Insured Retirement Institute
1101 New York Avenue, NW | Suite 825
Washington, DC 20005

t 202-469-3000
f 202-469-3030

www.IRIonline.org

July 3, 2013

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

Re: Duties of Brokers, Dealers, and Investment Advisers
Release No. 34-69013; IA-3558; File Number 4-606

Dear Ms. Murphy:

On behalf of our members, the Insured Retirement Institute ("IRI")[1] appreciates the opportunity to provide comments in response to the Securities and Exchange Commission's (the "SEC" or the "Commission") request for information on the Duties of Brokers, Dealers, and Investment Advisers (Release No. 34-69013; IA-3558; File Number 4-606) (the "RFI"). We commend the Commission for taking such a deliberative approach as it considers whether to establish a uniform standard of conduct for investment advisers ("IAs") and broker-dealers ("B-Ds") when providing personalized investment advice about securities to retail customers. We believe the RFI demonstrates the SEC's commitment to formulating a rule proposal that, if necessary, will effectively address any actual concerns with respect to the existing legal and regulatory standards of conduct to which IAs and B-Ds are held without

[1] The Insured Retirement Institute has been called the "primary trade association for annuities" by U.S. News and World Report and is the only association that represents the entire supply chain of the insured retirement strategies industry. Our members include major insurers, asset managers, broker-dealers, banks and financial advisors. We currently have over 500 member companies and provide member benefits to more than 150,000 financial advisors and 10,000 home office financial professionals. Our official mission is to: (1) encourage industry adherence to highest ethical principles; (2) promote better understanding of the insured retirement value proposition; (3) develop and promote best practice standards to improve value delivery; and (4) advocate before public policy makers on critical issues affecting insured retirement strategies.

depriving customers of access to the kinds of financial products and services they want and need. We look forward to working with the Commission as it considers these issues.

Executive Summary

The following is an overview of our comments with respect to the standards of care applicable to IAs and B-Ds. We respectfully offer these comments to assist the SEC in determining whether and how to formulate a rule proposal enhance investor protection, preserve consumer choice in products and services, and promote consumer access to products and services.

1. Retail customers should be entitled to the same general protections when receiving comparable investment services, regardless of the regulatory status of their financial professional.

2. An extensive variety of investment services and products are currently available to help Individuals achieve their own unique financial goals. The SEC should not deprive investors of access to services and products that could meet their needs.

3. There are significant and valuable differences between IAs and B-Ds. For example:

    a. IAs have ongoing and long-term relationships with their customers. B-Ds relationships with their customers tend to be more transactional and episodic in nature.

    b. Customers sometimes choose to work with an IA because they want to give their financial professional discretionary trading authority or rely on their financial professional to manage their portfolios. B-Ds do not generally provide those kinds of services.

    c. For customers with higher account balances or who engage in high volumes of trading, fee-based accounts offered by IAs may be more cost-effective and appropriate. Commission-based brokerage accounts might work better for customers with lower account balances or who utilize a 'buy-and-hold' investment strategy.

4. Any proposal to modify the applicable standards of conduct for IAs and B-Ds must recognize and account for these significant and valuable differences, and should not adversely impact the continued viability of either business model. For example:

    a. Financial professionals should be permitted to sell only proprietary or a limited range of products, and should not be required to expand the scope of services they currently provide.

    b. The existing guidance and precedent that currently applies to each business model cannot and should not simply be layered on top of the other.

5. We believe that all potential conflicts of interest should be treated the same, and addressed with appropriate disclosure. We would therefore oppose any proposal that would prohibit non-cash compensation or sales contests.
6. We generally support the duty of care component of the Uniform Standard, under which a B-D or IA, when providing personalized investment advice to a retail customer about securities, would be subject to suitability obligations, product-specific requirements, a duty of best execution, and fair and reasonable compensation requirements.
7. We would support enhanced disclosure requirements for IAs and B-Ds to reduce or eliminate potential investor confusion about the duties owed to investors by their financial professionals.
8. Financial professionals could face undue litigation risk if the standard of conduct rules allow for judicial interpretation beyond Congress' and the SEC's intended meaning. Applying the traditional definition of "fiduciary" to B-Ds would likely result in a significant expansion of the grounds upon which claims could be brought against financial professionals. This would not result in meaningful additional protection for investors, and would dramatically increase the cost of operating a B-D, which would eventually translate into increased costs for investors. To help address this concern, any proposal to change the standard of conduct for financial professionals should be rules-based rather than principles-based, and must be properly and carefully formulated to ensure that the rules cannot be abused by courts presiding over claims of customer loss in the absence of wrongdoing by their financial professionals.
9. The SEC should focus on completing its rulemaking efforts with respect to the standards of conduct to which IAs and B-Ds are held before attempting to reconcile other disparities between the current regulatory schemes.
10. The SEC and the U.S. Department of Labor must coordinate to ensure that the rule proposals being advanced by each agency do not create conflicting obligations for financial professionals.

In the first part of this letter, we will expand on each of the key points listed above to describe the parameters of a uniform standard of conduct that we could support. The second section will provide information about the current market for personalized investment advice to help the Commission formulate a rule proposal that is precisely targeted to address actual concerns with the current regulatory structure.

