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*Via Electronic Filing*

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

**Re: Request for Data and Other Information, Duties of Brokers, Dealers and Investment Advisers, Release No. 34-69013; IA-3558; File No. 4-606**

Charles Schwab & Co., Inc. (“Schwab”) appreciates the deliberative approach to potential rulemaking that the Commission is taking with its extraordinary *Request for Data and Other Information, Duties of Brokers, Dealers and Investment Advisers* (“Request”).<sup>1</sup> The potential rules the Commission is contemplating could result in some of the most significant regulatory changes for broker-dealers and investment advisers in the past 70 years. A cautious approach is warranted.

Schwab is a dually registered investment adviser and broker-dealer serving approximately 4 million households including clients of almost 7,000 independent investment advisers. In the aggregate Schwab maintains almost 9 million client accounts with over \$2 trillion in assets. On this basis, we offer our perspective on a uniform standard of care and potential harmonization of rules between broker-dealers and investment advisers.

To respond to the Request for Data, we commissioned a survey (“Schwab Survey” or “Survey”) of independent investment advisers (“RIAs”) asking questions about current and potential future compliance costs in terms of time and money based on the assumptions for rule harmonization that the Commission set forth in its Request. We received over 800 responses, with a clear majority indicating that they had enough information to provide cost estimates and consider the impacts of potential rules. Based on the data we collected from the Survey, a major concern is the substantial additional costs RIAs would incur if broker-dealer-like rules are applied to them in the areas of (1) licensing and registration and continuing education, (2) books and records and supervision, and (3) client communications. Even a rules-based duty of care, as articulated in the Request, would impose new costs and burdens on RIAs.

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<sup>1</sup> Request for Data and Other Information, Rel. No. 34-69013; IA-3558 (March 1, 2013) (“Request”).

For RIAs with at least \$90 million assets under management, on average the additional burdens would increase compliance costs by 150% in the first year, and 101% in year two and each year thereafter. The additional compliance burdens would take valuable time away from clients, require some firms to hire new staff or outside consultants, and erode considerably their gross annual revenues. As a result, some firms would be placed in the difficult position of considering whether to cut services or raise fees. Depending on how broadly the Commission would apply harmonized rules (whether to some or all RIAs), harmonized rules could cost the RIA industry well over \$1,000,000,000.

The Schwab Survey also asked RIAs about the potential positive and negative impacts on their clients. 88% indicated that their clients would suffer at least one negative impact from rule harmonization, while only 13% thought there would be at least one positive impact.

In light of this data on costs and burdens, before proposing and adopting harmonized rules and applying them to RIAs, the Commission should quantify any potential benefits. Most RIAs are small businesses in the commonsense use of that term, and such a significant increase in regulatory burden would have to be justified. Schwab respectfully suggests that, given the data from the Schwab Survey, the Commission take no further action in terms of harmonizing rules outside of a uniform standard of care, and de-couple its consideration of the uniform standard of care from other potential rule areas for harmonization.

Below, we explain the methodology and provide more detailed results of the Schwab Survey, then discuss those results in light of the Commission's stated purpose for considering rule harmonization. We then reiterate our support for a uniform standard of conduct based on the best interest of the client for broker-dealers and RIAs applicable to the one area they overlap: the provision of non-discretionary investment advice for transaction-based compensation. As with harmonized rules for RIAs, a new fiduciary standard for broker-dealers should be economically justified. Fiduciary rules must be flexible to accommodate different business models, preserve investor choice, and minimize regulatory costs.

Schwab previously submitted two comment letters relating to the Commission Staff's January 2011 *Study on Investment Advisers and Broker-Dealers as Required by Section 913 of the Dodd-Frank Act* ("Study"). We draw the Commission's attention to those two letters again,<sup>2</sup> and simply refer to them below as applicable without repeating all the data and analysis we previously submitted for the Commission's consideration.

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<sup>2</sup> Letter dated Aug. 30, 2010 from Christopher Gilkerson, SVP and Deputy General Counsel, Charles Schwab & Co., Inc. to Elizabeth Murphy, Secretary, SEC Re: Study Regarding Obligations of Brokers, Dealers, and Investment Advisers, Rel. No 34-62577, IA-3058 (July 30, 2010), <http://www.sec.gov/comments/4-606/4606-2670.pdf>, ("First Schwab Letter on the Study"); Letter dated Nov. 16, 2010 from Christopher Gilkerson, SVP and Deputy General Counsel, Charles Schwab & Co., Inc. to Elizabeth Murphy, Secretary, SEC Re: Study, <http://www.sec.gov/comments/4-606/4606-2844.pdf>, ("Second Schwab Letter on the Study").

## **I. SCHWAB SURVEY – APPROACH AND METHOD**

In the Request, the Commission referenced the staff’s prior Study and its recommendation that the Commission consider harmonizing certain regulatory requirements of broker-dealers and RIAs where they “perform the same or substantially similar function, such as the provision of personalized investment advice about securities to retail customers.”<sup>3</sup> The purpose of the Request is to help the Commission “continue to evaluate the potential impact of harmonization”<sup>4</sup> in the areas set forth in the Request, including costs. Schwab’s view is that the Request and Study, when read together, provide sufficient detail to determine what RIAs would be required to do if the Commission were to move ahead and adopt the harmonized rules specified in the Request (the “Assumed Harmonized Rules”). Accordingly, the Schwab Survey solicited, and this letter provides, data that the Commission requested and needs about the potential costs of the Assumed Harmonization Rules.

### **A. Survey Firm and Goal**

Schwab retained Koski Research, Inc. to conduct an “Advisor Survey on Potential Costs of SEC Rule Harmonization” and to compile the results.<sup>5</sup> See Attachment 1 for a written version of the Schwab Survey, which was conducted electronically. The goal of the Survey was to inform RIAs of the Assumed Harmonized Rules and have them consider and report their estimated cost of compliance and their view of the positive and negative impacts of the Assumed Harmonized Rules.

### **B. Survey Distribution and Respondent Population**

On May 28th Schwab emailed the Survey to a broad-based distribution list consisting of staff at RIAs who have entered into an Investment Manager Service Agreement with Schwab and have clients who maintain active accounts with Schwab.<sup>6</sup> Schwab sent potential respondents an email which included a link to a survey hosted by Koski Research. The email referenced the Commission’s Request and gave a brief overview of the content and purpose of the survey and invited recipients to click on the link to complete the survey. Survey responses were transmitted electronically to Koski Research. The Survey closed on June 7. The total number of respondents was 834, which included responses from 483 firms with \$90 million or more in assets under management.<sup>7</sup> The margin of error for the opinion-based questions is plus or minus 3.5 percentage

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<sup>3</sup> Request at 54.

<sup>4</sup> Request at 56.

<sup>5</sup> Koski Research, Inc. is an independent marketing research firm based in San Francisco.

<sup>6</sup> A small number of RIAs in the potential population were excluded, those who had previously asked Schwab not to mail them surveys as a general matter.

<sup>7</sup> This letter segregates adviser responses into above and below \$90 million AUM, as those advisers with at least \$90 million in AUM are either registered with the Commission or could be eligible to register with the Commission.

points at the 95% confidence level on the total sample and greater when looking at results for specific subgroups.<sup>8</sup>

The invitation was very specific about the content and purpose of the Survey. Accordingly, respondents self-selected to constitute an informed and engaged population. 85% of the respondents indicated that they were principals and/or senior management at their firm, with 73% indicating that they serve as their firm's chief compliance officer.<sup>9</sup>

### **C. Survey Approach**

In the 10 page Survey, respondents were advised that “[t]he SEC has asked the public for estimates of the potential costs of possible regulatory changes.” Respondents were asked to review carefully details on each area of the Assumed Harmonized Rules, and to give their best estimate of the economic impact on their firm, considering both staff hours and other costs.

Question 1 of the Survey asked Respondents to establish a baseline of their current compliance-related costs.

Questions 2-5 divided the Assumed Harmonized Rules into four categories: (1) Licensing, Registration, and Continuing Education, (2) Books and Records and Supervision, (3) Client Communications and Marketing, and (4) Duty of Care.<sup>10</sup> For each of these four areas, a short summary reminder about current IA rules was followed by a description of the Assumed Harmonized Rules, drawing upon both the Request's and Study's assumptions and explanations (including references to various broker-dealer rules). Respondents then filled-out a grid to report (a) estimated value of additional staff time for (i) setup and first year costs and (ii) subsequent ongoing annual costs, and (b) cost of additional compliance-related items for (i) setup and first year costs and (ii) subsequent ongoing annual costs.<sup>11</sup> After each of the four areas, respondents indicated whether they had sufficient information to provide their estimates.

Question 6 asked about the use and importance of solicitors and the potential impact of requiring solicitors to be registered in the future (similar to “finders” under broker-dealer rules, as explained by the Request and Study).

