly articulate a uniform fiduciary standard through rulemaking; to provide adequate up-front disclosure guidance; to avoid subjecting broker-dealers to Section 206 legal precedent; and to implement the standard in a manner that is equally applicable to broker-dealers and investment advisers, and equally enforceable by securities regulators and retail customers.

Please contact the undersigned if you would like to further discuss these issues or if we can otherwise assist as you consider this important topic.

[12] CFA Letter at pp. 9-10.

Sincerely yours,

Ira D. Hammerman
Senior Managing Director
and General Counsel

cc: Luis A. Aguilar, Commissioner
Daniel M. Gallagher, Commissioner
Troy A. Paredes, Commissioner
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# APPENDIX A:

- **Scenario 1: Unsolicited Transactions – Brokerage Account**

    - **Transaction:** Lucy directs her FA to purchase 100 shares of Apple (AAPL) in her transactional account. The FA believes that AAPL is overpriced and does not recommend this transaction. FA purchases AAPL at Lucy's request and marks the transaction *"unsolicited."* Client receives a confirmation of the transaction.

    - **Open Issues:**
        - Standard of conduct obligations for unsolicited transactions in transactional accounts and self-directed accounts
        - Guidance regarding what constitutes appropriate documentation to prove "no advice" transactions or instances where client refuses/contradicts FA advice.
        - Guidance required to address FA obligations when client refuses/contradicts FA advice.

- **Scenario 2: Solicited Transactions – Brokerage Account**

    - **Transaction:** FA calls Jon and recommends purchasing 500 shares of General Electric (GE) in Jon's brokerage account. Jon agrees and the purchase is marked "solicited." Jon receives a confirmation.

    - **Open Issues:**
        - Ensuring fiduciary at "point of sale" with no ongoing duty of care obligations after advice is given
        - Parameters of duty of care obligations
        - FA's obligations in satisfying "best interest of the client" standard
        - Monitoring requirements at "point of sale"

- **Scenario 3: Transactions – Fee based Account**

    - **Transaction:** FA recommends that Lucy open a fee based account, which offers specific asset classes or multi-asset class diversified portfolios to provide broad diversification for her portfolio. FA has a fiduciary duty to ensure that all transactions in this account are in Lucy's "best interest."

- **Open Issues:**
  - There are no significant open issues anticipated regarding the standard of conduct for accounts already subject to the fiduciary standard of conduct.

- **Scenario 4: Principal Trading**

  - **Transaction:** The Smiths are interested in purchasing certain corporate bonds. The firm has a deep inventory of corporate bonds and the FA seeks to fill the Smiths' order from the firm's inventory.

  - **Open Issues:**
    - Obligations of BDs and IAs to provide "specific facts" about transactions so that investors can understand the conflicts with principal trading (for example disclosure of compensation received for role in transactions)
    - Approval of the use of blanket disclosures in account opening agreements
    - Obligation to obtain affirmative consents from clients and timing (i.e. per transaction)
    - Clarifying BD obligations for transactions with clients when offering securities typically traded on a principal basis such as corporate bonds, new issues and other securities which are initially only offered on a principal basis

- **Scenario 5: Initial Public Offering (IPO)**

  - **Transaction:** FA seeks to purchase shares of the Facebook IPO for the Smith accounts. The firm is the underwriter.

  - **Open Issues:**
    - Disclosures of conflicts in writing/timing of disclosures
    - Consent requirements
    - Obligations to retail client when the firm acts as an underwriter.
    - Rules related to the allocation of investment opportunities where the firm owes the client a fiduciary duty

- **Scenario 6: Holistic Review of "Client Relationship"**

  - **Transaction:** As a result of several months of market volatility, Lucy and Jon ask their FA to meet with them to provide a review of the overall performance of all of the family's accounts held at the firm. The FA responds and provides the Smiths with a review of the fee-based as

well as other accounts including transactional brokerage and self-directed accounts.

- **Open Issues:**
  - Under fiduciary rules, if FA chooses to provide the "Smiths" with a holistic review of all of their accounts including brokerage and self directed accounts, the FA may potentially create a fiduciary obligation for self directed accounts or other transactional accounts that contain "no advice" transactions by "doing the right thing" for the client.

- **Scenario 7: Sale of Proprietary Products**

  - **Transaction:** FA recommends a variety of structured products to Lucy and Jon for their fee-based and brokerage accounts. There are a variety of similarly performing products available at a lower cost while the proprietary structured products have slightly higher fees. FA believes that these structured products are appropriate for the Smiths given multiple factors including performance.

  - **Open Issues:**
    - Increased disclosure regime highlighting conflicts of interest and fees
    - New monitoring and review obligations
    - Client consent
    - Determining whether "best interest" mean "best price"
    - Special obligations when selling structured products

- **Scenario 8: Allocation of Investment Opportunities**

  - **Transaction:** FA has a group of clients with similar accounts and Investment objectives who also have multiple accounts with the Firm. FA frequently shares investment ideas that he presents to some of these clients. What is FA's obligation under a fiduciary standard to present these ideas to all clients in this group?

  - **Open Issues:**
    - Monitoring and review of processes including systems to ensure fair allocation of investment opportunities across clients
    - Disclosures to client
    - Client consent