Important Consumer Protection Considerations

As required by the Dodd-Frank Wall Street Reform and Investor Protection Act of 2010 (the "Dodd-Frank Act"), the SEC has undertaken a review of the current regulatory framework for IAs and B-Ds. We concur with the general concept underlying this initiative – that retail customers should be entitled to the same general protections when receiving comparable investment services, regardless of the regulatory status of their financial professional. However, it is equally important that the SEC not place unnecessary restrictions on financial professionals' ability to conduct business and address the needs of their customers. We sincerely hope the SEC recognizes and respects the distinction between harmonization and a "one-size-fits-all" approach. We also urge the Commission to take into account the broad diversity of business models, distribution channels, and consumer segments. Different financial services companies and financial professionals serve the full spectrum of American investors, at different asset levels and life stages, throughout the country, from small town, Main Street America to large metropolitan areas.

As the Commission contemplates whether, and if necessary, how to proceed with this rulemaking effort, we urge it to fully consider each of the issues specifically included in Section 913 of the Dodd-Frank Act and the potential consequences of any proposed changes to the current system. In particular, the SEC should consider the extent to which the uniform fiduciary standard outlined in the RFI (the "Uniform Standard") or any of the alternatives described in the RFI (the "Alternatives") would:

- enhance investor protection;
- preserve consumer choice in products and services; and
- promote consumer access to products and services.

As the Commission is aware, life insurers, B-Ds, and financial professionals who offer or provide advice on variable insurance products are currently subject to extensive regulation by the state insurance departments, the Financial Industry Regulatory Authority ("FINRA"), and the Commission. In proceeding with this initiative, the SEC must bear in mind the comprehensive and rigorous system that already governs the activities of financial professionals who offer variable insurance products to their clients. State insurance regulators have instituted a number of requirements that financial professionals must follow in making recommendations to clients, including disclosure and suitability requirements. During the sale of variable insurance products, financial professionals are also subject to all applicable SEC and FINRA regulations currently in effect.

We urge the Commission, prior to any rulemaking, to identify areas where it deems the rules applicable to IAs and B-Ds ineffective, duplicative, unclear and/or inconsistent, and then develop an approach to address those concerns. The regulation of IAs and B-Ds is critical to the SEC's mission of protecting investors, and any effort to reform these rules should be accomplished in a targeted and precise manner that avoids any adverse effects on investors or the industry and financial professionals who serve investors. It is crucial that the Commission consider any potential adverse impact that rule changes might have on the ability of Americans at all economic levels to obtain, and the industry to provide, a wide variety of products and services that are tailored to their needs.

Importance of Preserving Investor Choice

We view the preservation of investor choice as a critical element of any proposed changes to IA and B-D standards of conduct. The importance of investor choice is evident when considering the broad spectrum of individual financial needs and goals, and the extensive variety of investment products and strategies available to help meet those needs and goals:

- Many investors pursue 'buy and hold' strategies for at least a portion of their portfolio. This is very common and entirely appropriate for many investors. When employing this kind of strategy, investors generally do not need or want ongoing services from their financial professionals, and therefore may not be well served if they are forced to pay annual advisory-based fees instead of a commission.

- Some investment products (e.g. fixed annuities) tend to require a large amount of up-front support by a financial professional, but less ongoing support. As a result, these products have historically been sold through a commission-based structure that aligns the payment arrangement with the transactional nature of the customer relationship.

- On the other hand, some investors prefer ongoing support from their financial professionals (e.g., discretionary trading authority or portfolio management) or intend to engage in investment strategies that entail a high volume of trading. This type of customer relationship may be best served by an advisory fee-based account.

- Similarly, some customers want to give their financial professional discretionary trading authority or rely on their financial professional to manage their portfolios. IAs can provide those kinds of services, whereas B-Ds generally do not. As such, these customers may prefer to work with an IA.

Any Uniform Standard of Conduct Must be Business Model Neutral

The RFI defines the Uniform Standard by reference to a number of assumptions about what it would entail, and when and how it would apply. One of the key assumptions is that the Uniform Standard would accommodate different business models and fee structures. Based on this assumption, B-Ds would still be eligible to receive commissions and would not be required to charge asset-based fees. We believe the marketplace today is efficient and that most retail customers are self-selecting the model that best fits their needs for each portion of their portfolio.

Scope of Services and Continuing Obligations

The RFI also states that the Uniform Standard would not generally require a B-D or IA to either (i) have a continuing duty of care or loyalty to a retail customer after providing him or her personalized investment advice about securities, or (ii) provide services to a retail customer beyond those agreed to between the retail customer and the B-D or IA. The B-D model generally entails representatives providing advice at the time of a transaction, without having a commensurate duty to update the customer when conditions change. Not all customers want or need a financial professional who will provide ongoing advice, and customers should not be forced by regulation to pay for a service they neither need nor want. Investors should be free to choose the structure that makes the most sense for them given their particular circumstances, rather than forcing all investors into a structure that is not universally appropriate or desirable.