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<sup>8</sup> All data are self-reported by study participants and are not verified or validated.

<sup>9</sup> There were some instances where more than one individual from a firm responded to the Schwab Survey. In these cases, where cost estimates differed, Koski Research calculated an average for that firm. For non-numeric questions, Koski Research reported the results using either the most complete response from a firm or, if there was more than one complete submission, the response from the most senior person at that firm. The purpose of this approach was to avoid overweighting responses from very large firms with many employees.

<sup>10</sup> Books and Records and Supervision were combined to reflect some likely efficiency in complying with those two categories and to simplify the Survey. Duty of Loyalty was excluded also to help simplify the survey.

<sup>11</sup> This is consistent with the Study's observation that the “associated costs would typically involve at least one-time costs to adjust to the harmonized requirements, and to some extent additional on-going compliance costs.” Study at 164.

Questions 7-9 asked respondents to estimate the overall increase in compliance hours and the positive and negative impacts on RIAs and their clients resulting from the Assumed Harmonized Rules.

Questions 10-11 asked for information about the person at the IA firm completing the survey.

Questions 12-15 asked for respondents to report their firms' assets under management ("AUM"), total gross revenue, operating profit after expenses, and number of employees, as these are four different measures about the size of a firm and potential economic impact of any additional regulatory burdens.

#### **D. Confidence in Respondents' Cost Estimates**

After establishing a baseline of current compliance costs, as discussed below the Schwab Survey walked respondents through the four areas of the Assumed Harmonized Rules. For each of the four areas, respondents were asked if they had enough information to provide an estimate of their likely costs. A clear majority of respondents believed they did (having either all or most of the information they needed).

<b>Rule Area</b>	All the information I needed	Most of the information I needed	Not enough information
Licensing, Registration, Continuing Education	24%	60%	16%
Books and Records and Supervision	24%	57%	18%
Client Communications and Marketing	26%	58%	16%
Duty of Care	26%	56%	18%

These results indicate that the Commission's Request and Study, and the Schwab Survey's explanation of the potential rule changes based on the Request and Study, enabled RIAs to understand what would be required under the Assumed Harmonized Rules and to provide their best estimates of the additional burdens and costs.

## II. SCHWAB SURVEY – DATA AND RESULTS

All totals below in the text and tables (unless otherwise specified), are stated as the mean average for advisers with at least \$90 million in AUM - those who are either registered with the Commission or could be eligible to register with the Commission.<sup>12</sup> See Appendix 2 for the full annotated results of the Survey.

### A. Current Compliance Costs

To set a baseline, the Survey asked respondents to estimate the total number of hours their firm spends annually on all compliance related activities, the approximate dollar value of that time, and other annual compliance expenditures (including use of consultants, legal fees, systems, and software). The results<sup>13</sup> are:

Total number of annual compliance hours	1603
Dollar value of annual compliance hours	\$86,500
Other annual compliance expenditures	\$29,546
<b>Total (hour costs + other expenditures)</b>	<b>\$116,046</b>

These numbers indicate that the average firm already has the equivalent of an almost full-time staff member dedicated to compliance activities, in addition to significant outside expenditures. On average the greater a firm's AUM, the more compliance hours it spends and the greater its overall expenditures. For example, the total compliance costs (dollar value of annual compliance hours + other expenditures) of firms with between \$250-\$499 million AUM are \$65,632, while for firms with \$500 million AUM or higher the total compliance costs are \$229,669.

### B. Costs of Compliance with Assumed Harmonized Rules

Respondents were provided with a brief summary of current requirements and short descriptions of possible regulatory changes in four broad categories and asked to provide four numbers for anticipated costs as outlined in section I.C above. The Survey contained the following points for respondents to consider in estimating their costs:

As you estimate these values of additional staff time, please consider all costs, including but not limited to:

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<sup>12</sup> Results for advisers with less than \$90 million AUM are reported in footnotes. Schwab believes data about these small and mid-size advisers is important to consider if there is any potential future proposal to harmonize state and federal rules governing advisers.

<sup>13</sup> For advisers with less than \$90 million AUM, the mean averages for current compliance related costs are:

Total number of annual compliance hours: 296  
Dollar value of annual compliance hours: \$19,400  
Other annual compliance expenditures: \$7,821

- Time to research, design, establish, and conduct policies and procedures related to SEC compliance – including staff training and principal oversight
- Time spent by your compliance staff, principals, as well as all other employees
- Time for staff to create and maintain records about clients, communications, and investment activities

As you estimate the cost of additional compliance-related activities, please consider all costs, including but not limited to:

- Expenses related to filing and maintaining records, including the archival of electronic communications
- Expenses for compliance consultants, lawyers, service providers, systems, and software.

The tables below summarize the cost estimates (mean average) provided by respondents for each of the four areas presented.

### ***Licensing, Registration and Continuing Education***<sup>14</sup>

	<b>Setup and First Year Costs</b>	<b>Subsequent Ongoing Annual Costs</b>
Estimated value of additional staff time	\$44,900	\$25,518
Costs of additional compliance-related activities	\$19,600	\$13,413
<b>Total</b> <sup>15</sup>	\$64,099	\$37,418

For firms with between \$250-\$499 million AUM, for licensing, registration and continuing education the total setup and first year costs are \$56,145, while the total subsequent ongoing annual costs are \$30,441. For firms with \$500 million AUM or higher the total setup and first year costs are \$97,655, while the total subsequent ongoing annual costs are \$56,467.

<sup>14</sup> For advisers with less than \$90 million AUM, for licensing, registration and continuing education the total setup and first year costs are \$24,215. The total subsequent ongoing annual costs are \$14,345.

<sup>15</sup> The “Totals” in each chart do not reflect the simple sum of the columns, because the two numbers in each column are two separate averages with different denominators (i.e., different number of respondents). We anticipated that some respondents would be unable to provide estimates for all areas of each cost grid. Accordingly, Koski Research programmed the survey to allow respondents to leave one or more grid spaces blank. For any given question, approximately 2-3% of respondents left one or two of the quadrants in each chart blank. This results in slight variances in the number responding to each quadrant of the grid. Respondents who did not provide any information at all for a given category of Assumed Harmonized Rules are excluded from the table. Note that for the four categories of Assumed Harmonized Rules, there were between 440 respondents (one quadrant of the duty of care table) and 463 respondents (one quadrant of the licensing, registration and continuing education table).

### ***Books and Records and Supervision<sup>16</sup>***

	<b>Setup and First Year Costs</b>	<b>Subsequent Ongoing Annual Costs</b>
Estimated value of additional staff time	\$32,139	\$21,878
Costs of additional compliance-related activities	\$17,617	\$12,444
<b>Total<sup>17</sup></b>	<b>\$49,678</b>	<b>\$34,249</b>

For firms with between \$250-\$499 million AUM, for books and records and supervision the total setup and first year costs are \$46,551, while the total subsequent ongoing annual costs are \$33,466. For firms with \$500 million AUM or higher the total setup and first year costs are \$75,978, while the total subsequent ongoing annual costs are \$49,272.

### ***Client Communications and Marketing<sup>18</sup>***

	<b>Setup and First Year Costs</b>	<b>Subsequent Ongoing Annual Costs</b>
Estimated value of additional staff time	\$18,529	\$13,774
Costs of additional compliance-related activities	\$10,602	\$8,176
<b>Total<sup>19</sup></b>	<b>\$28,877</b>	<b>\$21,646</b>

For firms with between \$250-\$499 million AUM, for client communications and marketing the total setup and first year costs are \$21,632, while the total subsequent ongoing annual costs are \$15,902. For firms with \$500 million AUM or higher the total setup and first year costs are \$43,055, while the total subsequent ongoing annual costs are \$32,266.

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<sup>16</sup> For advisers with less than \$90 million AUM, for books and records and supervision the total setup and first year costs are \$21,517. The total subsequent ongoing annual costs are \$14,251.

<sup>17</sup> See footnote 15.

<sup>18</sup> For advisers with less than \$90 million AUM, for client communications and marketing the total setup and first year costs are \$14,944. The total subsequent ongoing annual costs are \$10,738.

<sup>19</sup> See footnote 15.

### *Duty of Care*<sup>20</sup>

	Setup and First Year Costs	Subsequent Ongoing Annual Costs
Estimated value of additional staff time	\$23,301	\$16,266
Costs of additional compliance-related activities	\$13,133	\$9,332
<b>Total</b> <sup>21</sup>	\$36,462	\$25,672

For firms with between \$250-\$499 million AUM, for duty of care the total setup and first year costs are \$21,191, while the total subsequent ongoing annual costs are \$18,809. For firms with \$500 million AUM or higher the total setup and first year costs are \$57,644, while the total subsequent ongoing annual costs are \$40,701.