Proprietary or Limited Range of Products

Consistent with the express language of the Dodd-Frank Act, the RFI indicates that financial professionals who offer or recommend only proprietary or a limited range of products would not, based on that fact alone, be considered in violation of the Uniform Standard. B-D firms currently offer an array of products and structures, ranging from those who sell only proprietary products to those who employ a completely open architecture, with many different variations in between. All of these are valid business models that can serve investors appropriately. We believe disclosure is the most effective way to help investors understand the breadth of a particular B-D's product offerings. The standard of conduct to which B-Ds are held must permit each B-D to decide what products and services to offer without running afoul of the standard. Investors might choose to work with a particular B-D because they would like to purchase mutual funds sponsored by that B-D's affiliated money manager, or because that B-D might be able to offer its proprietary products at a lower price than products manufactured by unaffiliated parties. A rule that limits the ability of the B-D to structure its products and services in the manner that is most competitive in the marketplace would not only take away investor choice but could also make investment advice unaffordable for many middle class investors.

Applicability of Existing IA Rules and Guidance to B-Ds

Under the Uniform Standard, Sections 206(3) and (4) of the Investment Advisers Act of 1940, as amended (the "Advisers Act") and the rules thereunder would continue to apply to IAs, and would not apply to B-Ds. Similarly, existing laws and rules applicable to B-Ds, including SRO rules and guidance, would continue to apply to B-Ds, but not to IAs. We support this approach because we would be concerned about the potential unintended consequences of subjecting B-Ds to 75 years of rulemaking and case law under the Advisers Act or, by the same token, subjecting IAs to the rulemaking of FINRA and other authorities. Ideally, the SEC and FINRA will coordinate future rulemaking to ensure consistency, except for situations where different business models or other legitimate differences justify a divergence in rules. We believe that this approach will yield similar results over a reasonable period of time but without significant cost or disruption to industry members.

The RFI also suggests that, under the Uniform Standard, certain fiduciary principles currently applicable to IAs with respect to allocation of investment opportunities and aggregation of orders would continue to apply to IAs, and would be extended to B-Ds. While this is certainly an important issue, we believe it would be premature to comment on whether it would be appropriate to extend the application of such prior guidance and precedent to B-Ds until we know what standard of conduct will ultimately apply. We respectfully reserve the right to comment further on this issue in the future.

Duty of Loyalty and Conflicts of Interest

The RFI indicates that the duty of loyalty component of the Uniform Standard would require:

- Disclosure of all material conflicts of interest between the financial professional and the customer;
- Delivery to customers of a written "relationship guide" similar to the current From ADV Part 2A at the time that a customer relationship is initiated;
- Oral or written disclosure of "new" material conflicts at the time advice is given to the customer;
- That potential conflict of interest posed by principal trades executed between B-Ds and customers should be treated in the same way as any other potential conflicts of interest; and
- Prohibition of certain non-cash compensation, specifically sales contests in which the participants are awarded trips or prizes other than cash.

We believe that, with the exception of the prohibition on sales contests (which we will discuss below), this represents a reasonable approach to balancing the SEC's stated objectives in undertaking this rulemaking effort. As discussed above, written disclosure from financial professionals to customers about the terms and conditions of their relationship, and specifically including disclosure of potential conflicts of interest, is consistent with the nature of fiduciary obligation, and fits within the current regulatory framework for IAs. We believe that extending this requirement to B-Ds would produce material benefits to customers by reducing the possibility for confusion on their part about the terms of their relationship with their financial professionals. Many B-Ds already provide these types of disclosures. In addition, many B-Ds are dually-registered as IAs or offer investment advisory services through affiliates. They are familiar with the current regime, and extending this requirement to cover all customers with whom they do business is a reasonable means by which to accomplish these goals.

Disclosure of Conflicts of Interest

We believe any potential conflicts of interest that exist when a customer relationship is established should be disclosed to the customer at that time, and new or additional conflicts that arise thereafter should be disclosed to customers when personalized investment advice is given. We also believe financial professionals should be given the option to deliver such disclosure by means of other media, rather than being required to deliver a new paper disclosure document or relationship guide when a new potential conflict arises. For example, many firms currently make disclosures regarding certain business practices, such as revenue-sharing arrangements, on their public websites. We submit that rules allowing for website disclosure, rather than solely requiring delivery of paper documents would be both appropriate and effective.

Principal Trading

With respect to disclosure regarding principal trading, we believe this should be treated in the same way as disclosure about other potential conflicts of interests. In addition, in the interest of reducing the possibility for confusion on the part of investors and promoting consistency of applicable standards, we believe the provisions of Rule 206(3) under the Advisers Act requiring trade-by-trade notification to customers should be eliminated.

Non-Cash Compensation

The RFI indicates that the Uniform Standard would prohibit certain types of non-cash compensation, specifically sales contests in which trips or other prizes are awarded. We agree that the payment of non-cash compensation of this type can create the potential for a conflict of interest, although no more so than cash-based sales contests. However, the payment of non-cash compensation should not be treated different than other potential conflicts; it should be disclosed in all circumstances. The Commission should recognize that B-Ds are already subject to specific FINRA rules regarding acceptance of certain types of non-cash compensation, such as trips and gifts paid for by product sponsors. As noted above, these rules would continue to apply to B-Ds under the Uniform Standard. Based upon the facts and analysis below, we believe that the current regulatory regime governing sales contests sponsored by B-Ds adequately addresses regulatory concerns without imposing a flat prohibition.

- <u>Applicable Regulations and Guidance</u>. The regulatory requirements governing non-cash compensation are found in FINRA rules, Notices to Members ("NTMs") and interpretive letters (collectively, the "Non-Cash Comp Rules").[2] The Non-Cash Comp Rules prohibit, with certain exceptions, the payment and acceptance of non-cash compensation in connection with sales of specified types of securities. This framework helps to ensure that B-Ds exercise proper supervisory control over associated persons to guard against the possibility that they might be inappropriately influenced by offers of non-cash compensation, which could compromise the requirement that they match the investment needs of a customer with suitable investment products.

- <u>Permitted Exceptions</u>. The exceptions included in the Non-Cash Comp Rules permit:

  - Gifts that do not exceed an annual amount per person fixed by FINRA (currently $100) and are not preconditioned on achievement of a sales target;

  - An occasional meal, a ticket to a sporting event or the theater, or comparable entertainment which is neither so frequent nor so extensive as to raise any question of propriety and is not preconditioned on the achievement of a sales target;

[2] See FINRA Rule 2310 (Direct Participation Programs) (which includes REIT securities); FINRA Rule 2320 (Variable Contracts of an Insurance Company); FINRA Rule 5110 (Corporate Financing Rules) (which addresses the sale and distribution of a public offering of securities); and NASD Rule 2830 (Investment Company Securities)

- Payment or reimbursement by offerors in connection with meetings held by an offeror or by a B-D that is a member of FINRA (a “FINRA Member”) for the purpose of training or educating associated persons of a FINRA Member, provided that the meeting meets certain criteria;

- Non-cash compensation arrangements (i.e., sales contests) between a FINRA Member and its associated persons or a company that is not a FINRA Member (a “Non-Member”) and its sales personnel who are associated persons of an affiliated FINRA Member, provided that the arrangement meets certain criteria; and

- Contributions by a Non-Member or other FINRA Member to a non-cash compensation arrangement between a FINRA Member and its associated persons, provided that the arrangement meets the requirements for a non-cash compensation arrangement between a FINRA Member and its associated persons (per Item 4 above).

With respect to the permitted exceptions for non-cash compensation, FINRA expressly states that the acceptance or payment of any form of non-cash compensation "cannot be preconditioned on the achievement of a sales target“(emphasis added). “[P]reconditioned on the achievement of a sales target” means an arrangement pursuant to which associated persons understand in advance that they must achieve either a dollar-denominated goal for selling any security or type of security or a goal of finishing within a group of top sellers of a security or type of security.[3] This is a key requirement to ensure customer protection.

While non-cash compensation is permitted to be provided as recognition for past sales or as encouragement for future sales, it may not be part of an incentive program or plan which requires that the recipient attain a specific sales goal as a condition precedent to receiving the non-cash compensation. In addition to the overarching requirement that non-cash compensation not be preconditioned on the achievement of a sales target, each non-cash compensation exception has additional requirements. For example, gifts are subject to an annual fixed limit, and entertainment must not raise questions of propriety. Training and education meetings require prior approval by the FINRA Member and are subject to requirements on location, guest expenses, entertainment and thorough recordkeeping.

- <u>Non-Cash Sales Contests</u>. With respect to non-cash sales contests (i.e., non-cash compensation arrangements between a FINRA Member and its associated persons), no unaffiliated Non-Member or other unaffiliated FINRA Member may directly or indirectly participate in a FINRA Member’s permissible non-cash compensation arrangement. Regarding non-cash sales contests applicable to the sale of investment company securities or variable insurance contracts, the contests must be based upon the total production of associated persons with respect to all investment company or variable product securities distributed by the FINRA Member, and the

[3] See NTM 05-40.

credit for each type of security sold must be equally weighted. Sales contests that award credit for all sales within a particular category of securities (e.g., sales of all mutual funds), are permitted, subject to the total production and equal weighting requirements. However, sales contests that award credit only for specific securities within a category, such as only awarding credit for sales of proprietary mutual funds, are not permitted.[4]

The total production and equal weighting requirements for non-cash arrangements for investment company securities or variable insurance products were designed to address the concern that non-cash incentive programs may motivate associated persons at the point-of-sale to recommend a specific product on the basis of the incentive rather than a desire to meet the investment needs of the customer. The requirements were also designed to prohibit non-cash contests that encourage associated persons to favor one fund or variable contract over another based on non-cash compensation benefits. Regarding the condition for equal weighting, a variety of different methods for determining compensation credits (e.g., gross production to the firm, net commissions to the associated person, new accounts opened, or assets under management) would be acceptable as long as the concept of equal weighting is met and not skewed by disparate commission, payout, or reallowance structures for individual products.[5]

- <u>Training and Educational Meetings</u>. In recognition of the need for associated persons to receive training, updates on any portfolio changes or structural changes to a current product, and explanations of new products, FINRA permits non-cash compensation in the form of payment or reimbursement by offerors in connection with a meeting held by an offeror or a FINRA Member for the purpose of training or educating associated persons of a FINRA Member. Clearly, providing non-cash compensation to associated persons in connection with training events incentivizes associated persons to learn about and stay current with a FINRA Member's products. It would not benefit retail customers to remove this permitted exception to the non-cash compensation rules.