### **C. Summary and Aggregate Costs**

To summarize the findings above, respondents reported that the proposed requirements for licensing, registration and continuing education would have the greatest burden, followed by books and records and supervision requirements, and then duty of care. Client communications and marketing would have the least impact. This order was consistent across staff time, outside costs, and first year/setup and ongoing/subsequent years dimensions. Not surprisingly, the estimates for first year and setup costs were uniformly higher than the estimates for ongoing costs in subsequent years. Estimates for staff costs were higher for all categories than estimates for non-staff and other outside expenses. Although RIAs adhere to a principles-based duty of care today, compliance with future rules under a duty of care would impose additional, not insubstantial costs. There would be costs to RIAs for a rules-based duty of care under a harmonized standard of conduct, even if the Commission were to determine not to propose and adopt the other three categories of Assumed Harmonized Rules. It is not accurate to assume that “[a]pplication of the new standard is unlikely to result in any direct costs to investment advisers.”<sup>22</sup>

The overall aggregate costs to comply with the Assumed Harmonized Rules would be considerable, given the size and revenue of the typical IA, as reported below. Both the Study and the Request bifurcate consideration of a rules-based fiduciary standard of conduct from other potential harmonized rules. Accordingly, we have aggregated the total costs of complying with the Assumed Harmonized Rules first to exclude duty of care and then to include duty of care.

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<sup>20</sup> For advisers with less than \$90 million AUM, for duty of care the total setup and first year costs are \$14,410. The total subsequent ongoing annual costs are \$10,741.

<sup>21</sup> See footnote 15.

<sup>22</sup> Study at 159.

Aggregate costs for the first three categories (excluding a rules-based duty of care) would be<sup>23</sup>:

<b>Cost for Compliance with Assumed Harmonized Rules, <u>minus</u> Duty of Care</b>	<b>Setup and First Year Costs</b>	<b>Subsequent Ongoing Annual Costs</b>
Estimated value of additional staff time	\$93,858	\$59,986
Costs of additional compliance-related activities	\$46,616	\$33,161
<b>Total<sup>24</sup></b>	<b>\$139,976</b>	<b>\$92,806</b>

Aggregate costs for all four categories (including a rule-based duty of care) would be:

<b>Costs for Compliance with all Assumed Harmonized Rules, <u>including</u> Duty of Care</b>	<b>Setup and First Year Costs</b>	<b>Subsequent Ongoing Annual Costs</b>
Estimated value of additional staff time	\$116,113	\$75,591
Costs of additional compliance-related activities	\$59,072	\$41,992
<b>Total<sup>25</sup></b>	<b>\$174,560</b>	<b>\$117,153</b>

Extrapolating across the approximately 10,500 RIAs registered with the Commission,<sup>26</sup> this would mean over **\$1.83 billion** in industry costs for setup and first year, with another **\$1.23 billion** each year thereafter.<sup>27</sup> Even if the Assumed Harmonized Rules only applied to half of those RIAs, it

<sup>23</sup> In a survey of this type, with multiple information sets for respondents to consider, it would be difficult to ask respondents to aggregate and provide just one estimate for all the Assumed Harmonized Rules. So as indicated above, the Schwab Survey broke it down into four categories. Certain efficiencies or economies of scale might be possible that are not fully reflected in the tables. For example, as RIAs design their new system of supervision, that system could cover some aspects of client communications review or how they make and keep new required books and records.

<sup>24</sup> See footnote 15.

<sup>25</sup> See footnote 15.

<sup>26</sup> “As of April 1, 2013, there were 10,615 investment advisers registered with the SEC (based on data derived from reports filed with the Commission on Form ADV).” *Doing the Right Thing: Compliance that Works for Investors*, speech by Commissioner Luis A. Aguilar (April 18, 2013), <http://www.sec.gov/news/speech/2013/spch041813laa.htm>; see Investment Adviser Association, *2012 Evolution Revolution: A Profile of the Investment Adviser Profession*, p. 8, available at [https://www.investmentadviser.org/eweb/docs/Publications\\_News/Reports\\_and\\_Brochures/IAA-NRS\\_Evolution\\_Revolution\\_Reports/evolution\\_revolution\\_2012.pdf](https://www.investmentadviser.org/eweb/docs/Publications_News/Reports_and_Brochures/IAA-NRS_Evolution_Revolution_Reports/evolution_revolution_2012.pdf).

<sup>27</sup> Unlike the uniform standard of conduct, which Congress limited under Dodd-Frank to firms “providing personalized investment advice about securities to a retail customer,” there is no limiting provision when it comes to the other Assumed Harmonized Rules, and the Commission has not indicated one.

would still be over **\$910 million** in industry costs for setup and first year, with another **\$615 million** each year thereafter.

#### **D. Impact on Annual Staff Hours**

After referring back to the baseline of current time their firm spends on compliance each year, the Schwab Survey asked respondents to generally estimate whether the Assumed Harmonized Rules would result in an increase in compliance hours and by how much. More than 8 out of 10 (84%) indicated that their compliance hours would increase by at least 25%. Over one-third (34%) thought that their compliance hours would at least double.

Taking the midpoint of the ranges provided, and a conservative approach,<sup>28</sup> we arrive at an average increase in time anticipated for compliance with Assumed Harmonized Rules of 63%. Using the estimates provided by the respondents at the beginning of the survey of 1,603 hours, this would imply an increase of 1,010 hours to reach 2,613 hours each year. For most firms, the over 1,000 additional hours to spend on compliance each year would require hiring additional compliance staff. In fact, 62% of the respondents indicated that they would need to hire new staff. Because the average firm responding to the survey had only 11 employees, and 58% had less than 10, this is a significant increase in payroll expenditures. For firms that cannot afford to hire additional staff, the additional time necessary to spend on compliance would divert valuable staff time and attention away from clients and managing their accounts.

#### **E. Other Impacts on RIAs**

The Schwab Survey asked RIAs to select from a menu of potential impacts on advisors from adoption of the Assumed Harmonized Rules. Respondents could choose multiple answers. 97% noted at least one negative impact, while 16% noted at least one positive impact.

##### The most selected negative impacts were:

- Decrease in firm profitability (91%)
- Would take time away from time spent with clients (85%)
- Need to hire additional outside consultants (81%)
- Have to consider raising client fees (59%)

##### The most selected positive impacts were:

- Higher degree of certainty in effectiveness of compliance program (14%)
- Better able to assure clients about safety of firm (5%)

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<sup>28</sup> The approach to derive the mid-point was conservative because the 34% who indicated their compliance costs would at least double were all counted at just a 100% increase.

**F. Impacts on Clients of RIAs**

The Schwab Survey also asked RIAs to select from a menu of potential impacts on clients of RIAs from adoption of the Assumed Harmonized Rules. Respondents could choose multiple answers. 13% noted at least one positive impact, while 88% noted at least one negative impact.

The most selected positive impacts were:

- Less confusion about differences between an IA and broker-dealer (8%)
- Increased protection from fraud or mishandling of account (6%)
- Better information for making decisions about financial advice (3%)

The most selected negative impacts were:

- Pay more for investment advice (71%)
- Less customized client service (63%)
- Lower level of service than today (59%)
- Fewer choices in terms of firms, products and services (49%)

**G. Increased Compliance Costs as a Percentage of Gross Revenue and Impact on Operating Profit**

In addition to considering the cost impact on firms according to size as measured by AUM, it is important to consider the cost impact on firms' revenue and operating profit. For firms reporting at least \$90 million AUM, costs to comply with all four categories of the Assumed Harmonized Rules would be a substantial percentage of total gross revenue and would significantly cut into firms' operating profit.

<b>Setup / 1<sup>st</sup> year</b>	Revenue Range Category	Category Midpoint	# Firms	Average Cost for Revenue Category	Cost as Percent of Revenue at Category Midpoint
	<\$1M	\$750,000	96	\$ 99,067	13%
	\$1M - \$1.99M	\$1,500,000	155	\$ 134,182	9%
	\$2M - \$4.99M	\$3,500,000	121	\$ 208,210	6%
	≥\$5M	\$5,500,000	78	\$ 300,963	5%

<b>Ongoing Costs</b>	Revenue Range Category	Category Midpoint	# Firms	Average Cost for Revenue Category	Cost as Percent of Revenue at Category Midpoint
	<\$1M	\$750,000	96	\$ 67,282	9%
	\$1M - \$1.99M	\$1,500,000	155	\$ 94,415	6%
	\$2M - \$4.99M	\$3,500,000	121	\$ 135,474	4%
	≥\$5M	\$5,500,000	78	\$ 202,015	4%

For smaller firms averaging less than \$1M in annual revenue, the additional costs would be over 10% of annual revenue. Even for larger firms which likely can benefit more from economies of scale, the additional costs would still constitute 4% or more of their annual revenue.