- <u>Recordkeeping Requirements</u>. B-Ds are also required to maintain records of all compensation received by the FINRA Member or its associated persons from offerors. The records must include the names of the offerors, the names of the associated persons, and the nature and value of the non-cash compensation received. These recordkeeping requirements permit B-Ds to conduct appropriate oversight of their associated persons who receive non-cash compensation.

- <u>Potential Enhancement of Non-Cash Comp Rules through Disclosure</u>. The current regulatory controls (i.e., that non-cash compensation cannot be preconditioned on the achievement of a sales target; the total production/equal weighting requirements for sales contests for

[4] See NTM 05-40.

[5] See NTM 98-75.

investment securities and variable contracts; and requiring that FINRA Members maintain records of non-cash compensation received by their associated persons) provide important and necessary controls over inappropriate sales practices and point-of-sale incentives. If the SEC believes that these long-established regulatory controls need to be enhanced, an appropriate approach would be to require clear and comprehensive disclosure in prospectuses and point-of-sale disclosure documents, similar to the current requirements for revenue sharing disclosure. In fact, the Uniform Standard takes this very approach; as noted above, it would "expressly impose certain disclosure requirements," including disclosure of all material conflicts of interest that a B-D has with a retail customer.

- No Basis for Treating Non-Cash Compensation Different from Other Potential Conflicts. It would be inconsistent to prohibit non-cash compensation when other issues of potential concern are satisfactorily addressed with proper disclosure. In fact, if the SEC prohibits sales contests that provide non-cash compensation, B-Ds could continue running sales contests for associated persons by either monetizing the value of the non-cash compensation that would have been awarded under the current regulatory scheme and providing cash awards instead, or shifting their non-cash compensation programs to fixed products over which the SEC and FINRA have no jurisdiction. This would deprive consumers of the protections afforded by the regulatory safeguards that currently exist with respect to non-cash compensation.

- Potential Impact of Prohibiting Non-Cash Compensation. Providing (or receiving) non-cash compensation and holding sales contests that provide non-cash compensation rewards are important components in the way that B-Ds run their businesses, and have been for many years. Prohibiting non-cash compensation and sales contests that provide non-cash compensation rewards would force B-Ds to fundamentally change the way they do business. The SEC Staff Report[6] and the RFI do not provide any information regarding customer harm resulting from sales contests that would warrant a flat prohibition, and there is no evidence that such a prohibition is justified under a cost-benefit analysis. The current regulatory scheme regarding non-cash compensation and sales contests that provide non-cash compensation rewards has been in place for many years and provides adequate protection to investors. Any concerns the SEC has regarding non-cash compensation and sales contests providing non-cash compensation rewards could be adequately addressed by requiring additional disclosure.

Duty of Care

The RFI explains that the Uniform Standard would include a duty of care under which a B-D or IA, when providing personalized investment advice to a retail customer about securities, would be subject to

[6] Staff of the U.S. Securities and Exchange Commission, Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Jan. 2011). www.sec.gov/news/studies/2011/913studyfinal.pdf

suitability obligations, product-specific requirements, a duty of best execution, and fair and reasonable compensation requirements. We are generally supportive of these concepts, so long as they are formulated in a reasonable manner that does not create undue burdens on IAs and B-Ds, or result in competitive advantages for any particular business model(s). We may have further comments once we see how exactly the SEC intends to implement the duty of care.

Addressing Investor Confusion through Disclosure

Enhancing protections for all investors while keeping access to investment professionals affordable for middle class and small balance investors should be the goal of any rulemaking. The SEC has stated that it is attempting to address, among other things, retail investor confusion about the obligations B-Ds and IAs owe to investors and to preserve customer choice without decreasing investor access to existing products, services, service providers or compensation structures.[7] Key elements of rulemaking should ensure that commission-based business models are maintained and that any new or amended rules are clear to ensure that B-Ds and IAs will be able to practically manage their business model without it being cost prohibitive.

One approach that would most likely meet this criteria is a simple, clear, and uniform disclosure containing information about the financial professional, including potential conflicts of interest . Improved disclosures would have the positive impact of improving transparency so that investors may make more informed decisions concerning both the services and the service providers.

Enhanced disclosure may also be vital to improving investors' understanding of their engagement with a financial professional. Simple, straightforward disclosure can often be more effective than a lengthy booklet. Two disclosure documents might assist retail investors in assessing and understanding their relationship with their financial professional. One could be a summary disclosure document that is required to be given by both B-Ds and IAs at the start of a customer relationship or when there is a material change in circumstances. The document would provide information about the professional experience of the financial professional and the firm, various forms of compensation, conflicts of interest, and services that will be provided (including whether one-time or ongoing, timeline, etc). Limiting the discussion to these main points would help keep the document concise and easy to

[7] The Rand Corporation's 2008 report on practices in the IA and B-D industries concluded that retail customers are confused about the regulatory status of the person from whom they receive financial services, but did not draw much in the way of conclusions about what substantive effect, if any, this may have on investor decisions regarding whom they chose as financial professionals or their level of satisfaction with the services that they received or the need for additional investor protection. See Angela A. Hung, et al., RAND Institute for Civil Justice, Investor and Industry Perspectives on Investment Advisers and Broker-Dealers (2008). http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf.

We cannot offer empirical evidence regarding this issue. We submit, however, that the most effective means by which to reduce any potential confusion is to adopt rules requiring all providers of financial advice to retail customers to deliver a disclosure document containing the type of information currently contained in a Form ADV.

understand. A second document – with information similar to what is currently included on Form ADV – could be provided by both B-Ds and IAs to new and existing customers.

To maximize the clarity and effectiveness of this disclosure for consumers, and to minimize the cost and administrative burdens on IAs and B-Ds, we would encourage the SEC to consider developing uniform documents that firms could use to satisfy their disclosure obligations. However, in doing so, we would caution the SEC to avoid requiring a recitation of details about all potential conflicts of interest; rather, the goal should be to ensure that consumers know what kinds of questions to ask when trying to select a financial professional. We would welcome the opportunity to assist the SEC if it decides to develop such uniform disclosure documents.

Potential Increase in Litigation Risk for B-Ds

If the SEC decides to impose a "fiduciary standard" on B-Ds (whether in the form of the Uniform Standard or some variation thereof), B-Ds would likely face a substantial increase in litigation by investors seeking to use the "fiduciary duty" as a basis for recovering investment losses, even in the absence of wrongdoing by the B-D. For example, an investor might argue that the financial professional breached his fiduciary duty by recommending a particular investment based on the applicable commission regardless of whether the commission actually played a part in the B-D's decision to make that recommendation. It is difficult to prove the motivation behind a recommendation to purchase an investment, a fact that becomes problematic when an investment declines in value and the investor has an incentive to try to recoup their loss through a lawsuit.

This prospect is exacerbated by the principles-based nature of the fiduciary duty currently applicable to IAs, and the resulting susceptibility to judicial interpretation and expansion of the fiduciary duty based on the facts and circumstances of each particular case. There are, however, a variety of ways the SEC could mitigate or avoid this risk. For example, if the standard of conduct for B-Ds is formulated in a rules-based (rather than principles-based) manner, there would be less room for the courts to expand the standard beyond what is intended by Congress and the SEC. This would also help to ensure that financial professionals fully understand the precise nature of their obligations to their customers, and give them the opportunity to modify their business models, product offerings, and compliance procedures accordingly. Furthermore, simply using different nomenclature to describe the standard could reduce investors' ability to use the standard of conduct as a means for recovering investment losses. Historically, courts have had significant flexibility in defining the scope of 'fiduciary' duties (both in the context of financial professionals and otherwise). Once the SEC clearly defines the standard of conduct it is going to impose on B-Ds, it is not necessary to label that standard as a 'fiduciary' duty. Simply calling it a 'uniform standard' or using some other terminology would still achieve the SEC's goals.

Adopting a rule that carries with it the potential for substantially more unwarranted litigation by investors would likely drive many financial professionals and service providers out of the broker-dealer business model, and would thereby deprive many investors of access to the type of advice most appropriate for their individual situations. In essence, this increased litigation risk could ultimately have the same effect as a flat prohibition of the commission-based model. Therefore, it is critical that any proposal be formulated in a manner that does not subject B-Ds to such increased litigation risk. We look forward to working with the SEC as the rulemaking process moves forward to formulate a rule that avoids this unintended and undesirable consequence.

Potential Areas for Further Regulatory Harmonization

The RFI asks for comments about other potential areas where the SEC might want to harmonize the rules for IAs and B-Ds (e.g., advertising and other communications; use of finders and solicitors; supervision; licensing and registration of firms; continuing education requirements; and books and records). Generally, we support the concept of harmonization where different rules are currently applied to individuals who perform similar functions. However, we believe that the SEC should focus on completing its rulemaking efforts with respect to the standards of conduct to which IAs and B-Ds are held before attempting to reconcile other disparities between the current regulatory schemes.

Department of Labor Fiduciary Rulemaking

While the SEC is considering possible rulemaking to harmonize the standards of conduct for IAs and B-Ds, the Department of Labor ("DOL") is undertaking its own initiative to redefine who is an investment advice fiduciary under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Throughout the DOL rulemaking process, commenters from the public, the media and the industry, as well as members of Congress (on both sides of the aisle) have expressed concern that the DOL proposal could significantly restrict access to advice. Unless it is carefully crafted in a manner that preserves the B-D compensation model, the SEC's rulemaking effort could have similar consequences. We would also strongly encourage the SEC to coordinate with the DOL to ensure that the rule proposals being advanced by each agency do not limit investor choice or create conflicting obligations for financial professionals.

Current Market for Personalized Investment Advice

In addition to requesting comments on the Uniform Standard and the Alternatives, the RFI asks for data and other information about the economics and characteristics of the current regulatory regime, including IA and B-D conflicts of interest and the cost and effectiveness of disclosure. In response to these requests, and to help ensure that the Commission approaches this rulemaking effort in the proper context, we offer the following information.

Retail Customer Accounts and Services Offered by B-Ds and IAs

The membership of the IRI consists of insurance companies, wholesale distributors of financial products, and providers of financial advice and services to retail investors. In many cases, these entities are parts of vertically integrated companies that provide all or some combination of these services.