#### **H. Use of Solicitors**

In the Request the Commission indicated that harmonized rules could include addressing the discrepancy between “finders” under broker-dealer regulation and “solicitors” under IA regulation. One potential for harmonization would be to require solicitors to be registered with the SEC similar to the way finders are required to be registered. Accordingly, the Schwab Survey asked RIAs to report how much they rely on solicitors, whether registered or unregistered.

40% of respondents with AUM over \$90 million indicated that they use solicitors, and half of those who use them indicated that they are not an important source of new clients. When firms who use solicitors were asked to evaluate the impact of a requirement that finders be registered, 60% indicated that it would have no or only a small negative impact on their firm’s growth, while 16% anticipated a large or very large negative impact.

### **III. SCHWAB SURVEY RESULTS AND COMMISSION’S RULEMAKING PURPOSE**

Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010<sup>29</sup> required the Commission to conduct a study to evaluate the effectiveness of existing standards of care for providing personalized investment advice to retail customers under both IA and broker-dealer laws and regulations. If the Commission finds gaps or shortcomings, Congress has directed it to consider addressing them by proposing and adopting new rules. Notably, Section 913 did not direct the Commission to consider harmonizing other RIA and broker-dealer rules.

The Study, however, in addition to recommending that the Commission establish a uniform fiduciary standard, also recommended that the Commission consider “harmonization of the broker-dealer and investment adviser regulatory regimes, with a view toward enhancing their effectiveness in the retail marketplace,”<sup>30</sup> but only “where such harmonization adds meaningful investor protection.”<sup>31</sup>

Neither the Study nor the Request discuss where and how applying broker-dealer rules to RIAs in the areas of licensing, registration and continuing education, books and records and supervision, and marketing and client communications would add “meaningful investor protection.” The Commission would have a high hurdle, given the substantial costs that would be imposed on RIAs

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<sup>29</sup> Pub. L. No. 111-203, 124 Stat. 1373 (“Dodd-Frank”).

<sup>30</sup> Study at ii.

<sup>31</sup> Study at viii.

as indicated by the Schwab Survey. The Commission should not saddle RIAs with unnecessary additional costs for harmonization's sake alone without any corresponding measurable benefits.

The Commission would also need to analyze the impact on competition among RIAs and broker-dealers and the impact on investor access to and fees for their services. For some RIAs, doubling their compliance costs, dedicating 10% or more of their annual revenue to comply with a new suite of rules, increasing time spent on compliance by 63% or more, and having to hire new staff - and for many of these small businesses it would mean increasing their staff size by 10% or more - could put them out of business. These are substantial "disadvantages of engaging in such harmonization" backed by the overwhelming data from the Schwab Survey as sought by the Commission's Request.<sup>32</sup>

Accordingly, Schwab believes that the most prudent course for the Commission would be the fourth option outlined in the Request: "Taking no further action at this time with respect to regulatory harmonization."<sup>33</sup> If the Commission were to proceed, it should tailor any proposed rules to the one narrow area where RIAs and broker-dealers provide substantially similar services: non-discretionary investment advice paid for by commission.<sup>34</sup> Assuming the costs could be justified by the benefits in that one area of overlap, there is simply no articulated need to apply the assumed broker-dealer-like rules to RIAs in any area outside of that narrow scope.

#### **IV. UNIFORM STANDARD OF CONDUCT – SUPPORT FOR LEAST BURDENSOME ALTERNATIVE**

Schwab's basic position on a uniform standard of conduct premised on a best interest standard has not changed:

- When broker-dealers (and RIAs) provide personalized investment advice to clients about buying or selling securities, they should do so in the best interest of their clients. This should be required explicitly under law.
- Broker-dealers, like RIAs, should disclose in a clear uniform manner up front in the customer relationship any conflicts of interest and the terms and scope of the services the firm will provide and the client will pay for.
- A broader rule-based fiduciary duty for broker-dealers and RIAs is not necessary, as additional or ongoing duties should continue to depend on context and circumstances under current law, including state common law of fiduciary duty.

Schwab's support for a fiduciary rule is predicated on the Commission showing the economic justification and articulating the harms that will be prevented. Any new rules, whether applicable to broker-dealers or investment advisers, must be narrowly tailored and subject to a robust cost-benefit

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<sup>32</sup> Request at 55.

<sup>33</sup> Request at 55.

<sup>34</sup> Firms that provide either discretionary investment management services or non-discretionary investment advice for a fee or "special compensation" are already subject to the Investment Advisers Act and rules thereunder.

analysis to make sure that they do not unnecessarily increase burdens on both firms and their clients.

## **A. Impact on Clients and Firms**

### *1. Retail Investors*

Schwab Investor Services, our retail division, serves individual investors across the whole spectrum of their investment needs. Our retail clients include those who are self-directed, those who seek occasional non-discretionary investment advice, and those who want an ongoing non-discretionary advice relationship or want someone to manage their account for them. In terms of “retail customers,” defined as a “natural persons” by Dodd-Frank Section 913(g)(2), Schwab maintains 6.3 million brokerage accounts (excluding retail investment advisory accounts) with over \$630 billion in assets, and 312,000 retail investment advisory accounts (including both non-discretionary fee-based, and discretionary managed account programs) with over \$80 billion in assets.

The contract we have with a client, including the price or fee that the client pays, determines the type of relationship(s) Schwab has with that particular client and the services we deliver to him or her. Retail clients want and need a choice of service, a choice of whether or not they want advice, and a choice of how to pay for it.

Consideration of any new rules governing the conduct of broker-dealers when it comes to giving investment advice should honor retail client preferences. A client with \$25,000 who needs an occasional mutual fund recommendation deserves the availability of advice from a financial professional just as much as a \$1,000,000 client who wants and can afford to pay a fee for advice on an ongoing basis.

In the Second Schwab Letter on the Study (November 2010),<sup>35</sup> Schwab provided retail client survey results from 634 Schwab retail customers, representing a total population of over 1.8 million retail customer households. The results indicated that retail clients both need and value different ways to invest and receive advice, whether through an independent RIA or through their broker-dealer at the time they trade.

The results of the retail client survey showed that 45% of Schwab retail clients make investment decisions entirely on their own. 32% seek occasional investment advice, 5% maintain a managed account, and 18% maintain more than one type of account (e.g., a commission-based account for occasional advice, and a fee-based account for ongoing advice). 21% prefer maintaining a combination of account types, and choose them based on the type and frequency of advice they need and how much they want to or can pay for account services (i.e., by commission or fee). 97% said that it was important to them to continue to have a choice in the type of account they maintain and how they pay for advice and other services. Notably, only 4% of retail clients with less than

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<sup>35</sup> See note 2, above.

\$250,000 in assets have their accounts managed for them, with 77% of them preferring or requiring the pay-as-you-go model for advice and trades.<sup>36</sup>

New regulations implementing a best interest, fiduciary standard can promote investor protection only if they preserve retail client choice as demonstrated by our retail client survey. Overly cumbersome or expensive rules will lead to firms raising their prices and/or reducing access to the commission-based, occasional non-discretionary advice which is so important to clients with a modest level of investable assets.

## 2. *Firms that Serve Retail Investors*

SIFMA's survey of its member firms indicates that it could cost on average almost \$8 million for a broker-dealer to comply with a uniform fiduciary standard, covering both (i) creation and delivery of a new relationship guide or disclosure modeled after Form ADV Part 2A, and (ii) the compliance and supervisory system and procedures and necessary training for a fiduciary standard.<sup>37</sup> For a firm like Schwab with thousands of registered representatives and millions of retail clients, the costs could be even higher.

Any increased costs of that magnitude could impact access to advice services, especially those clients who have limited assets to invest and cannot afford to pay an ongoing fee for investment advice. As the Commission has recognized, it must take care to honor its mandate from Congress under Dodd-Frank Section 913 to:

(1) preserve[e] retail customer choice with respect to, among other things, the availability of accounts, products, services, and relationships with investment advisers and broker-dealers, and (2) not inadvertently eliminate[e] or otherwise impeded[e] retail customer access to such accounts, products, services and relationships (for example, through higher costs).<sup>38</sup>

The costs for the disclosure aspect of any new rule can be minimized by allowing broker-dealers and RIAs to use a "layered" approach, with key information delivered at account opening supplemented by additional details available on a firm's website. An annual notification to clients could remind clients about the full disclosure always available on the firm's website.<sup>39</sup> This would cut down on the need to mail lengthy paper disclosures to clients, which constitute the great bulk of disclosure costs.

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<sup>36</sup> See Second Schwab Letter on the Study (attaching retail client survey results).

<sup>37</sup> Letter dated July 5, 2013 from Ira Hammerman, Senior Managing Director and General Counsel, Securities Industry and Financial Markets Association to Elizabeth Murphy, Secretary, SEC at 17-23.