The member firms that provide financial advice to retail customers include B-Ds and IAs. Many of these firms are dually-registered as both B-Ds and IAs, and offer both brokerage and investment advisory services to their customers (although not all individual financial professionals employed by these firms are dually registered as both IA representatives and B-D representatives). These customers range from individuals with as little as a few thousand dollars to invest to wealthy individuals, small institutions, and qualified retirement plans, such as 401(k) and 403(b) plans and their individual plan participants. At present, a significant portion of the revenue produced by member firms that provide retail financial advice is derived from brokerage or other transaction-based compensation, but a considerable percentage is derived from fees charged for investment advisory services. In addition to the fact that many providers of financial advice to retail customers offer both brokerage and advisory services, there are additional variations within those categories. For example, many financial professionals offer "wrap-fee" arrangements, under which the customer pays a combined fee for both advisory services and brokerage or transaction services. It is not uncommon for a single customer or household group to have multiple different arrangements with a single provider at the same time. For example, one household may have an advisory account for asset accumulation as well as an annuity purchased on a commission basis or a brokerage account to hold distributed employer stock in order to maintain tax advantages for that equity.

Characteristics of Retail Customers Using B-Ds or IAs

The RFI seeks information regarding the characteristics of retail customers who invest through B-Ds as compared to IAs, as well as customer perceptions of the cost/benefit tradeoffs of each regulatory regime. Even if this information could be gathered, the ability to draw meaningful conclusions from it is severely limited. IRI member organizations have relationships with millions of customers. Each individual customer has different demographic characteristics (age, income, education, and family status, among others) and different investment goals, time horizons, and risk tolerance. In addition, each investor has different preferences about the way in which they wish to interact with their financial professional and whether they wish to receive financial services from one or multiple sources. That being said, we believe that certain generalizations can be made, including the following:

- <u>Frequency and Duration of Contact</u>. Investment advisory relationships generally involve contact with the IA representative at regular or specified intervals, whereas brokerage-based relationships may, but do not necessarily include such ongoing contact. An advisory relationship generally includes a comprehensive discussion regarding the customer's investments at least once annually, whereas contact between customers and B-D representatives in brokerage-based relationships is often initiated by one party or the other with respect to a specific investment opportunity or other circumstance.

- Discretionary Authority. A great number of relationships between customers and IAs are conducted pursuant to discretionary investment authority granted to the IA, and many transactions are executed by the IA representative without discussion or notice to the customer until after execution. Relatively few brokerage arrangements are based on discretionary authority, and the majority of transactions are solicited by the B-D representative, as opposed to being unsolicited or originated by the customer. IA representatives often manage the customer's portfolio on an ongoing basis, whereas B-D representatives generally provide episodic advice or services.

- Disclosure about Account Types. Firms that offer both brokerage and investment advisory arrangements have different approaches to advising customers about which type of account to open. Firms that offer investment advisory services are required to offer potential customers a disclosure document referred to as a Form ADV, which sets forth the services provided by the IA, the firm's compensation arrangements, and other information such as disclosure about potential conflicts of interest. B-Ds do not typically provide a specific disclosure document, although most firms provide disclosures to customers about certain practices through a variety of means. Particular areas of focus are compensation arrangements such as revenue-sharing and 12b-1 or other ongoing distribution payments. This disclosure may be delivered though point-of-sale documents, disclosures on firm websites, or other means.

- Considerations in Advising about Account Type. Factors that may be considered in advising the customer about what type of account to open include the expected frequency of transactions, the degree to which the customer wishes to delegate authority for selecting and executing transactions to the financial professional, and other services that the financial professional may provide to the customer, such as comprehensive financial, tax, or estate planning advice. Certain customers have indicated that they believe that an advisory relationship in which compensation to the IA is calculated based on the value of the assets managed by the IA better aligns the interest of the customer and the IA, by reducing the financial incentive to recommend transactions involving sales commissions or other transaction-based compensation or to churn customer accounts, and also because the compensation payable to the IA increases based on the increasing value of the customer's assets.

- Minimum Account Balance Requirements. Many financial professionals who offer investment advisory services in which their compensation is based on the value of the assets under management require that investors maintain a minimum account value. The minimum amount varies across the industry, but a common minimum account size for an advisory relationship is $25,000 - $50,000. Many IAs find it necessary to maintain minimum account sizes due to the absolute cost of providing services to retail customers. In most cases, the IA representative conducts an initial meeting with the customer at which their goals and circumstances are

> discussed and a plan or strategy is agreed upon. The representative generally has a responsibility to oversee and manage the customer's assets on an ongoing basis and to meet or confer with the customer about the process. All of these activities involve the expenditure of time and resources by the representative, for which the representative and his or her support staff must be compensated. Fees for investment advisory relationships vary widely based on the services provided, but are commonly in the 1.5% range and do not generally exceed 3% per year of the assets under management under any circumstances. If a customer maintains an account that contains only $10,000 in assets, a 3% fee equates to $300 per year in fees payable to the IA, which in many cases is not sufficient revenue to allow the IA to perform the necessary services and be fairly compensated. In some instances, this has restricted the ability of investors with small account balances to have access to investment advisory services.