<sup>38</sup> Request at 10.

<sup>39</sup> Only 6% of Schwab retail clients thought that posting disclosures on a website would be ineffective.

The costs for the supervisory procedures and training aspects of any new rule can be minimized by creating a principles-based rule (see below) that is narrowly tailored with straight-forward documentation requirements. FINRA should not duplicate the Commission's rules, nor should it rewrite its rulebook. If it does, those additional costs should be included in the economic analysis the Commission prepares. For example, Schwab estimates that it recently spent \$5.5 million (in staff time and other costs) to analyze and implement new suitability requirements under FINRA Rule 2111.

Costs would increase dramatically if there is any inconsistency between new Commission rules and the Department of Labor's proposal to expand its fiduciary definition to cover non-discretionary, occasional advice to retail accounts. Any attempt by the Commission to create a uniform standard of conduct consistent with the mandate of Dodd-Frank would be undermined if DOL moves ahead without coordinating with the Commission. Dodd-Frank Section 913(g)(1) specifically states that "the receipt of compensation based on commission . . . shall not, in and of itself, be considered a violation of [a fiduciary] standard applied to a broker or dealer." But if DOL stretches its fiduciary requirements to cover transaction-based advice, a broker-dealer would be in violation of its fiduciary duty and engaging in prohibited transactions for receiving commission-based compensation. The additional potential costs and burdens of inconsistent federal rules should be assessed, and we urge the Commission to work with the DOL to minimize the potential disruption to firms and their clients.

## **B. Narrowly Tailor Any New Fiduciary Rule**

Given the potential impact on investors and firms, the Commission should consider the least burdensome manner to implement a uniform standard of conduct.

A premise of the Commission's consideration of any new rules for broker-dealers and RIAs is to apply similar rules to similar conduct. Accordingly, any new fiduciary standard should be narrowly tailored to address the one area of overlap and potential gap: the provision of non-discretionary investment advice for sales-based or transaction-based compensation.<sup>40</sup>

Today, broker-dealers are prohibited from providing either discretionary investment management or non-discretionary investment advice for a fee unless they are dually registered as investment advisers and comply with the requirements of the Investment Advisers Act. Moreover, as reported by the Investment Adviser Association, only 8% of RIA assets under management are non-discretionary.<sup>41</sup> That may overstate the overlap, because some non-discretionary investment advisers contract with their clients to provide continuous and regular supervisory or management services, something broker-dealers do not provide.<sup>42</sup> Congress recognized this difference between

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<sup>40</sup> See First Schwab Letter on the Study at 7-8.

<sup>41</sup> Letter dated July 3, 2013 from David Tittsworth, Executive Director, Investment Adviser Association to Elizabeth Murphy, Secretary, SEC ("IAA Letter") at 8.

<sup>42</sup> IAA Letter at 8, note 18. Moreover, only a very small percentage of RIA business is for commission- or transaction-based compensation.

broker-dealers and RIAs: “Nothing in this section shall require a broker or dealer or registered representative to have a continuing duty of care or loyalty to the customer after providing personalized investment advice about securities.”<sup>43</sup>

Given the narrow area of overlap, the Commission should consider a straight-forward rule, simply tracking the language of Dodd-Frank Section 913(g)(1):

“The standard of conduct” when providing non-discretionary “personalized investment advice about securities to a retail customer” for a commission or other transaction-based compensation is “to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice.”

This could be called the “Fiduciary Rule for Non-discretionary Advice.” It would cover the one area where broker-dealers and RIAs overlap, and would not necessitate re-writing overall rulebooks. In addition to the Fiduciary Rule for Non-discretionary Advice, broker-dealers would continue to follow broker-dealer rules, and investment advisers would continue to follow investment adviser rules.

With this narrowly tailored rule, there would be no need to change the current fiduciary standard that applies to discretionary investment management and non-discretionary investment advice for a fee. Those services are already covered by existing Commission rules, interpretive guidance, and case law. It would be consistent with the common law of fiduciary duty, which is flexible and based on the facts and circumstances of the relationship between the firm and its client.<sup>44</sup>

As the least burdensome alternative, it would address the concerns of broker-dealers that an over-broad rule would fundamentally change their contractual relationships with their clients and result in the need either to increase the price of their services or to reduce investor access to their advice services. It would also address the concerns of investment advisers that any new fiduciary rule not “water-down” the current fiduciary standard that applies to investment advisers today under Section 206 of the Investment Advisers Act.

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<sup>43</sup> Dodd-Frank Section 913(g)(1).

<sup>44</sup> See First Schwab Letter on the Study at 8-9.

## V. CONCLUSION

We have appreciated this opportunity to provide the cost data the Commission requested with respect to a potential rulemaking on rule harmonization, and to provide our views on a possible uniform standard of conduct.

Because the congressional mandate under Dodd-Frank Section 913 did not include applying broker-dealer-like rules to RIAs in the areas of licensing, registration and continuing education, books and records and supervision, client communications and marketing, Schwab believes that rule harmonization should be de-linked from consideration of a uniform fiduciary standard.

Our RIA clients thoughtfully answered an extensive survey, and we aggregated their input. The data from the Schwab Survey presents a high hurdle for the Assumed Harmonized Rules. Based on the Survey data, RIA costs could increase by 150% in year one, and 101% in subsequent years. This could consume 4-12 % of an RIA firm's gross revenues, depending on its size. Most RIAs, who consider themselves small businesses, would have to hire new staff, increase prices, or reduce services. The overwhelming majority of RIAs think rule harmonization would negatively impact, not benefit, their clients. Based on data from the Survey, and depending how broadly the Commission would apply harmonization, it could cost the RIA industry in excess of \$1 billion.

Given the impact on RIAs and retail investors, the Commission must carefully weigh the costs of any new rules, identify the harms that would be remedied, and provide economic justification for action. Any new fiduciary rule should preserve investor choice and access and focus on the one narrow area of overlap between broker-dealers and investment advisers: the provision of non-discretionary investment for sales-based or transaction-based compensation.

Please contact me at 415-667-0979 if you have any questions relating to the Survey and our comment letter.

Very truly yours,



Christopher Gilkerson

Cc: The Hon. Mary Jo White, Chair  
The Hon. Elisse B. Walter, Commissioner  
The Hon. Luis A. Aguilar, Commissioner  
The Hon. Troy A. Paredes, Commissioner  
The Hon. Daniel M. Gallagher, Commissioner  
Mr. John Ramsay, Acting Director, Division of Trading and Markets  
Mr. Norm Champ, Director, Division of Investment Management  
Mr. Craig Lewis, Director and Chief Economist, Division of Economics and Risk Analysis

Enclosures: Appendix 1 and Appendix 2

# **APPENDIX 1**

# Advisor Survey on Potential Costs of SEC Rule Harmonization

We thank you in advance for your time and patience with this important survey relating to the future of RIA regulation. We know that some of you may have multiple lines of business. Because our response to the SEC will focus on the regulatory impact on the RIA industry, **please focus on the RIA part of your business when you answer this survey.** Your participation is voluntary, and survey responses will be aggregated and not reported on an individual basis.

The SEC has asked the public for estimates of the potential costs of possible proposed regulatory changes. The first section of this survey will ask about what your firm is currently spending on compliance-related activities. You will then be presented with information about four compliance-related areas where potential changes may occur based on assumptions the SEC made regarding:

- Licensing, Registration, and Continuing Education
- Books and Records and Supervision
- Client Communications and Marketing
- Duty of Care

Please carefully read the detail provided which is intended to give you enough information to enable your best estimate of the economic impact each of these changes will likely have on your firm. Economic impact may mean staff hours as well as other costs. Even with this detail we understand that the best you can do is provide approximations.

## Current Compliance-Related Costs

To begin, we are going to ask some questions about your current compliance-related costs, including time your staff spends plus cash expenses. As you answer the following questions, please consider all costs, including but not limited to:

- Time to research, design, establish, and conduct policies and procedures related to SEC compliance—including staff training and principal oversight
- Time spent by your compliance staff, principals, as well as all other employees
- Time for staff to create and maintain records about clients, communications, and investment activities
- Expenses related to filing and maintaining records, including the archival of electronic communications
- Expenses for compliance consultants, lawyers, service providers, systems, and software

**1a.** Please provide an approximate estimate of the total number of hours your RIA firm currently spends **annually** on all compliance related activities, taking into account time spent by all levels of staff at your firm (not just compliance personnel).

Hours of staff time \_\_\_\_\_

Don't know/not sure

**1b.** Please estimate the approximate dollar value of the time you entered above that your RIA firm spends annually on compliance.

Cost of staff time \$ \_\_\_\_\_

Don't know/not sure

**1c.** Above and beyond staff time estimated above, please estimate your RIA firm's other annual expenditures on compliance-related activities, for example expenses such as outsourcing, compliance consultants, legal fees, systems, software, and licensing fees.