The current regulatory regime offers retail customers a wide variety of choices about how to obtain financial services, and it is clear from the information provided above that a substantial number of customers have chosen each model. This is the result of careful consideration by customers about the relative merits of each approach, and their reasoned conclusions about which model best fits their goals and circumstances. We do not believe any approach that would restrict the current availability of services is warranted or in the best interest of investors.

Form ADV and Other Disclosure Documents

Currently, only registered IAs regulated by the SEC have a mandate to provide a disclosure document to investors in a specified form.[8] This document, referred to as a Form ADV, contains information about the background and investment methodology employed by the IA, the services they provide, the means by which they are compensated, and potential conflicts between the interest of the IA and the customer. Forms ADV are commonly 25 -50 pages in length, and are mandated by the SEC to be written in "Plain English", so as to be easily understood by the reader. Depending upon the complexity of the services

---

[8] In October 2010, FINRA Regulatory Notice 10-54 requested comments on a Concept Proposal to require a disclosure statement for retail investors at or before commencing a business relationship. In the "Background and Discussion" section of the Regulatory Notice, FINRA explained:

> Even as the legislation that became the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) was being developed, FINRA staff considered how it might implement a heightened standard of care with respect to broker-dealers. The staff determined that no matter how the ultimate contours of such a standard would be concluded, retail customers would benefit from an upfront disclosure document that sets forth in plain English a firm's accounts and services, its associated conflicts of interest and any limitations on duties owed to the customer. The staff conceived of a document similar in purpose to Form ADV, which is required under the Investment Advisers Act to be provided to each advisory customer. The staff believed that such a document would not only provide useful information to a retail customer, but also would help clearly define the scope of the duties owed to that customer.

RN 10-54 contemplated a disclosure document for broker-dealers that would require firms to provide detailed disclosures regarding, in part, the nature and scope of services offered by the firm, fees associated with services, and conflicts of interest that may arise between a firm and its customers.

provided and other arrangements employed by the IA, drafting and review of a Form ADV for a single firm may require the efforts of multiple professionals and hundreds of hours of time. In addition, SEC rules provide that IAs must provide a current Form ADV to customers on an annual basis, and must update the information contained in the document under certain circumstances. While the cost of producing Forms ADV for all IAs is considerable in the aggregate, the industry has developed a protocol for production and delivery of these documents to customers, which we believe is both manageable and justified in terms of the benefits that it creates for those customers.

In the current regime, there is no requirement that B-Ds produce or deliver a standardized form of disclosure document to customers. Individual firms have their own requirements with respect to matters that must be disclosed to customers, either orally or in writing, but we do not believe there is either a formal or informal template or list of matters to be included. We also believe a standardized form of disclosure document, such as a Form ADV, is preferable to a requirement that a financial professional provide verbal disclosure to a customer, either at the time of account opening or on an ongoing basis. The number of subjects and level of specificity contained in a disclosure document is difficult to convey verbally, and the potential for confusion on the part of the investor is consequently greater.

While B-Ds are not generally required to produce or deliver a comprehensive disclosure document such as a Form ADV, many firms produce written disclosure material about specified subjects. These include revenue-sharing arrangements, order allocation and aggregation procedures, and information regarding protection of confidential information, as provided in SEC Regulation S-P. Many B-Ds produce comprehensive descriptions regarding the products and services that they provide. These may include some or all of the above matters.

The current regime under which Forms ADV are delivered to customers of IAs has been in place for more than 70 years. These documents are prepared under specific standards adopted by the SEC, and we are not aware of any significant number of substantive complaints from customers about the form or its content. If such complaints had arisen to any material extent, we believe that both the securities industry and the regulatory agencies would be aware of them.

Conclusion

While the effort to enhance investor protection by completely re-engineering the regulatory structure may have good intentions, there are large market issues that must be considered. Well intentioned regulation can sometimes result in unintended consequences. The chief concern regarding any potential rulemaking is that if it is unnecessary, or if it is designed or implemented poorly, it could result in increased cost to many investors, reduced investment choice and decreased access to investment professionals. The greatest impact of regulation that is not carefully considered and, if necessary, crafted would likely be on middle class and small-balance investors who may be less likely to save for retirement and other goals without the assistance of a financial advisor. At a time when most Americans are not saving enough for their retirement, a rule that results in less saving could devastate the ability of middle class investors to have a comfortable retirement. In addition, a poorly implemented proposal would result in significant and unwarranted job loss in the financial services industry, particularly among financial professionals who serve investors with smaller accounts, at the very time when financial advice is most needed due to the baby boomers entering retirement.

We appreciate the chance to present our members' views on the RFI. We believe this process presents a valuable opportunity for the SEC to take a comprehensive look at our current regulatory system and address the areas that may need to be improved through rule changes that will improve investor protection without increasing costs or limiting investor access or choice. Please feel free to contact me, Lee Covington, Senior Vice President & General Counsel (202-469-3002) or Jason Berkowitz, Vice President of Regulatory Affairs & Compliance (202-469-3014), if we can provide additional information or to further discuss these issues.

Sincerely,

Catherine J. Weatherford
President & CEO