Cash expenses \$ \_\_\_\_\_

Don't know/not sure

### **Potential Compliance-Related Costs of Proposed Regulatory Changes**

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In the next section, you are going to be presented with a series of potential new regulatory requirements. For each item, we present a brief summary of current requirements for reference and then some information about possible new requirements under proposed regulatory changes. The summary of current requirements is not intended to be exhaustive, but is simply a reference point. The information about possible new requirements is based on an SEC study and SEC statements about harmonizing broker-dealer and investment advisor rules.<sup>1</sup>

For each item, we will ask you to estimate the approximate value of incremental staff time and other additional compliance-related costs to meet these new requirements. We will ask you to estimate these as 1) setup and first year costs; and 2) subsequent ongoing annual costs.

<sup>1</sup> "Harmonization" generally means that advisors and broker-dealers in the future would be subject to the same set of rules in the areas identified in this survey. This includes advisors possibly following certain broker-dealer rules for the first time, including rules similar to FINRA's. Note that the SEC has not yet determined whether to issue proposed rules.

### **Licensing, Registration, and Continuing Education**

#### **CURRENT REQUIREMENT**

Today, a new investment advisor is required to register with the SEC or a state securities commission. Employees who provide advice (Investment Advisor Representatives) generally must register with the state in which they reside or do business after completing the Uniform Investment Advisor Law Examination known as the Series 65 (or 66) Exam or, as an alternative in some states, meet the exam waiver requirement by holding one or more of the following pre-qualifying designations: CFP, ChFC, PFS, CFA, or CIC. There is no specific continuing education or training requirement by regulation, although qualifying designations may include such obligations.

## POTENTIAL NEW REQUIREMENTS UNDER HARMONIZATION

Under new regulations, licensing requirements for advisory personnel could be patterned after broker-dealers. Federal level broker-dealer requirements include qualifying examination and licenses for personnel who work with clients and recommend and sell securities (such as the Series 7), for supervisors and principals (for example the Series 24), and for operations personnel (the Series 99)—plus continuing education for all. Individuals at advisory firms could be required to register with a regulator (FINRA in the case of broker-dealers) by filing and keeping current a detailed form that is available to the public including employment history, terminations, customer complaints, and certain lawsuits.

New obligations for advisors could include:

- Required coursework and preparation for principals and back-office personnel prior to taking federal licensing exams
- Mandatory continuing education on industry regulations initially and every 3 years (the “Regulatory Element”)
- Firm’s own continuing education for its employees (sometimes outsourced) tailored to its own business and based on an annual needs assessment (the “Firm Element”)
- Maintenance of books and records tracking the continuing education status of all of licensed employees
- Registration of each non-clerical employee with a regulator by filing employment and disciplinary history, and maintaining and updating that information including when an employee leaves or joins a firm

**2a.** Using the grid below, please provide your best estimate of the approximate value of incremental staff time and other additional costs to meet these new licensing, registration, and continuing education requirements. Your response to each item is valuable, even if only your best estimate, based on the information provided. (See the footnotes below for examples of costs you should consider when completing each row.)

	Setup and First Year Costs	Subsequent Ongoing Annual Costs
Estimated value of additional staff time <sup>1</sup>	\$	\$
Cost of additional compliance-related activities <sup>2</sup>	\$	\$

**2b.** Did you have the information you needed to provide your estimates?

- Yes, all the information I needed
- Yes, most of the information I needed
- No, it was not enough information

<sup>1</sup> As you estimate these values of additional staff time, please consider all costs, including but not limited to:

- Time to research, design, establish, and conduct policies and procedures related to SEC compliance—including staff training and principal oversight
- Time spent by your compliance staff, principals, as well as all other employees
- Time for staff to create and maintain records about clients, communications, and investment activities

<sup>2</sup> As you estimate the cost of additional compliance-related activities, please consider all costs, including but not limited to:

- Expenses related to filing and maintaining records, including the archival of electronic communications
- Expenses for compliance consultants, lawyers, service providers, systems, and software

## Books and Records and Supervision

### CURRENT REQUIREMENT

Today, an investment advisor must keep specified books and records for five years. Advisors also need a general system of supervision for compliance with the Investment Advisers Act (and similar state laws), including a Code of Ethics and a compliance program tailored to the RIA's business.

### POTENTIAL NEW REQUIREMENTS UNDER HARMONIZATION

Under new regulations, advisors could be required to make and keep **additional books and records**, modeled after broker-dealer requirements. Today, broker-dealers must maintain more extensive books and records than advisors. Expanded books and records requirements could include:

- Retention of all documents and communications that relate to advisor's "business as such," not just enumerated records. Includes all internal memoranda (meeting notes, emails, typed memos) and communications through employee mobile devices such as texts.
- Creation and retention of applications for employment, and a summary of each employee's compensation arrangement and last 10 years of employment history
- Creation and retention of a record for each new customer account with 9 items of personal information including investment objectives, signed by the account manager, approved by a principal, and with a copy provided to the client every three years
- Storage of electronic records kept in a specific format not commonly used outside the brokerage industry, known as "write-once, read-many", or "WORM," including a contract with a third-party that grants them access to electronic records in the event the RIA is unavailable to respond to regulatory inquiry

**Supervision requirements** could be expanded such that a firm supervisory compliance program might be required to:

- Perform (by principal) and document periodic reviews of all staff activities
- Conduct documented testing of procedures and controls
- Conduct documented supervision of outside business activities of personnel (for example, insurance sales or participation on any boards)
- Establish a supervisory hierarchy with assignment of direct supervision of each registered person, and document any delegations of supervisory authority
- Conduct registered principal review and endorsement of all trades
- Document a product review and approval process prior to investing clients in a new product

**3a.** Using the grid below, please provide your best estimate of the approximate value of incremental staff time and other additional costs to meet these new books and records and supervision requirements. Your response to each item is valuable, if only your best estimate, based on the information provided. (See the footnotes below for examples of costs you should consider when completing each row.)

	Setup and First Year Costs	Subsequent Ongoing Annual Costs
Estimated value of additional staff time <sup>1</sup>	\$	\$
Cost of additional compliance-related activities <sup>2</sup>	\$	\$

**3b.** Did you have the information you needed to provide your estimates?

- Yes, all the information I needed
- Yes, most of the information I needed
- No, it was not enough information

<sup>1</sup> As you estimate these values of additional staff time, please consider all costs, including but not limited to:

- Time to research, design, establish, and conduct policies and procedures related to SEC compliance—including staff training and principal oversight
- Time spent by your compliance staff, principals, as well as all other employees
- Time for staff to create and maintain records about clients, communications, and investment activities

<sup>2</sup> As you estimate the cost of additional compliance-related activities, please consider all costs, including but not limited to:

- Expenses related to filing and maintaining records, including the archival of electronic communications
- Expenses for compliance consultants, lawyers, service providers, systems, and software

## Client Communications and Marketing

### CURRENT REQUIREMENT

Today, communications from RIA firms must be accurate and not misleading, with specific requirements for specific communications such as those relating to performance, recommendations, and fees. Additionally, there is a ban on testimonial advertising.

### POTENTIAL NEW REQUIREMENTS UNDER HARMONIZATION

Borrowing from FINRA rules, new regulations could require: (1) prior registered principal approval of certain retail client communications which are distributed or made available to more than 25 clients or prospects, such as newsletters, emails, advertising and sales materials; (2) written procedures for the preparation, review, and documentation of client correspondence (to 25 or fewer clients or prospects) and other communications; and (3) pre-and post-regulatory filing requirements for certain types of retail communications.

Expanded requirements could include:

- Qualification and registration of a principal to review and approve retail client communications
- Establishment and documentation of a system to facilitate and document principal review and approval of retail client communications

- Education and training of firm personnel on client correspondence consistent with the firm’s procedures governing correspondence, including documentation and surveillance
- Filing with a named regulator (either pre- or post-use) marketing materials that mention mutual funds, ETFs, UITs, variable insurance products, closed-end funds, options, CMOs, or derivatives
- Prohibitions against performance projections, or hypothetical or back-tested performance results

**4a.** Using the grid below, please provide your best estimate of the approximate value of incremental staff time and other additional costs to meet these new client communications and marketing requirements. Your response to each item is valuable, even if only your best estimate, based on the information provided. (See the footnotes below for examples of costs you should consider when completing each row.)

	Setup and First Year Costs	Subsequent Ongoing Annual Costs
Estimated value of additional staff time <sup>1</sup>	\$	\$
Cost of additional compliance-related activities <sup>2</sup>	\$	\$

**4b.** Did you have the information you needed to provide your estimates?

- Yes, all the information I needed
- Yes, most of the information I needed
- No, it was not enough information

<sup>1</sup> As you estimate these values of additional staff time, please consider all costs, including but not limited to:

- Time to research, design, establish, and conduct policies and procedures related to SEC compliance—including staff training and principal oversight
- Time spent by your compliance staff, principals, as well as all other employees
- Time for staff to create and maintain records about clients, communications, and investment activities

<sup>2</sup> As you estimate the cost of additional compliance-related activities, please consider all costs, including but not limited to:

- Expenses related to filing and maintaining records, including the archival of electronic communications
- Expenses for compliance consultants, lawyers, service providers, systems, and software

## Duty of Care

### CURRENT REQUIREMENT

Today, advisors operate under a **principles-based** duty of care, which generally requires an RIA to invest client assets as a prudent investor would, including considering the client’s investment objectives and exercising reasonable skill and diligence. This duty includes undertaking a reasonable investigation of the client’s circumstances and the investment opportunity, and consideration of market conditions, price and execution of trades, risk and return, and diversification.

**POTENTIAL NEW REQUIREMENTS UNDER HARMONIZATION**

New regulations could require a **rules-based** duty of care, requiring compliance with new mandatory rules that would borrow from broker-dealer regulation (including FINRA rules).

Expanded requirements could include **establishing and documenting**:

- *Product-specific and customer-specific suitability requirements*, including an obligation to collect and update detailed information on clients' financial situation (approximately 10 mandated data elements) and to investigate, obtain, and retain adequate information about the securities recommended
- *Heightened suitability and disclosure requirements* for “higher risk” products (as set forth today in a numerous broker-dealer rules or FINRA notices) such as hedge funds (alternative investments), structured products, certain debt securities, municipal securities, direct participation programs, variable insurance products, penny stocks, options, any other “complex” products, and for assuring clients are put in appropriate mutual fund share classes
- *Best execution of trades*, not simply relying on the executing broker’s process, but also analyzing factors such as size of orders, where the orders execute, and the costs of access to various markets
- *Charging fair and reasonable compensation*, substantiated by research and documentation, not unfairly discriminating among clients in terms of pricing, and strict limitations on receiving cash or non-cash compensation from third parties

**5a.** Using the grid below, please provide your best estimate of the approximate value of incremental staff time and other additional costs to meet these new duty of care requirements. Your response to each item is valuable, even if only your best estimate, based on the information provided. (See the footnotes below for examples of costs you should consider when completing each row.)

	Setup and First Year Costs	Subsequent Ongoing Annual Costs
Estimated value of additional staff time <sup>1</sup>	\$	\$
Cost of additional compliance-related activities <sup>2</sup>	\$	\$

**5b.** Did you have the information you needed to provide your estimates?

- Yes, all the information I needed
- Yes, most of the information I needed
- No, it was not enough information

<sup>1</sup> As you estimate these values of additional staff time, please consider all costs, including but not limited to:

- Time to research, design, establish, and conduct policies and procedures related to SEC compliance—including staff training and principal oversight
- Time spent by your compliance staff, principals, as well as all other employees
- Time for staff to create and maintain records about clients, communications, and investment activities

<sup>2</sup> As you estimate the cost of additional compliance-related activities, please consider all costs, including but not limited to:

- Expenses related to filing and maintaining records, including the archival of electronic communications
- Expenses for compliance consultants, lawyers, service providers, systems, and software

- 6a.** Currently, an SEC-registered investment advisor may pay an unregistered solicitor or finder to help obtain new clients so long as the solicitor and the advisor comply with the disclosure requirements in the cash solicitation rule, SEC Rule 206(4)-3. Under harmonization, RIAs could be required to only use registered solicitors, i.e. persons or firms who are registered as either broker-dealers or investment advisors.

To assess the potential impact, please give us some information about your firm's current use of solicitors for developing new business. Which best describes your firm's use of solicitors?

- We do not use solicitors at all
- We use only registered solicitors
- We use only unregistered solicitors
- We use a combination of registered and unregistered solicitors
- Don't know/not sure

(Q6b and Q6c apply only to those who answered that they do use solicitors/finders in Q6a):

- 6b.** Which of the following best describes how important these solicitors are to your firm's business development activities?

- We use solicitors occasionally, but they are not an important source of new clients
- Solicitors are an important source of new clients along with other sources
- Solicitors are our primary means of locating new clients
- Don't know/not sure

- 6c.** Do you expect a requirement to only work with registered solicitors would have a negative impact on the future growth of your firm?

- No negative impact on growth
- A small negative impact on growth
- A moderate negative impact on growth
- A large negative impact on growth
- A very large negative impact on growth
- Don't know/not sure

7. Earlier in this survey, you estimated that your firm currently spends  (insert Q1a answer) hours annually on all compliance-related activities, accounting for time spent by all levels of staff at your firm (not just compliance personnel). Given all four areas of potential new regulations associated with harmonization as detailed in the prior questions of this survey, please estimate the percentage increase in the total number of hours your firm will spend annually on compliance-related activities should these new regulations be adopted. Again, please take into account time spent by all levels of staff at your firm, including principals.

- No increase in compliance hours
- Less than 10% increase in compliance hours
- 10% to 24% increase in compliance hours
- 25% to 49% increase in compliance hours
- 50% to 74% increase in compliance hours
- 75% to 99% increase in compliance hours
- At least a doubling (100%+ increase) of compliance hours
- Not enough information is provided to estimate the increase in compliance hours

8. Which of the following are likely impact(s) on **your RIA firm** if the possible requirements outlined earlier in this survey are adopted?

- Decrease in our firm profitability
- Have to consider raising client fees
- Additional time required for compliance would take away from time spent with clients
- Discontinue some products or client services
- Need to hire additional outside consultants, agencies, or outsourcers
- A higher degree of certainty in the effectiveness of our compliance program
- Better able to assure our clients about the safety of our firm
- Need to hire new staff
- None of the above
- Don't know/no opinion

9. Which of the following are likely impact(s) on **clients of RIA firms** if the possible requirements outlined earlier in this survey are adopted?

- Increased protection from fraud or mishandling of their account
- Less confusion about the differences between an RIA and a broker-dealer
- Receive better information for making decisions about financial advice
- Enjoy better investment performance
- Pay more for investment advice
- Lower level of service than today
- Fewer choices in terms of firms, products and services available
- Less customized client service
- None of the above
- Don't know/no opinion

## Questions About You and Your Firm

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- 10.** Do you serve as your firm's compliance officer?
- Yes
  - No
  - Don't know/not sure
- 11.** What best describes your role in the firm?
- I am a principal or other member of senior management; my primary responsibilities are overall firm management and client contact. I rarely perform operational tasks.
  - I am a principal or senior manager who also has operational responsibilities.
  - I am primarily in an operational role.
  - Other (Specify) \_\_\_\_\_
- 12.** What are the total assets under management (AUM) of your RIA firm (in custody at Schwab and at other custodians)?
- Less than \$90 million
  - \$90 million – \$249 million
  - \$250 million – \$499 million
  - \$500 million – \$1 billion
  - More than \$1 billion
  - Don't know/not sure
- 13.** For the fiscal year ending in 2012, what was the total gross revenue of your RIA firm?
- Less than \$1 million
  - \$1 million – \$1.9 million
  - \$2 million – \$4.9 million
  - \$5 million – \$10 million
  - More than \$10 million
  - Don't know/not sure
- 14.** For the fiscal year ending in 2012, what was the operating profit of your RIA firm, after all expenses including reasonable principal compensation (base and bonus)?
- Less than \$50,000
  - \$50,000 – \$99,999
  - \$100,000 – \$249,999
  - \$250,000 – \$499,999
  - \$500,000 – \$999,999
  - \$1 million – \$2 million
  - More than \$2 million
  - Don't know/not sure

- 15.** Including yourself, what is the total number of staff (employees and owners) at your RIA firm? \_\_\_\_\_
- Don't know/not sure
- 16.** Please share any additional comments, ideas, or concerns you may have on proposed changes to industry regulations. Are there additional ways that regulations may impact your ability to do business as an RIA? \_\_\_\_\_

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## **APPENDIX 2**



## Topline Report: Regulatory Harmonization for RIAs

### Prepared for Schwab Advisor Services

Annotated Survey Results Prepared July 1, 2013

#### Firms with \$90M+ AUM Only

#### Current Compliance-Related Costs

**Q.1a.** Please provide an approximate estimate of the total number of hours your RIA firm currently spends annually on all compliance-related activities, taking into account time spent by all levels of staff at your firm (not just compliance personnel).

**Q.1b.** Please estimate the approximate dollar value of the time you entered above that your RIA firm spends annually on compliance.

**Q.1c.** Above and beyond staff time estimated above, please estimate your firm's other annual expenditures on compliance-related activities, for example expenses such as outsourcing, compliance consultants, legal fees, systems, software, and licensing fees.

Annual Expenditures	Mean	Median
Hours of Staff Time	1603	320
\$ Value of Staff Time	\$86,500	\$33,000
Other \$ Expenditures	\$29,546	\$14,822

Base: \$90M+ AUM Firms Answering (Base range 456 – 467, with data averaged for multiple respondents per firm)



## Estimated Incremental Costs to Meet Proposed New Regulations

Please provide your best estimate of the approximate value of incremental staff time and other additional costs to meet these new [type of requirements, for each question as follows]:

Q. 2a. Licensing, registration and continuing education requirements

Q. 3a. Books and records and supervision requirements

Q. 4a. Client communications and marketing requirements

Q. 5a. Duty of care requirements

### Mean Estimated Annual Expenditures

Incremental Annual Costs	Q. 2 Licensing	Q. 3 Books	Q. 4 Client Comm.	Q. 5 Duty of Care	Total
<b>Initial Set-Up (Total)</b>	<b>\$64,099</b>	<b>\$49,678</b>	<b>\$28,877</b>	<b>\$36,462</b>	<b>\$174,560</b>
Internal	\$44,900	\$32,139	\$18,529	\$23,301	\$116,113
Other	\$19,600	\$17,617	\$10,602	\$13,133	\$59,072
<b>Subsequent/Ongoing (Total)</b>	<b>\$37,418</b>	<b>\$34,249</b>	<b>\$21,646</b>	<b>\$25,672</b>	<b>\$117,153</b>
Internal	\$25,518	\$21,878	\$13,774	\$16,266	\$75,591
Other	\$13,413	\$12,444	\$8,176	\$9,332	\$41,992

Base: Firms with \$90M+ AUM Answering. (Base range 440 – 469 for specific entries with data averaged for multiple respondents per firm)

### Confidence in Estimates

Q. 2b, 3b, 4b, 5b. Did you have all the information you needed to provide your estimates?

Rule Area	All the information I needed	Most of the information I needed	Not enough information
Licensing, Registration, Continuing Education	22%	63%	15%
Books and Records and Supervision	23%	60%	17%
Client Communications and Marketing	25%	61%	14%
Duty of Care	26%	57%	17%

Base: Total Respondents at \$90M+ AUM Firms (524)



## Use of Solicitors and Impact of Proposed Regulations Regarding Solicitors

**Q.6a.** *Currently, an SEC-registered investment advisor may pay an unregistered solicitor or finder to help obtain new clients so long as the solicitor and the advisor comply with the disclosure requirements in the cash solicitation rule, SEC rule 206(4)-3. Under harmonization, RIAs could be required to only use registered solicitors, i.e., persons or firms who are registered as either broker-dealers or investment advisors.*

*To assess the potential impact, please give us some information about your firm's current use of solicitors for developing new business. Which best describes your firm's use of solicitors?*

Response	%
We do not use solicitors at all	57%
<b>Net: Use Solicitors</b>	<b>40%</b>
We use only registered solicitors	16%
We only use unregistered solicitors	10%
We use a combination of registered and unregistered solicitors	14%
Don't know / Not sure	3%

Base: Firm Representatives with \$90M+ AUM (483)

**Q.6b.** *Which of the following best describes how important these solicitors are to your firm's business development activities?*

Response	%
We use solicitors occasionally, but they are not an important source of new clients	54%
Solicitors are an important source of new clients along with other sources	39%
Solicitors are our primary means of locating new clients	6%
Don't know / Not sure	1%

Base: Firm Representatives with \$90M+ AUM who use solicitors (193)

**Q. 6c.** *Do you expect a requirement to only work with registered solicitors would have a negative impact on the future growth of the firm?*

Response	%
No negative impact on growth	27%
A small negative impact on growth	33%
A moderate negative impact on growth	24%
A large negative impact on growth	10%
A very large negative impact on growth	6%
Don't know / Not sure	1%

Base: Firm Representatives with \$90M+ AUM who use solicitors (193)



## Perceptions of Overall Impact of Proposed Regulations

**Q.7.** Earlier in this survey, you estimated that your firm currently spends (NUMBER OF HOURS ESTIMATED) hours annually on all compliance-related activities, accounting for time spent by all levels of staff at your firm (not just compliance personnel). Given all four areas of potential new regulation associated with harmonization as detailed in the prior questions of this survey, please estimate the percentage increase in the total number of hours your firm will spend annually on compliance-related activities should these new regulations be adopted. Again, please take into account time spent by all levels of staff at your firm, including principals.

Response	%
No increase in compliance hours	1%
Less than a 10% increase in compliance hours	1%
10% to 24% increase in compliance hours	14%
25% to 49% increase in compliance hours	25%
50% to 74% increase in compliance hours	17%
75% to 99% increase in compliance hours	7%
At least a doubling (100%+) of compliance hours	34%
Not enough information provided to estimate the increase in compliance hours	1%

Base: Firm Representatives with \$90M+ AUM/Those answering Q. 1a (Staff hours for current compliance) (463)

**Q.8.** Which of the following are likely impact(s) on **your RIA firm** if the possible requirements outlined earlier in this survey are adopted?

Response	%
<b>Negative Impacts</b>	<b>97%</b>
Decrease in our firm profitability	91%
Additional time required for compliance would take away from time spent with clients	85%
Need to hire additional outside consultants, agencies, or outsourcers	81%
Have to consider raising client fees	59%
Discontinue some products or client services	21%
<b>Positive Impacts</b>	<b>16%</b>
A higher degree of certainty in the effectiveness of our compliance program	14%
Better able to assure our clients about the safety of our firm	5%
Need to hire new staff	62%
None of the above	1%
Don't know / No opinion	1%

Base: Firm Representatives with \$90M+ AUM (483)



Q.9. Which of the following are likely impact(s) on **clients of RIA firms** if the possible requirements outlined earlier in this survey are adopted?

Response	%
<b>Positive Impacts</b>	<b>13%</b>
Less confusion about the differences between an RIA and a broker-dealer	8%
Increased protection from fraud or mishandling of their account	6%
Receive better information for making decisions about financial advice	3%
Enjoy better investment performance	0%
<b>Negative Impacts</b>	<b>88%</b>
Pay more for investment advice	71%
Less customized client service	63%
Lower level of service than today	59%
Fewer choices in terms of firms, products and services available	49%
None of the above	7%
Don't know / No opinion	2%

Base: Firm Representatives with \$90M+ AUM (483)

### Respondent Firm Profile Information

Q. 10. Do you serve as your firm's compliance officer?

Response	%
Yes	72%
No	28%

Base: Firm Representatives with \$90M+ AUM (483)

Q. 11. What best describes your role in the firm?

Response	%
I am a principal or other member of senior management; primary responsibilities are overall firm management and client contact. I rarely perform operational tasks	34%
I am a principal or senior manager who also has operational responsibilities	50%
I am primarily in an operational role	5%
Other	8%

Base: Firm Representatives with \$90M+ AUM (483)

Q. 12. What are the total assets under management (AUM) of your RIA firm (in custody at Schwab and other custodians)?

Response	%
Less than \$90 million	-
\$90 million - \$249 million	40%



\$250 million - \$499 million	27%
\$500 million - \$1 billion	16%
More than \$1 billion	17%
Don't know / not sure	-
Mean	\$495.8K
Median	\$248.1K

Base: Firm Representatives with \$90M+ AUM (483)

Q. 13. For the fiscal year ending in 2012, what was the total gross revenue of your RIA firm?

Response	%
Less than \$1 million	20%
\$1 million - \$1.9 million	31%
\$2 million - \$4.9 million	27%
\$5 million - \$10 million	10%
More than \$10 million	6%
Don't know / not sure	5%
Mean	\$3.2 million
Median	\$1.4 million

Base: Firm Representatives with \$90M+ AUM (483)

Q. 14. For the fiscal ending in 2012, what was the operating profit of your RIA firm, after all expenses including reasonable principal compensation (base and bonus)?

Response	%
Less than \$50,000	14%
\$50,000 - \$99,999	9%
\$100,000 - \$249,999	18%
\$250,000 - \$499,999	16%
\$500,000 - \$999,999	13%
\$1 million - \$2 million	7%
More than \$2 million	8%
Don't know / not sure	15%
Mean	\$655.8K
Median	\$196.1K

Base: Firm Representatives with \$90M+ AUM (483)

Q. 15. Including yourself, what is the total number of staff (employees and owners) at your RIA firm?

Response	%
1 – 2	5%
3 – 5	28%
6 – 9	29%
10 – 14	13%
15 or more	24%
Don't know / not sure	1%
Mean	15.9
Median	7.5

Base: Firm Representatives with \$90M+ AUM (483)



**Notes:**

- For numeric data, an average of responses at a firm was included.
- For attitudinal questions, data is based on single “Firm Representative” in cases of multiple respondents per firm.